Northern Ireland Assembly

COMMITTEE FOR FINANCE AND PERSONNEL

OFFICIAL REPORT
(Hansard)

Devolution of Corporation Tax

15 June 2011

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:
Mr Conor Murphy (Chairperson)
Mr Dominic Bradley (Deputy Chairperson)
Mrs Judith Cochrane
Mr Leslie Cree
Mr Paul Girvan
Mr William Humphrey
Mr Ross Hussey
Mr Mitchel McLaughlin
Ms Caitríona Ruane

Witnesses:

Ms Kate Barker	)	Economic Advisory Group
Mr Mark Nodder	)	
Mr Bill Pauley	)	Department of Finance and Personnel
Mr Tony Simpson	)	

The Chairperson:

The next evidence session is on the devolution of corporation tax powers and the impact of reducing corporation tax on the NI economy. The Economic Advisory Group has provided evidence to the Department for Enterprise, Trade and Investment (DETI) on those issues. I welcome Ms Kate Barker, who is the chairperson of the Economic Advisory Group, and Mr Mark Nodder, the managing director of the Wright Group, who I know from my time buying buses for the Department for Regional Development (DRD).

Mr Mark Nodder (Economic Advisory Group):
Thank you very much. That is much appreciated.

The Chairperson:
The Committee is keen to get a range of evidence on the devolution of corporation tax powers. I know that you gave the Department of Enterprise, Trade and Investment some advice on that, and we are keen to get some information on it from you. I invite you to make an opening statement, after which there will be some questions from Committee members.

Ms Kate Barker (Economic Advisory Group):
I will make a relatively brief opening statement. Thank you very much for giving us the opportunity to come to talk to you. The position that we, as a group, started from was to look ahead to what the outlook for the Northern Ireland economy would be if no significant policy intervention were made. Of course, the truth is that the outlook would not be very encouraging. The view presented to us — the economic forecast said some pretty dubious things, but, as far as one can tell, this is a reliable view — was that, without any change in policy, there would not be much prospect of starting to close the gap between the standard of living here and in the rest of the UK. I think that that is a really important place to start.

The other issue, of course, is that there is a big public finance deficit between Northern Ireland and the rest of the UK. Given the constrained fiscal environment, which looks to me as though it will be fiscally constrained for a number of years yet, there is a real issue around how easy it will be to sustain the kind of public sector that we have here. One of the most discouraging features of the forecast that we looked at was a slow jobs recovery.

Speaking personally, rather than on behalf of the group, I started off looking with a very open mind at what could be done in Northern Ireland. As a group, we started looking at a whole range of interventions, of which lower corporation tax was one. The main reason why we were happy to put out our report on the impact of low corporation tax, which I supported and which is good and useful, is that, bluntly, it was extremely difficult to find another intervention that would have the same impact in pushing the private sector in this economy on to the kind of growth trajectory that it needs to follow if we are to start to close those gaps, create jobs and be in a position to keep in Northern Ireland the very good graduates that we are exporting today. It is really about making a move to achieve what I understand Northern Ireland has been trying to achieve for a long time, which is to move up the value chain in order to have better, more value-added employment.

There has been a lot of discussion about the cost of the policy. I do not think that anybody would deny that, in the short term, there would be a cost to the public sector. However, I think that it is useful not to think too much about it as a cost to the public sector, because at the same time as the public sector bears the cost, the private sector will benefit.

There is a thought that all the money — I sometimes hear this argument — would flow through to company directors, but, of course, it would not. It would flow to the businesses themselves. Mark may want to comment on that from his angle. You might expect to see businesses investing in areas where economists tend to believe that companies find it difficult to hang on to supernormal profits — in domestic areas of the economy, where it is sometimes argued that that is dead weight — and you may see people competing more and prices falling, which would be of more general benefit. The view that a tax reduction would feed through to company directors is not accurate. It is important to recognise that, alongside the public sector cost, there would be an immediate benefit to the private sector, to which there would be a response that would benefit people in Northern Ireland.

We took a good look at the empirical relationships between corporation tax and foreign direct investment. We used the Oxford Economics model, which I know others have used here, because it is the only disaggregated tax model for Northern Ireland; there is not a lot of choice. We took a good look at the assumptions and went through some of the previous work they had done. I think that the work we produced is as accurate as we can make it. I want to say strongly that I am not going to go for broke for every point estimate in that report. It would be a pretty foolish person who went for broke over a forecast of additional jobs in 2030. I am certainly not going to do that. The big point that comes over in the report is that potential improvements to the private sector economy would be very substantial over the medium term.

We challenged all the assumptions and asked other people to look at their work. We say in the report that DETI asked another group to do alternative work that was very much in line with that. As far as we can tell, it is a reasonably good view, in broad terms, of the kinds of benefits that Northern Ireland could expect from the policy.

Apart from importing foreign direct investment (FDI), which we all know brings a whole chain of opportunities, such as improving opportunities for innovation, helping smaller companies to have more demanding customers and improving the whole competitiveness of the economy, the two big things that you would get are a larger private sector economy here and improved living standards. I repeat that, because it is so important to understand that the issue is about the whole economy and about having a more export-intensive economy and a more productive economy.

