Ulster Bank

NET GOAL OF CORPORATION TAX OR WE'LL PAY THE PENALTY

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Article appears in the Irish News Special Supplement published on 19th July 2011

This month (July) is 21 years since England's crushing World Cup semi-final defeat to West Germany when Stuart Pearce's spot-kick was saved and Chris Waddle blasted over the bar - denying the men in white the prize of a World Cup final place. Ever since that humid Italian evening in July 1990, England football fans have been left wondering 'what if', as West Germany went on to win in the final.

21 years on, Northern Ireland is within touching distance of its own major prize in the form of powers to control our rate of corporation tax. There have been plenty of negative economic shocks over the past few years, but having the most significant policy tool to rebalance the local economy – the power to set corporation tax – almost within our grasp is perhaps the most positive surprise. We don't want to be left thinking 'what if' in the years ahead, as the outcome of not securing a lower rate of corporation tax could be bleak.

A number of factors have been behind this opportunity arising. First, economists and local business figures have engaged in a commendable act of corporate social responsibility for NI Plc – and on behalf of the next generation - in consistently arguing for a 'game-changer' for the local economy.

Second, in Owen Paterson – the Secretary of State – Northern Ireland has landed one of the most enthusiastic supporters of cutting corporation tax and someone who is determined not to preside over the status quo. In turn, this has culminated in a Treasury consultation paper on the *"Rebalancing the Northern Ireland Economy"* which has devolving / cutting corporation tax at its heart.

Given the economic climate, nothing short of throwing all the policies we can muster at the challenge is urgently required. Those not advocating for such an approach to rebuilding and rebalancing the economy are vastly underestimating the challenge that confronts NI Plc.

During the decade prior to the current downturn, Northern Ireland benefited from three key sources of employment growth: retail, construction and the public sector. These industries will not be the source of jobs growth during the next decade. Meanwhile, manufacturing employment levels, in aggregate, will largely stay flat. However, agri-food and pharmaceuticals offer significant growth potential. As far as the service industry is concerned, the *Business Services & Finance* sector offers the greatest potential but output within this sector is almost 40% below its 2007 peak. Notwithstanding the aforementioned opportunities, Northern Ireland clearly has a major job creation problem going forward.

Northern Ireland has world class businesses, but simply just doesn't have enough of them. In rebuilding NI Plc, the private sector requires an influx of new foreign direct investment (FDI). FDI has transformed the Irish Republic and the 12.5% corporation tax rate was a critical factor in this regard, with the RoI effectively becoming the Real Madrid / Barcelona of the FDI world. So much so that the Irish government has resisted relentless pressure to raise its tax rate.

The 12.5% rate was one of the policies the Irish got right and without it the RoI would be teetering on the edge of the abyss and would not be experiencing the export led recovery that Northern Ireland desperately seeks to emulate. Adopting a similar rate *(or better still a 10% rate!)* will undoubtedly make Northern Ireland a more marketable place to invest in and it will send out a powerful signal that the executive is serious about the economy being a priority, particularly with the anticipated reduction / phasing out of grant assistance.

Such a move will also see domestic firms benefit on the bottom line and provides an incentive to invest and expand for the future. Overall, it has been estimated that the tax cut could create 90,000 jobs over the next 20 years. Not surprisingly, no attempts have been made to estimate the job creation prospects of a ‘plan B’ *(not cutting corporation tax).*

Funding the tax cut is not costless. Some view such a move as unaffordable. Indeed, in their eyes, not developing the private sector is a price worth paying as maintaining the status quo is paramount. A common approach in defence of public expenditure cuts is to equate the corporation tax cut to cutting doctors and nurses. Clearly there is the need to distinguish between different kinds of public expenditure, with the front-line protected as much as possible. Unless we truly believe the public sector is currently running like a Swiss watch, radical restructuring and reform should be embraced with both hands. Furthermore, not all public expenditure is ‘front-line’ and the ‘rebalancing’ mantra needs to encompass a shift in resources from non-front-line expenditure to the front-line.

It is also worth remembering the first principles of public finances. Without private sector profit, there is no government revenue to fund any public expenditure. Therefore all taxes paid for by public sector employment ultimately are sourced from private enterprise. The rebalancing challenge also requires addressing the overwhelming mindset that NI Plc is a ‘not for profit economy’. The uncomfortable reality is that Northern Ireland’s annual subvention of £10bn is funded from private sector profit in ‘middle-England’.

To date, there has been too much focus here on maximising the block grant. But this does not, has not, and will not maximise economic prosperity. Northern Ireland enjoyed a public expenditure boom throughout most of the last decade, which funded a rise in public sector jobs equivalent to almost the population of Newry. Despite this boom, Northern Ireland failed to narrow the prosperity gap with the UK. Northern Ireland already receives more public expenditure than it should need - even when specific regional circumstances are factored in - with each citizen receiving 25% more than their English counterparts and 12% more than individuals within the North East.

On the corporation tax front, a massive amount of effort has gone into weighing up the costs and benefits of lower the rate. This investment will cost £385m in a single year, which represents 2% of NI’s annual public expenditure entitlement (£19bn). Phasing the cut in over time would mean the cost would be a fraction of one percent of Northern Ireland’s annual public expenditure total. To date, the same degree of concern has not been shown with regard to making best use of the remaining 98%.

A frequently cited view is that lower corporation tax will lead to some firms effectively receiving a cheque in their hip pocket without increasing any economic activity. For some firms this will be true. Deadweight with public expenditure is often unavoidable. But at least the corporation tax policy is swapping subsidy for an incentive, and should be seen as creating more favourable conditions for the private sector and making the incentives more attractive than they currently are. Huge blocks of public expenditure currently have no incentives attached to them whatsoever. The principle of swapping public expenditure for incentives should be explored and extended elsewhere.

As far as Northern Ireland’s long-term economic outlook is concerned, economists may find themselves coining the phrase *“if you don’t want to know the result look away now”.* Without radical action in the form of a lower corporation tax rate, Northern Ireland is destined for a lengthy period of weak economic growth and high unemployment, and will languish towards the bottom of the regional prosperity table. An export-led recovery is required but, through a lack of private sector opportunities, an export led decline - in the form of people leaving Northern Ireland - is what we will get, with our children and grandchildren leaving these shores for work elsewhere. This is the stark reality surrounding the current debate over whether a lower rate of corporation tax should be adopted and whether we can afford it.

The consultation window on the UK Treasury *"Rebalancing the Northern Ireland Economy"* paper has now closed and we eagerly await the Chancellor's verdict in the autumn. Some commentators have suggested that given that David Cameron and George Osborne have recently visited Northern Ireland, are they now going to say 'no' to the devolution of corporation tax powers? It remains to be seen whether the Chancellor leaves the Stormont executive the simple task of putting the corporation tax ball into the back of the net of an open goal. Should that situation arise, Northern Ireland must take full advantage of this potential once-in-a-lifetime transfer - *of corporation tax powers* – window and not do a Chris Waddle by hoofing the ball over the bar. Otherwise, we will be left wondering 'what if?' for the next 20 years and beyond. The corporation tax debate, they think it's all over…………………?

Richard Ramsey, Irish News, July 19, 2011