Ulster Unionist Party response to Consultation paper on the Reduction of Corporation Tax

June 2011

Background to the UUP response

The Ulster Unionist Party is Northern Ireland's oldest unionist party, tracing its roots back to the late 19th Century and first constituted in Belfast in 1905. We are responsible for securing the foundation of the state, nurturing its development, and creating the circumstances for the gradual stabilisation of the region at the turn of the 21st century.

Two years ago we were the first main political party to make a specific pledge to work towards devolving corporation tax rate varying powers to the Northern Ireland Assembly. We particularly welcome the support and enthusiasm which the Coalition government has since shown for this transformational initiative.

The aim of change

Devolving the power to vary Corporation Tax (CT) is not an end in itself, but the means to an end; the aim is to rebalance the Northern Ireland economy, with key outcomes:

- The Northern Ireland workforce addresses its traditional under-productivity by attracting new jobs, businesses, increasing employment, creating wealth, lessening the dependency on the public sector, and lowering demand on the Welfare State;
- The people of Northern Ireland begin to enjoy prosperity levels closer to the UK average;
- Northern Ireland becomes less reliant on HM Treasury for the Block Grant, which consequently can be lowered, easing the pressure of subsidy on other regions of the Kingdom.

Reasons for a Special Case

Northern Ireland's private sector development has been hampered by two factors unique to the region, each representing a compelling argument for specific actions to be taken to assist it:

- The Troubles, which saw decades of systematic targeting of the private sector by terrorists, who blew up businesses, and subjected individual business people to intimidation, kidnap, mutilation and assassination;
- A land border with the Irish Republic; as transportation and other links become faster, more accessible and advantageous to businesses, the physical link to the Republic of Ireland (RoI) is more of an issue than ever.

Why Rebalance the Economy

Headline statistical analysis of the NI economy provides the evidence base:

- Northern Ireland is over-reliant on public expenditure, which has been estimated at 75% of GDP and consequently the region is over-reliant on the public sector for employment – 32% as compared to 21% in Great Britain;
- The claimant count now stands at approximately 60,000 people (6.6% of the workforce), representing an annual increase of over 7%. This compares disturbingly to the 0.3% overall increase in the United Kingdom;
- Northern Ireland has the highest proportion of inactive people of working age – 28.4% compared to 23.3% UK-wide;

- The average local forecast rate for growth in Northern Ireland in 2011 is 1.3% - this is considerably below the rate projected by the International Monetary Fund for the UK (2%).

Why Corporation Tax

No-one, including the Ulster Unionist Party, believes a lower rate of CT in NI is the "silver bullet" that will achieve the aim of rebalancing the NI economy on its own. However, if we compare what is required to rebalance the economy to a toolbox of equipment, then we might describe CT as the monkey wrench that is suited to heavy duty work, but requires the support of other tools of varying sizes and gauges to complete the job.

The evidence base for lowering CT is compelling:

- The UK Government, having already reduced the main rate by 2% in April 2011, is committed further reducing it by 1% in each of the next financial years until it reaches the rate of 23% in 2014-2015;

- The above is consistent with international trends, particularly since 1980;

- The taxation regime of a country is consistently identified in surveys of business investors as one of the key factors that influence their investment location decisions;

- Northern Ireland's private sector is populated mainly by SMEs. The Confederation of British Industry in Northern Ireland has identified that by current trends, the Northern Ireland economy needs nearly 150 new large businesses to match the GB average. This can only be achieved through an aggressive targeting of foreign direct investment.

We liken CT to a "starting line" tax. Without it, FDIs are unlikely to consider you as a location, particularly for profit centre operations; with it, you get to the starting line, which offers the opportunity to market your full offer to the potential investor.

Impact on Foreign Direct Investment (FDI) Strategy

From the "Pathfinder" strategy of the 1980s, document after document from successive NI administrations has attempted to devise and implement economic policy that tackled the fundamental issue of comparative lack of prosperity and lower productivity: none has succeeded.