However, although the policy is necessary to get a higher growth trajectory, it is not sufficient. It does not take the pressure off the need to continue to do good work on skills, infrastructure and good planning, because, if those things are not right, foreign direct investment will be more difficult to attract. Lowering corporation tax is not an easy option, and, after it is introduced, you will not be able to sit back and say that you have done everything.

Having looked hard at the issue, the group's strong recommendation is that Northern Ireland should press to have the power to set corporation tax rates devolved here and that it would help to induce economic convergence. I am really encouraged by the degree of support that I detect in the Northern Ireland business community and, indeed, the political community for the policy.

The Chairperson:
In your closing remarks, you talked about the power to set the rate, but you made a clear case that it should be part of a combined package, some of which involves taxation and other areas of government, such as planning and infrastructure spend. Essentially, all that it will be is a mechanism to assist economic growth or a rebalancing of the economy. In your view, are we limiting our ability to fully deploy that mechanism by limiting ourselves to setting the rate rather than deciding the policy on corporation tax?

Ms Barker:
As opposed to dealing with the corporation tax base?

The Chairperson:
Yes.

Ms Barker:

I can see attractions in having some ability to deal with the corporation tax base, perhaps around capital allowances in particular. However, I would be a bit cautious about going further in making further changes to the corporation tax base. One of the reservations that many people express about the policy is to do with the administration and having a different policy here from the rest of the UK. Those difficulties would be added to if you were to start to change the base as well as the rate. A lot of people think that the administrative costs to businesses from a change to the rate would be relatively containable, but they might find that it would be more difficult if the base were changed as well.

When going out to sell Northern Ireland to people who are coming in, selling the base rate of corporation tax is a good sell. Invest NI feels strongly that that is the kind of thing that it wants to have in its locker. Selling small changes to the base is less certain. The important thing will be to say that we are doing this today and it will be permanent. With changes to the base, there might always be a worry that somehow you might move it a little bit, but a strong commitment to a headline rate is a very good selling point for Northern Ireland.

The Chairperson:

Aside from changes to the base, how do we ensure that the lowering of corporation tax will not simply be something that is given to companies — particularly foreign companies that will take their profits out of the country — to add to their profits? How do we ensure that that profit is reinvested? According to your paper, foreign direct investment accounts for around 54% of economic activity. Rather than having the policy simply as a selling point for foreign direct investment, how do we ensure that whatever benefits accrue from a reduction in corporation tax rates is fully ploughed back into the economy, including that 54% and the other 46%, and economic growth here?

Ms Barker:

You asked about foreign profits, so I will ask Mark to comment on how he feels existing companies might react. The truth is that you cannot offer any guarantee that some of the profits will not flow away. However, you should not worry about that too much, because, to some extent, people will reinvest profits here if they see profitable opportunities. A lot of work has been done in the UK on foreign direct investment. Foreign companies tend to a higher propensity to invest, they tend to be higher value-added and they tend to add to the research and development capacity of the country. They are often more demanding purchasers for small and medium-sized businesses. The fact that their profits are going away does not detract from the fact that bringing those kinds of jobs into Northern Ireland would have a very helpful and stimulative effect. Mark might want to say a little bit about how domestic companies might respond.

Mr Nodder:

The key for us, as we come out of a difficult period following the recession, will be reinvestment and growth. Unlike a lot of other manufacturers locally, our company took a view during the recession that we would batten down the hatches and keep things together as far as we could so that, when the economy eventually recovered, we could benefit from the upswing. In doing that, we took a conscious decision — I am speaking only for my own company — to carry a lot of employment. We practically maintained full employment, even though our vehicle throughput fell by something like 35% to 40%. The result is that, instead of making money over the last couple of years, we have lost money. We have substantially eaten into what would have been our reserves; reserves that we now need to invest in growth.

We are looking at ways in which we can get back on the horse and start riding again. We have always had a history of investing practically everything that we have made back into the Province for employment here, but now, looking forward, it is ever more paramount that that is where the money is channelled. We are concerned that the help that we have had from Invest NI in the past will not be just as forthcoming in the future. We know that the rules are tightening for Invest NI and that the opportunities for it to subvent will be reduced. Large companies like ours will have limited opportunities to get that kind of assistance, so it behoves us to make those investment decisions for ourselves.

We operate in a very competitive marketplace. My competitors are not just from across the water in GB; I have competitors throughout Europe and, increasingly, in India and China. There is no doubt that they have a much more competitive labour base, but we like to think that we build better vehicles, do things in a smarter manner and concentrate on our innovative capability in technologies and advanced manufacturing. However, that cannot be sustained and grown without investment. The source of investment is the profits and cash that we generate.

