Should the fiscal powers of the Northern Ireland Assembly be enhanced?

Northern Ireland has been characterised by an inability to narrow the persistent economic gap relative to Britain. Some commentators have suggested that regional Corporation Tax variation may be the "game changer" in closing this gap. This paper draws on a range of papers that help us better understand the historical and institutional context. However, the analysis of tax variation is broader than this. Consideration is given as to which taxes might be the most suitable candidates for devolution. While greater tax variations could certainly complement an emphasis on increased competitiveness aimed at improving economic outcomes, they are no substitute for such a focus. As is often the case in institutional and economic development, issues of sequencing and policy capacity are salient.

Key Words: Devolution, Institutions, Fiscal Decentralisation, Competitiveness, Economic Development, Northern Ireland

JEL classifications: H71, O18, R51, R58

INTRODUCTION

A range of arguments for and against greater fiscal devolution in terms of the potential impact on economic efficiency exists in the academic literature (HEALD, 2003; RODRíGUEZ-POSE and GILL, 2005). Likewise, political discourse has often highlighted the supposed ‘economic dividend’ of decentralizing political power (PIKE et al., 2012). Yet knowledge surrounding the possible institutional burdens and the precise balance between different tiers of government will be required if the overall costs and benefits are to be evaluated. For example, in this paper the focus is on the extent to which greater fiscal decentralisation could improve the economic performance of a territory with a devolved administration (DA). Northern Ireland is one of the three territories within the UK (along with Scotland and Wales) equipped with such a DA.

Heald, writing in 2003, observed that the literature on public expenditure in Northern Ireland remained underdeveloped; he also noted that regional policy capacity remained underdeveloped (HEALD, 2003). Both intellectual and policy underdevelopment remains the case more than a decade later. For good or ill, political and economic institutions are entwined when issues of fiscal decentralisation are considered. As reiterated in the July 2015 UK budget, the prospects for devolving (and hence reducing) Corporation Tax in Northern Ireland have been tied to achieving overall political progress. In particular, delivering the Stormont House Agreement (SHA) and the most recent Fresh Start Agreement, and public finance stability have been seen as a precondition for granting powers over tax devolution. If devolving taxation is regarded as an economic ‘carrot’ to the business community, then the British government remain willing to wield an administrative ‘stick’ to political leaders in order to secure its desired political outcomes. However, whatever the future of Northern

Ireland Assembly (NIA), in the wake of the May 2016 election, the economic and financial issues will not disappear.

The proposal on devolving Corporation Tax is just the latest proposal in a recurrent attempt at closing the economic gap with the rest of the UK (BIRNIE and HITCHENS, 2001). This long-standing weakness is well-known (BIRNIE and HITCHENS, 1999; BROWNLOW, 2013). It is obvious that, although helpful, peace has not in itself been sufficient to close the gap with even the UK average excluding South East England (HM TREASURY, 2011, p.3). Lower GVA per capita relative to other UK regions has been attributed to low levels of productivity coupled with high rates of economic inactivity (HM TREASURY, 2011, p.8).

While greater political stability has helped promote growth, a simple political determinism does not explain economic performance. The evidence instead supports the hypothesis that economic outcomes are contingent upon the institutional structures through which actors operate. A knowledge of the precise ‘institutional geography’ under which devolution occurs is required if the economic implications of devolution are to be understood fully (RODRíGUEZ-POSE and GILL, 2005, pp.406-7). It is therefore important to note that Northern Irish devolution has never been an economic panacea. Since 1921 weak (and indeed strong) economic performance happened during periods of devolution as well under periods of so-called ‘direct rule’.[1]

In the next section the historical and institutional context is discussed. The current and potential gains from devolving tax are then covered. This analysis is followed by considering in brief Scottish and Welsh institutional geographies; it is at this point in the analysis that the feasibility of granting greater tax varying powers to the NIA is introduced. The analysis presented in this paper is supportive of those who highlight the importance of institutional design and sequencing in the analysis of fiscal decentralisation. This implies that, rather than expecting that lower Corporation Tax by itself can somehow act as ‘game changer’, institutional or policy reforms that promote greater competiveness should be made prior to devolving future fiscal powers.