Increased FDI would play a significant part in rebalancing the economy the Northern Ireland Economy. In our opinion reviewing the rate of CT has the potential to be a game changer compared to the current transitory initiative that is Selective Financial Assistance (SFA):

- SFA pitches its appeal to potential FDI investors on the premise that it lowers the costs of doing business in NI. However a disproportionate number of the jobs that it has so far attracted are unskilled and low paid. The Ulster Unionist Party acknowledges the value of this type of FDI, to the point of encouraging a concerted effort to lobby the EU not to end SFA in NI in 2013;

- A lower CT rate will empower Invest NI to target FDI profit centres, e.g. manufacturing and tradable services. This will impact directly upon the productivity and prosperity issues identified at the start of this submission;

Costs

Under the Azores Judgement from the European Court of Justice (ECJ), there appears to be little doubt the UK Parliament will only be able to devolve tax varying powers in respect of corporation tax if the Northern Ireland Assembly is prepared to face the full fiscal consequences of such an alteration, i.e. a commensurate cut in the Block Grant.

The debate regarding the devolution of CT varying powers has been significantly hindered by the inability of the Department of Finance and Personnel, as well as Her Majesty's Treasury to detail exactly the proportion of the United Kingdom corporation tax take that is generated within Northern Ireland. Unfortunately both Departments have provided sums which significantly differ from one another, a disparity of up to £175m and therefore it is difficult to properly assess the potential impact on the Block Grant with complete certainty.

Nevertheless a reduction of £200-£400m from the Block Grant would represent approximately 1.5% to 2% of the overall budget for Northern Ireland. We accept that the short-term loss of revenue resulting from the lower tax rate will have to be met from the resources of the devolved administration.

This represents short-term pain, but we believe that the degree of pain is variable and to some extent under the control of Northern Ireland Assembly; we also believe the biggest cost would be the political failure to do anything to address the systemic fault line in our economy, leaving our people under-producing and less prosperous than their fellow UK citizens.

We would welcome:

- A formal, written opinion from the European Commission that ECJ is likely to accept the Northern Ireland Assembly has met the three key criteria arising from the Azores Ruling;
- An agreement between the Northern Ireland Assembly, the Government of the United Kingdom, and the European Union which clearly identifies a formula to define the full fiscal consequence of devolving tax varying powers in respect of CT;
- The outcome of running that formula, i.e. the actual cost as measured in the cut to the Block Grant;
- A binding agreement that the Northern Ireland Assembly will benefit from other tax revenues clearly arising from the decision to cut CT, i.e. through additional National Insurance contributions, income tax, VAT receipts, as well as savings made as a consequence of a reduced spend on social security benefits. Alternatively, as these new savings and revenue funding streams would benefit HMT, we believe that this could be reflected in the amount offset within the value of the Block Grant.
- An appreciation that Northern Ireland may be entitled to an amount of the savings generated through in

It is not possible to define the actual costs, as this will depend on several factors, some within and others outside of the control of Her Majesty's Treasury and the Northern Ireland Assembly. Therefore issues to keep in mind include:

- How will CT varying powers be implemented, as well as what additional mechanisms will be required;

- What changes in the global market will impact on the Northern Ireland Economy, and what the Assembly's ability would be to react;

- Will the Republic of Ireland maintain its current rate CT, and what other factors may change which would require the Northern Ireland Assembly to react.

We address the issue of how best to manage costs under our implementation section below.

Benefits

A transformational action is the Holy Grail of those who have held political responsibility for the NI economy over the decades. In the 1960s, the Unionist Party, under Terence O'Neill, began a process that was interrupted by the Troubles. The strategy holds good forty years later; identify a policy to achieve your aim, liberate your public and private sector leaders to shape the strategies and programmes to make it happen, monitor and adapt to changing circumstances.