I will give a small example. People talk about some of the cost advantages of having a labour pool here that is paid slightly less than a labour pool across the water in GB, but, as I said, I am comparing our labour rate with rates in India and China. We are on an island that is separated from the nearest place by 14 or 15 miles of water. I will boil it down to, for instance, the cost of building a bus, which is what I do — we build approximately 1,000 a year. The cost of bringing the materials for one bus onto this island is something like £700. The cost of shipping that bus back to most of our customers in GB is about £600. That £1,300 of oncost is unique to our geographical location.

Those things, as well as energy costs and the business rate, are the things that we are highly focused on, because, ultimately, our market is becoming global. There is not enough business in Northern Ireland. We are always delighted to get business in Northern Ireland, as we are in the Republic, but there is not enough to sustain a big manufacturer like our company, which employs 1,200 people. We have to be competitive in global markets, and we are going to do that by investing in advanced manufacturing, while, at the same time, having a lean cost base wherever we can. The opportunity for us as an indigenous manufacturer comes from the potential ability to free up funds for reinvestment, stimulate further growth and ensure that we sustain our competitive advantage.

Mr Girvan:
Thank you very much for your presentation. I appreciate that, as everyone has said, devolution of corporation tax-varying powers may not be a panacea that will sort everything. My understanding is that, under the current business plan, we have a corporation tax that is set at a certain level, but the tax breaks in the United Kingdom system give you an advantage. No company is paying the full tax at that percentage because they can write down a certain amount through other processes, whereas the system in the Republic of Ireland — the system that we are comparing ours to — where they pay 12·5%, is fairly straightforward. They pay that 12·5%. If you dig into the figures, you will see that, when they are worked out using the current format and calculation form, we probably pay around 17% or 18%.

I know that some people may ask how I am working that out, but businesses can get tax breaks, and money identified as being used for reinvestment can be forward-planned over several years as a forward tax write-off. It has happened that a number of businesses have said that they have to invest and have carried that money forward to ensure that they can retain employment for a time.

If this change were to happen and those other tax advantages were to be removed along the way, similar to what has happened in the Republic of Ireland, would there be the same acceptance from a Confederation of British Industry (CBI) and business perspective? Ultimately, other tax breaks could be removed to allow this to go forward. What is your opinion on that? I would value your input.

Ms Barker:
I cannot answer from any company's point of view. However, I asked earlier about the tax base, and it is important that we keep the same tax base as the UK. Perhaps you are also getting at a different question, which is whether we have thought about the difference between effective tax rates and top-level tax rates. As a matter of fact, one of the pieces of work that looked again at some of the analysis in the report suggested that a very similar conclusion would be reached if the same analysis were run using effective tax rates. I do not think that that detracts from the overall argument. When the Treasury makes a calculation of how much is paid, it allows for that difference in base; quite clearly, this would be a lowering of tax. If you are asking whether we have thought about the effective rate, the answer is yes. If you are asking a separate question about whether I think it is desirable to keep the same structure of corporation tax as the rest of the UK, my answer is yes, both for the reason you gave — the other advantages — and to try to keep administrative simplicity where we can.

Mr Nodder:
I will make just one observation. You are right to raise the point. Tax computations are, by the nature of the beast, sometimes difficult and can carry with them an administrative burden. From our perspective at the Wright Group, I can tell you that, in recent years, we have been able to avail ourselves of some additional relief, which has not been huge, for some of our R&D work. It was an incredibly long, torturous and complex process to get that acknowledgement. I could not obtain it locally, and, in the end, had to make tracks to Cardiff and bring in expensive experts to make the case on our behalf, although there was a net result at the end of the day. I am not being facetious — it was a costly exercise. It gave us some limited additional opportunity and, as with any business, we try to avail ourselves of all opportunities. We would all prefer, if at all possible, to have something that is cleaner, simpler and easier to administer, but I do take your point.

Mr Mc Laughlin:
Thank you very much for that very interesting presentation. It has shone some light on what is a

very complex and difficult consideration. I have been convinced for some time that there are advantages not just in reducing corporation tax but in achieving a level playing field with the South of Ireland. The competition between the two systems and investment promotion agencies is crazy for such a small territory. In my view, we have to consider the other issues in relation to tax yields and advantages. That is proving to be complex and difficult. Your anecdote about your company's experience seems to be reflected in the experience of the Executive, primarily through the Department of Finance and Personnel (DFP).

There is a divergence in even finding an agreed baseline in respect of revenue flows. Even if you had the power, you could not use it unless that can be resolved. You need to know what the risks and costs are. Whatever difficulty you had at an individual company level, we need a more open approach to the economy so that the Executive can make fully informed decisions on how to use the power, assuming that it is transferred.

I have made the point — it is not reflected in the presentation, but I think that it should be — that a strategic projection on the benefits to the regional economy should take into account the benefits, or the reasons why there are not benefits, of harmonising the regime. Even in the travails that they are going through in the South, they manage to not only sustain foreign direct investment but outperform a lot of other economies in that regard. That indicates that they may be on the inside of that particular recovery curve. They certainly are as far as we are concerned.

