Northern Ireland is at an economic crossroads and cutti...

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I have co-written a comment article on Northern Ireland's corporation tax debate with Andrew Baker, a Reader in Political Economy at Queen's University, Belfast for the blog of [SPERI - The Sheffield Political Economy Research Institute.]

I admit I never expected to spend so much time debating tax and Northern Ireland, but have been heavily involved in this debate since writing '[Pot of Gold or Fool's Gold]' for the Irish Congress of Trade Unions in 2010 when incensed by the arguments for tax cuts and seem to have been in the debate ever since. In the [current paper Andrew and I argue]:

As the UK struggles to shake off the effects of the 2008 crash and faces a host of questions about the sustainability of its future political economy, devolution opens some interesting possibilities for Northern Ireland. The debate so far has focused on a proposal to cut corporation tax to 12.5%, bringing Northern Ireland in line with the Republic of Ireland. Given the shared land border, this might seem like a common-sense proposal. But cutting corporation tax is not so straightforward.

First, the principal economic rationale advanced in favour of the move is that it will create a level playing-field across the whole of Ireland. But this cannot be achieved just by devolving the power to set corporation tax to the Stormont executive. As a sovereign nation-state, the Republic of Ireland offers a range of tax breaks and incentives to entice foreign investment. These measures will not be open to the Northern Ireland Assembly.

Cutting corporation tax is therefore an effort to emulate and compete with a bigger neighbour on tax, when it is only possible to be a pale imitation. Moreover, there is the added complication of an exchange rate risk when trading with the Eurozone that does not apply south of the border.

Second, despite the weakness of the level-playing-field argument, cutting corporation tax may stimulate higher levels of investment and poach some investment from elsewhere in the UK. Cutting corporation tax might therefore be something worth *trying, if it came with no economic penalty.*

However, it would in fact come with a considerable penalty. Because of EU rules, stemming from the Azores judgement, if it was to cede corporation tax setting powers to Stormont, HM Treasury would have to reduce the size of Northern Ireland's annual block grant. It currently puts this figure at £700 million per annum, which is about 8.7% of the total block grant. Gerald Holtham estimates that, even if the cut were just £300 million, then compensating for that loss would require an additional £2.4 billion in private-sector profits. This translates into an additional £10 billion of Gross Value Added (GVA) (current figure £28 billion).

According to these conservative calculations, breaking even on the budget would therefore require the Northern Ireland economy to grow by a third! Viewed in this light, cutting corporation tax looks like a considerable gamble with the existing budget and public services. A more candid reading might invoke the spectre of self-harming.

Third, the much-vaunted 12.5% rate for corporation tax is a headline rate, but headline rates are a notoriously unreliable guide to the amount of tax corporations actually pay. For example, in the United States, where the headline rate is 35%, the second highest in the OECD, most corporations are actually paying single figures in corporation tax. A similar picture is evident in the UK, as recent headlines about Starbucks and Amazon have indicated.

Any jurisdiction seeking to lower its headline rate should be aware that many large corporations are not even currently paying 12.5% in the UK, let alone the current headline rate of 24%, and may accordingly have few incentives to relocate their activities on the basis of such a reduction.

Fourth, the issue of 'sequencing' further complicates the case for a corporation tax cut. If a corporation tax cut is to pay back its revenue, it will likely require prior economic reform that targets skill upgrading in high-end sectors. It is arguable that lower corporation tax should follow, rather than precede, moving to a high-skill, high-productivity, high-wage economy. Given the current skills base, the timing of the proposed cut in Northern Ireland is highly questionable and might further polarise an already polarised society.

Such uncertainty is further compounded by the length of time needed to reach the levels of inward investment that would compensate for reductions in the block grant. For there is no suggestion that these public expenditure reductions can be phased in over time. Administrative, monitoring and transaction costs further muddy the waters.

Beyond these 'economic' considerations, there are also a number of more 'political' factors in play.

First, the Treasury is engaged in protracted wrangling with Northern Irish politicians. For *example, the Treasury briefed the Financial Times to report a £700 million block-grant cut, but the Northern Ireland press put the figure at £300-400 million. There is also disagreement about who might get to keep any additional revenue generated by any growth in Northern Ireland that results from a corporation tax cut, as the Treasury seeks to minimise any erosion of its fiscal powers.*

Second, with few exceptions, Northern Irish politicians are notoriously reluctant to engage in serious economic debate. They are much more comfortable discussing policing, flags and marches — the classic issues of a divided society. Corporation tax is a convenient hook, because it can be presented as 'the answer', while simultaneously stifling more serious debate and thought about the nature of Northern Ireland's economic problems. Should corporation tax powers not be granted, it will also enable local politicians to point the finger of blame at London. Ultimately, it is a great way of abdicating responsibility.

Finally, the public debate in Northern Ireland has been one-sided. Local media and political elites seem to think this is a simple 'win-win', assuming that the case for cutting corporation tax is water-tight and unambiguous. Due consideration has not been given to the issues discussed here and more critical voices have largely been ignored. Such narrow debate is not the basis for good policy-making. Instead, it can foster precisely the kind of unhealthy 'groupthink' that appears to have engulfed Northern Ireland's political elites on this whole issue of corporation tax.

This debate continues solely because of the support of firms like KPMG. It's a typical case of money talking at cost to the majority and dogma over-ruling all economic logic.

This is an important issue, and one where for the people of Northern Ireland it is vital that the corporate tax cutting lobby do not win.