A lower rate of CT would impact positively in a number of key areas:

- It would allow Invest NI to target FDI profit centres, rather than the current cost centres, with a consequent improvement in individual productivity, prosperity and an uplift in NI plc's ability to pay its own way in the world, rather than rely on HM Treasury. This, in itself, would strengthen the Union immeasurably;

- It will encourage existing FDIs to invest in Innovation and Research & Development (R&D), particularly if such areas are incentivised;

- It would encourage indigenous SMEs to further expand into other further challenging areas as the Northern Ireland economy is injected with a sense of dynamism ;

- The introduction of more large businesses will open opportunities for existing indigenous companies to join the new supply chains;

- An enhanced number of large (international) companies will advance Northern Ireland's Corporate Social Responsibility capacity, offering opportunities to boost the social economy, the arts, sports, culture and all other aspects of a vibrant, successful society;

- A strengthened private sector will rebalance the economy to the point where we can maximise buy-in for the need to review the public sector to ensure every job has meaning and purpose for the post-holder and public alike;

The Minister for Enterprise, Trade and Investment has identified benefits measurable as follows:

- A potential increase in employment of 58,000 jobs by 2030;

- Living standards in NI rising by 13.5% over the same period;

Pursuing, and achieving, the power to set our own CT rate requires Risk Management by the Northern Ireland Assembly. Some risks can be influenced by the devolved administration here, others cannot. That acknowledged, the biggest single risk to the Assembly is to do nothing. This was the story of the 2007-2011 Assembly, it's greatest achievement was to survive that long: survival without delivery. The previous Assembly may be forgiven for survival; but the 2011 class must deliver, by getting on with the big ticket decisions, like CT.

Implementation

The Ulster Unionist Party would welcome three key phases to achieve the aim of lowering Northern Ireland's CT

- Westminster legislates to devolve the tax varying power to the NIA;
- The Northern Ireland Assembly pre-announce the intention to lower the CT rate two years hence, thus giving Invest NI the lead-in time to get new FDI on the ground;
- The rate of CT in Northern Ireland is lowered incrementally over a period of three to five years, allowing the Northern Ireland Assembly the flexibility to react to changing global economic conditions.

Economic Enterprise Zone

No-one believes a reduced rate of CT alone will achieve the aim of rebalancing the NI economy to the point where historic under-productivity and lower prosperity levels are addressed and rectified. A basket, or toolbox, of measures will be required, making up the economic Enterprise Zone supported by the current Secretary of State for Northern Ireland, Owen Paterson MP.

We believe complementary measures could include:

- A simplified business tax regime;
- Less red tape and bureaucracy;
- A planning process run at a speed that acknowledges the needs of business;
- Incentives for Innovation, R&D -including the transfer of SFA funds, should the latter end as is currently being proposed under EU regulations;
- Employee and employer National Insurance Contribution holidays for new jobs;
- A strategic drive to maximise the benefits of agglomeration of FDI;
- Enhanced non-financial assistance, e.g. reviewing public procurement processes and protocols to ensure they do not inadvertently exclude indigenous SMEs who lack the capacity to bid under current regulations.
- A scheme of rewarding success e.g. when a business has established it could potentially receive additional support to expand

Conclusion

There is no doubt that the Northern Ireland Assembly would be taking a risk by assuming responsibility for setting Northern Ireland's rate of CT. The tax take from CT is volatile, yet will be required to fund public services which thrive on stability and long-term financial certainty. However, a transformational action is required to address the fundamental issues within the economy here, not least the relative lack of productivity and prosperity. While CT is not the answer if taken in isolation, it has the potential to be a key driver if applied as part of a series of rebalancing measures.

A differential corporation tax rate should not be seen as a threat to the politics of the United Kingdom. Rather, it could be seen as a way to celebrate the diversity that exists throughout the United Kingdom

Recommendation

The Ulster Unionist Party would like to see the UK Government move as soon as possible to see the power to vary the rate of CT devolved to the Northern Ireland Assembly. At that point, we recommend that the Northern Ireland Executive, and most notably the Department of Finance and Personnel, undertake a wide-ranging and comprehensive investigation into possible options for the Assembly to take.

What the Ulster Unionist Party is recommending for Northern Ireland is by no means full fiscal autonomy but rather improved fiscal self-sufficiency.