There is a lot of interest in this issue, but there is also a lot of concern about the potential costs. We have a very fragile economy. We have an economy with an inappropriate profile, particularly as regards the private sector. Everyone tends to think of the dominant influence of the public sector and the impact of a reduction in the block grant. That is creating concern that could lead to paralysis on the issue. We need to be bold. We know that there will never be parity under the present arrangements. The best that we have ever done was somewhere around 85% — that is a historical high — and that was with the Executive getting a fair wind in the early stages of the last mandate. It was not going to get any better. We knew that that degree of parity was never going to be achieved despite, we should assume, the best efforts of direct rule Ministers and others to manage the situation.

There are lots of different perspectives and analyses here, but the Executive are in a position to manage that process. We know exactly how it impacts and how it lands, particularly as regards disadvantaged communities that have never had the culture or expectation of employment or career opportunity. We are dealing with people for whom that is their lived reality on a generational level. For them, the public sector is a comfort blanket in a sense. There is a lot of ability and talent here that never gets the opportunity. We will have to be very bold. I strongly welcome the positive approach that you are taking. However, we should be mapping out what it is that we are aiming for, and what we are aiming for has to be very ambitious for those people.

Ms Barker:

I recognise the concern about the public sector cost. However, apart from all the difficulties around the negotiations and administrative issues that need to be resolved, one of the reasons why we looked at something that was a little bit in the future when we did the modelling was that we believe that, if you have a pre-announcement, there is more chance that the private sector will be ready to take up the slack. If we are serious about wanting to rebalance the economy, we must recognise that the truth is that it is just so hard to find a better way to do it.

Mr Humphrey:

Thank you very much for the presentation. You are quite right that the devolution of corporation tax-varying powers to Northern Ireland is the best, or perhaps the only, lever or mechanism available to us at the moment. I know that you are not a politician, but I am going to ask you a question that moves into the realms of politics. The Secretary of State for Northern Ireland is clearly someone who is a strong supporter of corporation tax powers being introduced in Northern Ireland as a lever to try to get inward investment and assist indigenous companies. That is hugely important and should never be forgotten. I have read various articles and looked at what is happening on the mainland, and it is clear that the Scottish First Minister is also interested in that concept. That will mean a variation between Scotland and England. Is that going to be a difficulty? If there is agreement here and we have incentivisation, it follows that Scotland will want to introduce that. That will potentially have a difficult knock-on effect for the north-east and north-west of England in particular. Will it be a barrier to us if the Cabinet across the water in London realise that it will have a knock-on effect in their constituencies?

Ms Barker:

You are quite right. I am not a politician, so I have no idea how the discussion runs around the Cabinet table. However, I will say two things in response to that question. First, even in advance of the debate, there was quite a lot of discussion in Scotland and Wales about wanting more fiscal flexibility. Therefore, although it is true that a change for Northern Ireland is likely to sharpen that debate, it will only sharpen it. It is a debate that was going on already, and Westminster has to think about it and talk about it. Secondly, when you look at the economy of Northern Ireland and its position, which Mark set out, with the sea border and the big land border with the Republic, you can see that it is in a very different place both physically and economically. In my opinion, it has a much stronger case for being considered as a special case than the other areas have.

You are completely correct that the position in Scotland would more readily open up competition with areas of northern England that are already not in a good economic state. I do not think that the same argument holds so much here. There may be little diversion from the UK, but the truth is that the bulk of the diversion of FDI here will not come from that area, and you will not have the sort of cross-border domestic competition here that you might have if you had something different in Scotland. Therefore, I think that the case here is very different and is recognised in the UK to be very different. Nevertheless, I am sure that that case will have to continue to be put.

Mr Cree:

Discussions on corporation tax invariably gravitate towards the cost of introducing the tax, but you mentioned one of my favourite points, which is the standard of living or GVA. You say that it will be 3·5% higher than the baseline. Can you expand on that a bit? You talk about here and the rest of the UK. Are you talking about the rest of the UK as a whole or the rest of the UK excluding the south-east of England, which gives you quite a different figure? Also, you anticipate significant growth in productivity through a greater number of people being in employment. Do you have any sort of feel for how that would affect the economically inactive?

Ms Barker:

The issue is set out in more detail in our report, but I hope that I can remember all the data. The comparisons that we have made are with the UK on average rather than with the rest of the UK or even the UK excluding the south-east. There are two issues around productivity. Productivity is expected to be higher by about 6% or 7% for each individual, but the standard of living will also rise, because, as you rightly say, the level of employment will rise, and we expect the gap in inactivity with the UK to be closed by those additional job opportunities. Therefore, the overall rise of about 13% is divided into efficiency gains for each person and the fact that more people will be working. It is about half-and-half.

Mr Cree:

When is that gap likely to close? Despite several economic programmes over many years, we have never managed to do it.

