Funding the Future

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Debate on whether or not Northern Ireland (and Scotland) should have control of their corporation tax rates is back on the agenda. I will be on air on BBC Northern Ireland debating this issue later this morning. That's because in 2010 I, fairly inadvertently, became a major commentator on this issue when I wrote a report for the TUC and Irish Congress of Trade Unions, entitled "Pot of Gold or Fool's Gold" which set out my arguments for opposing such a move in full. There are many of them. At the time I suggested three major reasons:

First, the chance that such a tax rate could be introduced in Northern Ireland without falling foul of EU law is remote in the extreme. And if it proved to be illegal the damage caused could be considerable.

I think there remains considerable risk of this.

Second, the Republic's low tax offering is not just a low tax rate — it's also a low tax base. The tax collected by any state is the tax base multiplied by the tax rate — and because both are low in the Republic then many companies operate there and pay little or no tax at all. This is something Northern Ireland could not emulate unless it were, in effect, to cede from the UK for tax purposes.

Nothing has changed here.

But doing that would have massive implications. First, the rest of the UK would then need to put up massive tax barriers to trade with Northern Ireland to prevent artificial tax abuse by companies really located in England, Scotland or Wales, That would be enormously harmful in terms of administrative burden to doing trade with Northern Ireland. And second, if it is assumed that the reduced tax rate will bring in increased taxes in Northern Ireland (and those proposing this idea seem to think that it will — although there is no evidence at all that the Laffer curve on which they base this idea actually exists) then that assumed increase in tax revenue has to be deducted from the subsidy now given to Northern Ireland so that it does not get a double dose of regional aid under EU law. The risk is that theif the assumption of increased tax is wrong — as I think not just likely but absolutely certain if the Republic's experience is copied — then the funds available for public services in Northern Ireland will be cut severely. As a *result this folly, promoted by the tax accountants of Northern Ireland for the benefit of their clients will impose real and lasting cost on ordinary people throughout Northern Ireland. And that's a risk no one should take.*

The last point is something I have explored in more depth with Queens University Belfast academic Andrew Baker. Writing together for Sheffield Political Economy Research Institute we have argued that:

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.

There is, of course, no way that Northern Ireland can grow by this amount and I'm quite sure that the proponents of this scheme know that. However, powerfully backed by KPMG, they continue to argue their case which is only to certain to deliver two things.

The first is a significant cut in the tax rate for existing Northern Ireland companies, which is no doubt why KPMG in Belfast is so keen on this.

Secondly, this change is guaranteed to make life worse for most people in Northern Ireland as they see increasing cuts in government spending in the area and the time when it is already committed to reducing its level of spending in the region.

These two issues being noted, there is just one thing that the reform is not guaranteed to deliver, and that is jobs. Accountants, like KPMG, are masters at the art of shifting profits but if low tax rates were really so good at creating mass employment of the sort that Northern Ireland needs then Jersey and Cayman would be covered with new small, high-tech industries, and they are not.

What is depressing is how one-sided this debate has been. Sinn Fein wants this change because it creates the possibility of a unified Irish tax rate, and that is enough for them. Unionists appear to buy into the entire Laffer curve idea, however debased it might be. As Andrew Baker and I say in our SPERI article:

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.

I fear Stormont is walking into a disaster all of its own making.