Ms Barker:

I see it happening at this point because, first, the political situation here is, in a way, more favourable than it has been. Secondly, this intervention is, to put it bluntly, much more of a bigger-ticket intervention than some of the ones that have been made in the past. It offers a significantly different rate of corporation tax and a significant incentive to get FDI here, and it does so in a way that the previous interventions have not. That is why, when you look hard at areas such as R&D and tax credits, you always have to ask the question: what is the capacity to keep on absorbing R&D in the economy? This is suggesting a different structure to the economy with much more foreign investment, and I believe that it would prove a more powerful intervention. That is why I think it would help to move the economy on in a different way.

Ms Ruane:

First, we really need to look at harmonisation across the island. You mentioned the island costs. I absolutely agree; it is very difficult when you are competing. However, in the answer to William, you mentioned that the difference between Scotland and Ireland is the land border. So, we really need to look at that in the next number of months. It will be crucial. We also need to look at the marketing of the island. I am not making a political point, but, worldwide, people do not make the distinction. Us making the distinction and competing makes it more difficult. So, I welcome a comment on that.

One of you mentioned the skill set. From my previous job in education, you will know my views on the education system here. The development of our economy is linked to our skill set and our education system, and a couple of things are really important. I am not sure that the economic and educational arguments have come together enough yet, although I have probably heard more leadership from the business community on the education debate than from other sectors of our community. I welcome your opinion on that.

We have literacy and numeracy difficulties. At the high end, we have done quite well.

However, 12,000 young people — the figure has actually come down to 9,500 — have been failed by an education system, and that impacts on companies such as yours. There is a narrow focus in career choice, and schools are not looking at careers in the way that they should. That leads to difficulties for your company. It is like: you are clever, so go into law or medicine. Then you have a narrow focus in the curriculum. For example, across the border, they are keeping six or seven subjects right up to leaving cert, whereas here they are leaving behind business and economics far too early. We need a much more holistic approach to this whole debate. We brought forward careers strategies. They are lovely strategies, but I am not sure that they are being embraced in the way that they should be.

Mr Nodder:

I absolutely agree that what we are talking about today is one strand of what should be, in business terms, a strategic plan for this Province going forward. You mentioned the skill set. For companies such as ours and other manufacturers, it is absolutely key that we get alignment and investment, so much so that, as much as we have very productive links at the highest level with both of our excellent universities, we train the people who build our buses, and we still operate a modern apprenticeship scheme. It is NVQ-approved. We basically take 70 or 80 young people every year and aim to give them a career for life. We invest in that. We get a little bit of support, but it is our decision to invest in that, because those skills are not readily available, and we have to teach people an awful lot of life skills as well as bus-building skills. We will continue to do that. That is one of the key strands of our philosophy of reinvesting what we earn.

You made an excellent point about harmonisation and the issue of grounding. I have been working for Northern Ireland plc for about 26 years. Before I began running the company, I spent most of my time on the road selling things that were made here to various communities and to between 30 and 40 countries worldwide. It has been an interesting journey over the past 20-odd years: bringing people over and getting them to engage with our local companies and invest in local manufacturers.

There were huge obstacles to surmount in those early days, because, frankly, although people understood where Ireland was, they did not really understand what Northern Ireland was or what it stood for. When they started to dig into it all they found was the mess of the Troubles, which would lead them to ask why they would want to come here. In those early days, 20 or 25 years ago, when I was working for Shorts and Bombardier, it was all we could do to get customers to come here, let alone start making investments and buying our things.

Of course, that has turned right around now. There is such a fantastic story to tell, and people are anxious to come here and see it for themselves. As a businessman who has seen that development and who believes passionately in what this little country has to offer, I sense that this is our time. If we blow this opportunity, we will all live to regret it, because this is a unique opportunity to do something very different.

Over the past year and a half or so, we have had the benefit of the services of Secretary of State Clinton's special economic envoy. If I were to distil one of Declan Kelly's parting speeches, which he made to a Chamber of Commerce lunch in the Europa Hotel, the message would be, "Guys, we have given you the opportunity and set you up. I have opened my Rolodex and introduced you to all the movers and shakers. There is a lot of momentum gathering behind you, but, fellas, it is time that you took charge of your own destiny."

In a business sense, that is what we do: we make a strategic plan. When we do that, we have a five- or 10-year vision that covers an awful lot of different strands, but once we set sail, it is ours to control. The subject that we are talking about today is one strand. The skill set is another strand, as is higher education. As a businessman, I plead for a uniform strategic approach to growing this economy, where we bring all of those strands together in the holistic fashion that you referred to. If we do that, we will have reasons to be extremely optimistic, because we have, to put it in buzz terms, some unique selling features in Northern Ireland. However, if we pass this opportunity up, we will all have cause for deep regret.

Ms Ruane:

I agree with a lot of what you said. I have been to India and China — two countries that you mentioned — and their approach, particularly that of India, even to something like education, is so different. Those countries approach science, technology, engineering and mathematics (STEM) subjects with the attitude that the subjects will be difficult but that it is a wonderful area. The task is not just about learning information to get an A in an exam and get into the best university; it is about really stimulating critical thinking, creating a mindset and stimulating entrepreneurial skills. There is something that we need to learn there. If we look at India as a competitor, we can see that there is something missing here.

You mentioned the two universities, but some of the best work is going on in the further education colleges. Our difficulty is with the snobbery, for want of a better word, in our society. Some young people are taking up inappropriate further education places; they are going to university rather than to further education colleges. Some of our best thinking is in our BTEC courses. If you have not already looked at some of the post-16 engineering courses, it is well worth doing so.

I know that the discussion is going away from corporation tax a little, but all these issues are linked. If we do not link them, we will not take the opportunities that you are talking about.

Ms Barker:
If I may, I will make a low-level point after Mark's very impassioned one. The Economic Advisory Group is not supposed to be about corporation tax alone; we started by looking at other things. When we come to think about what we will be looking at next year, the other issues that will be needed to make the lower corporation tax rate a success will absolutely be our priority, and those issues will include the provision of skills. I am shocked by that failure at the bottom, and that is something we will want to take a hard look at. However, it is also a very long-term aim.

Mr D Bradley:
Good afternoon. You are obviously very positive and enthusiastic about the possibility of a reduction in the rate of corporation tax. Not everyone shares your joy, enthusiasm and positivity. We have heard some statements from public figures recently that are not in agreement with your view. Some of their reservations centre on the reduction in the block grant and the impact that it might have here. In your paper, you write that the impact of any reduction to the block grant can be managed in a variety of ways. In what ways can reduction in the block grant, as a result of the introduction of a lower rate of corporation tax, be managed?

Ms Barker:
First, I will try not to reiterate the point I made earlier, that it is important to focus on the fact that, at the same time as the reduction, you should see a positive impact in the private sector, so it is important not to think about this as a loss of jobs overall.

Secondly, because we anticipate that, over the slightly longer term, revenue will flow back with an improvement in the economy, there will not be a permanent lowering of the rate of the block grant to Northern Ireland. That makes a difference to how you manage it. Sometimes short-term projects can be managed by re-profiling. Sometimes, it is emotively put: "We will have to pay for this, so we will have to close hospitals." That cannot be right. I am sure that there are better ways of managing it. Consideration might be given, for example, to a slightly higher rate of asset sales for a period. When one thinks about it as a price that the public sector has to pay in any case, I am sure that public sector efficiency, as in the rest of the UK, is something that is very much on your mind. I believe it can be managed without serious adverse effects on the Northern Ireland economy as a whole. However, I do not deny that there will be hard decisions and choices to be made within the public sector. It will be a spur to making the sector more efficient.

Thirdly, it is sometimes put as a gamble: you pay the costs, and it is a gamble. To be blunt, doing nothing is much more of a gamble. You are then gambling that the rest of the UK will continue making the subvention to Northern Ireland at the same rate as at present, whereas Northern Ireland will have passed up what Mark rightly described as an opportunity to change the game. I am not sure that that is the case. You have to be careful what you compare that cost to the public sector to.

The Chairperson:
Thank you very much for your evidence. No doubt we will continue to deliberate on this issue.

We will now hear from Department of Finance and Personnel officials. I welcome Bill Pauley, the head of strategic policy division in the central finance group of DFP, and Mr Tony Simpson, who is also from that division. I do not wish to steal any of your thunder before you begin to speak, but we are 20 minutes behind schedule. We have had a fairly detailed discussion on some aspects of the corporation tax issue. Therefore, I would appreciate it if both witnesses and members would keep their observations and questions tight, so that we get the business finished today.

Mr Pauley (The Department of Finance and Personnel):
Thank you. We have provided the Committee with an update paper, which I hope you find useful. We have tried to summarise the key parts of Her Majesty's Treasury (HMT) report as well as the discussions that the Minister of Finance and Personnel, along with the First and

deputy First Ministers and the Minister of Enterprise, Trade and Investment, have had with the Northern Ireland Office (NIO) and Treasury Ministers. It is a hugely complex issue, and it was hard to keep it succinct, but we tried to provide something useful. We also tried to answer the questions put to us by the Assembly's Research and Information Service. I acknowledge that it has been hard to provide definitive answers to each of those. Many relate to things that are still undecided, and many of those are dependent on each other.

Overall, the costs and benefits of the corporation tax measure remain estimates. The Finance Minister is very clear that he believes the cost estimates remain high and subject to negotiation around what our share of the UK corporation tax is and to the estimates of behavioural effects such as profit shifting and the impact of wider taxes such as income tax and national insurance, as well as the administrative and compliance costs. We have a deal of work to do in discussion with the Treasury to quantify those.

The benefits are also estimated. When the document was launched, the Finance Minister issued a statement noting that the level of benefits in the HMT paper is quite low in that it expects a single step change in our economy rather than the ongoing convergence between our economy and that of that of UK regions. However, it does at least recognise that opinions differ. You have just heard from Kate Barker that her group produced a paper that showed that impact. It also showed that we need to take other actions in support of the measure to ensure that we get the type of reaction in our economy that is described in the Economic Advisory Group report as opposed to that single step production increase that the Treasury document forecasts.

We have also been to a few consultation events; some as officials. We have been to events at Northern Ireland Council for Voluntary Action (NICVA) and with other business organisations. Ministers held an event in London on 8 June, and another event is scheduled for 28 June here in Belfast.

The paper finishes with a few next steps. Essentially, after this consultation period ends, the Executive will have to decide whether they wish to ask for these powers. The next step would be that the Government would have to decide whether to agree to that, and we would work out the detail of some of the precise measures during that process. Thank you.

The Chairperson:

Thank you very much. There are a lot of questions around this, but some of the big variables and unknowns are the costs and benefits. Some of those cannot be resolved because they depend on other economic factors as well as on the passage of time. Some of those will not be resolved in advance of the Treasury agreeing to the measure, and the Assembly working out a way and means of devolving and deploying the ability to vary the regional corporation tax rate.

In essence, is DFP attempting to negotiate a formula with the Treasury, so that if cost was x and benefit was y, then z would accrue to the Treasury? We are never going to be able to pin down the costs and benefits because they depend on other circumstances beyond the transfer of powers. How has that discussion been worked out with the Treasury? Is it, in effect, the agreement of a formula by which the block grant would be impacted on if certain things happen in a certain way, or do we just make it up year on year depending on economic circumstances?

Mr Pauley:

I do not think that “formula” would be the best way to describe it. There are three elements to the cost. We have to bear in mind that the Azores ruling requires us to bear the full fiscal consequences. That means identifying those as closely as is practicably possible in order for Europe to accept that we have met the Azores requirement. The work in the HMT documents shows an examination of tax returns with a BT postcode, based on an average of over five years in actual calculation. Quantifying those on average over the five years, the Treasury estimated that that was 1·5% of the UK corporation tax take. That excludes branch plants. However, that is quite a hard measure from tax returns and is something that HM Revenue and Customs (HMRC) is working up. The Northern Ireland Affairs Committee’s recent report, for example, expressed the need for HMRC to do more on that so that we would have a firmer figure. We concur with that. That work is ongoing.

We then come to profit shifting and tax-motivated incorporation, which are really behavioural effects. Measures could be put in place to help prevent profit shifting, and we will need to look at the measures that are to be put in place to prevent or discourage that vis-à-vis the cost that the Treasury has estimated in its paper would be set against our block. Tax-motivated incorporation is to do with how people behave and change, and we want to examine how that would be addressed. We will never get as direct and accurate an estimate of those effects as we will of that first element. At a point in time when the block might be adjusted, we will have to agree with the

Treasury a methodology for calculating those effects. The ones that are shown in the Treasury paper are an improved methodology from the Office for Budget Responsibility (OBR), which it uses to make its Budget calculations. To that extent they carry a validation: The OBR methodologies are the basis on which the nation currently calculates its finances.

The other element is the other taxes, such as income tax or National Insurance. We are another step away from how we might estimate their impact, particularly in their early years. The sum of those effects would come later, but, nonetheless, they are just as important, and, from our perspective, just as much a fiscal consequence. It is crucial that, in any adjustment that is made to the block, they are taken into account, even if it is a bit more difficult to do so.

The Chairperson:

Are those principles not simply about the level of corporation tax yield but the total tax take across the board that people, per head of population, pay in the form of VAT, PAYE and so forth? Is that still a point of dispute, or is it a matter of working out exactly what the amount is? Does the Treasury agree in principle that those factors can be taken into account?

Mr Pauley:

The document indicates that they can be considered. There is still no agreement on exactly how they would be considered or taken into account, but the document indicates that those are other effects that need to be considered as we move forward. Certainly, they are significant, and that work needs to be done. Kate Barker and her colleagues have left the meeting, but their report also recognises the importance of those wider effects being taken into account in order to deliver the level of benefits that they anticipate are important. We see that as crucial too.

The Chairperson:

OK.

Mr Cree:

I want to make a couple of quick points. We all know that these are complex matters. In all those calculations, will income tax, superannuation or savings on benefits by having people gainfully employed, for example, be part of the final argument, which is that there is a net increase in tax take to the Treasury, and, therefore, they should be brought into the equation?

There was another interesting point that caught my eye. In your written briefing, under the heading of "Benefits", you mention that:

"Net FDI is estimated to increase by between £105 and £175 million in the first year (after taking account of the displacement of FDI from the rest of the UK)."

How do you ever work out a thing like that?

Mr Pauley:

Those figures are lifted directly from the document published by the Treasury, which has worked those figures out using the model.

Mr Cree:

Is that their estimate?

Mr Pauley:

It is their estimate of the impact on FDI. They include a central estimate and a high and a low estimate. I believe that it is the central estimate that we have put in the paper. The UK already attracts quite a high proportion of the global FDI flows. The Treasury anticipates that, if we have this measure, some FDI that goes to the UK would come here, which, indeed, we hope for. The net effect on the UK as a whole is taken into account.

Mr Cree:

Can we not corroborate that figure?

Mr Pauley:

That figure has come from a Treasury model. We have not seen the detailed basis for it or all of the working out behind that model. In several meetings, we have discussed the workings of it with the Treasury on that aspect and on the other aspects of its findings.

The Chairperson:

To be clear on the point that Leslie has raised, is the Treasury working out a figure on the basis of the power that it may devolve to us being successful and having an impact on business that might have stayed in Britain? Is that intended to penalise us for the success of the device that is given to us?

Mr Pauley:

Yes, in other parts —

The Chairperson:

It is having your cake and eating it.

Mr Cree:

It is double accounting, really.

Mr Pauley:

In other parts of the calculation of the costs, the Treasury estimates account for the profit-shifting argument. It says that some profits will be shifted from the rest of the world to Northern Ireland, rather than to the UK, so the UK will get the benefit of a corporation tax rate of 12·5%, should that be the figure that we move to. That is the figure that the Treasury uses in its document for calculating the numbers. If companies from the rest of the world were to shift profits to a Northern Ireland address, the UK would benefit, because they would otherwise be offshore. If companies in the rest of the UK were to shift their profits to Northern Ireland, there would be a loss to the UK because those companies would be paying the Northern Ireland rate rather than the current UK rate.

The model is quite detailed in that it takes some pluses and minuses into account. It is a model that is based on expectations. The figures go up to the end of this spending review period and are listed from Treasury forecasts. That level of corporation tax is, of course, highly dependent on the Government's growth targets over that same period being achieved. Those are all estimates to give us an understanding of the scale of the task and the size of the numbers to help to reach a judgement about what the impacts of the measure will be.

Mr McLaughlin:

Thank you very much for the presentation. I have a concern, about which I have been pressing individual Ministers when the opportunity has presented itself. There is a divergence between our calculations or estimates and those from the Treasury. My concern is about precisely how much corporation tax is gathered in this region. Your document states that the Treasury has used a methodology that is based on analysis of tax revenues by postcode. That appears to be an intrinsically sounder approach to come up with more precise figure work. Can I take it that we still do not have access to those figures to see whether we can close the gap? Unless we can fill that information gap, I foresee a nightmare scenario in which we get the power devolved here but cannot implement it because we cannot work out how much it will cost us.

Mr Pauley:

We have to reach a point where we can know those costs, and HMRC has to do further work on that. I am pleased that the Northern Ireland Affairs Committee at Parliament has asked HMRC to look at that further. I am not sure that we could meet the Azores requirement for the full fiscal consequences unless we could tell people that we knew what they were, even for this first element of that.

Mr McLaughlin:

There is an imperative on both sides to come up with an agreed data set.

Mr Pauley;

Yes. HMRC systems do not currently allow for tax receipts to be identified separately, simply because they were never set up to ask for the information in that way. Work has been ongoing since the coalition Government came to power, and HMRC is working to further refine the estimates in its document and to try to explore and clarify exactly what some of the costs might be. If the Government were to agree to any Executive request for that measure to be devolved, the systems would be adjusted again to look at how the returns for future years are coming in and what proportion of those are directly attributed to Northern Ireland.

One of the questions from the Research and Information Service was about the Department's own estimate, which, again, is very much an estimate based on very different assumptions to those in the Treasury work, which, as I said, was based on postcode returns in its first phase. It estimates 1·5% of the UK revenue. The estimates we used were those for Northern Ireland's share of pre-tax profits coming from regional accounts. Corporation tax is very complex. We spoke earlier about the effective rate and the different alliances that might come into play for different companies of different sizes, of branch plants being able to share them and of groups of companies being able to carry forward tax and bring back tax in different ways. We have had a brief discussion with Treasury colleagues on that as well, and I think the difference between the two lies in that area. The estimate in the document is based on postcodes, and that is its starting point from actual returns.

Mr McLaughlin:

Air passenger duty is also clearly a vital element of all of this. Has the consultation period been extended to 24 June? I think I heard that.

Mr Pauley:

Yesterday it was announced that the consultation period for the paper on rebalancing the economy has been extended from 24 June to 1 July. The consultation deadline on air passenger duty is Friday 17 June.

Mr McLaughlin:

The document refers to the discussions involving DETI, DRD and DFP. Has DFP made a submission before the deadline?

Mr Pauley:

We have not yet. There is an Executive meeting tomorrow, and after that we hope to make our submission. We are on schedule —

Mr McLaughlin:

Just about.

Mr Pauley:

With a day to spare. We hope that the submission will go on time and will reflect the Executive's views.

The Chairperson:

Are you aware of whether the information you have given us on air passenger duty has gone to the Committees for Regional Development and Enterprise, Trade and Investment? Is there a consultation exercise going there as well?

Mr Pauley:

I do not know.

Mr McLaughlin:

It is too late.

The Chairperson:

It is, but we are proposing to share whatever is in the annex with the other Committees anyway. I was just asking whether it was already with them, but if it is not it will be too late for those Committees to give any proper consideration to it. Thank you very much indeed.