THE HISTORICAL AND INSTITUTIONAL CONTEXT

The economic as well as political aspects of Northern Ireland’s institutional/historical context are exceedingly complex; three of the more important observations are that the jurisdiction was firstly a product of partition. Secondly, it was a self-governing (or devolved) province within the UK and indeed it was the only devolved territory within the UK during 1921-72 (HEALD, 2003, p.22). Thirdly, under the Government of Ireland Act 1920, the region was supposed to have extensive devolution of revenue and provide an Imperial Contribution to Westminster (HEALD, 2003, p.26). However, under financial pressure the Imperial Contribution declined; rather than the financial flow being from Stormont to Westminster, as was intended under the terms of the 1920 Act, the actual direction was the reverse (BIRRELL and MURIE, 1980; GIBSON, 1996).

The specific financial and economic failings of the 1921-72 Stormont settlement are important as they illustrate the problems inherent in operating a revenue-based system when such a devolved settlement is asymmetric with inadequate provision for equalisation (HEALD, 2003, p.26). Lawrence provided a pioneering account of the evolution of public finance (LAWRENCE, 1965). Gibson’s assessment was that the five decade experiment in fiscal decentralisation through to 1972 was ‘not a total success but neither was it a total failure’ (GIBSON, 1996, p.61). More recent writers have reiterated Gibson’s emphasis on an institutional-economic nexus and suggested that it helps explain the region’s poor economic performance during the "Golden Age".[2] Gibson's emphasis is updated in this paper. Political conflict was a barrier to a devolved political settlement; civil unrest also damaged economic development (BIRNIE and HITCHENS, 1999, pp.149-151). One undoubted implication was that violence negated the main thrust of regional industrial policy since the 1960s: namely, the promotion of economic growth by means of attracting inward investment (BROWNLOW, 2013, p.296). Economic damage due to violence forced the government to step in to provide funds to stabilise output and employment.

As economic historians have demonstrated, Northern Ireland's relative economic weakness predated the Troubles (CRAFTS, 1995; BROWNLOW, 2013). The productivity gap and higher rates of unemployment can for instance be traced back to the 1920s (BIRNIE and HITCHENS, 1999). The alleged sources of economic underperformance have been multi-causal as well as long standing. In order to develop an understanding of the institutional and historical context for the later discussion as to what role fiscal decentralisation might play in improving economic outcomes (as opposed to improving governmental accountability) a brief assessment of the sources of economic weakness is required.

[Insert Table 1]

Table 1 illustrates the large number of shortfalls in performance which are indicated when one compares the out-turn in terms of where the region had reached by about 2010 relative to the target set in 1999. Some of these performance shortfalls could be attributed in part to the impact of the 2008-9 global recession. However, where a target was set in relative terms, Northern Ireland compared to the UK average, both were impacted together. In relative terms, the region's GDP per capita and wage levels remain very similar to where they were at the end of the 1990s (or, indeed, the start of the 1980s). Recognition of persistent economic underperformance has helped to spark the debate around the possibility of devolving the power to reduce Corporation Tax (NORTHERN IRELAND ECONOMIC REFORM GROUP, 2010; ECONOMIC ADVISORY GROUP, 2011). However, the policy debate associated with reducing relative Northern Irish tax rates, be it the debate over Selective Employment Tax in the 1960s or the current proposal reduce Corporation Tax, often fails to consider (a) the dangers in a race to the bottom within the UK, or (b) what offsetting reductions in public expenditure might occur. By way of illustration, the final direction that the current policy debate on building an English "Northern powerhouse" may take may complicate future calculations of the feasibility of tax devolution.

One bright spot is the recent very rapid growth in R&D spending in Northern Ireland manufacturing, though even here performance remained below the target level set back in 1999. The *Economic Strategy* in 2012 contained some forecasts through to 2030 of what might happen to the region's economy if there is little change with respect to either policy or performance ("business as usual"). These suggest most of the gaps, in terms of performance relative to the UK average, e.g. in terms of GDP per capita and GDP per worker and employment rates, will persist at current levels until 2030.

With the exception of Air Passenger Duty (APD) on trans-Atlantic flights there has been little or no debate around any wider variation of fiscal powers. The Assembly has very limited control over the tax base (it can vary the Regional Rate and, now, the long-haul rate of APD and it could, theoretically, introduce some new taxes).[3] In this, Northern Ireland contrasts with both Scotland and Wales where there has been a consideration of the advantages and disadvantages of fiscal devolution across the entire range of taxes. Such a consideration would be timely.

CURRENT AND POTENTIAL FISCAL DEVOLUTION OPTION

In terms of the current background to regional public expenditure two aspects are particularly relevant. First, the main source of funding is the block grant. In 2010-11 the block grant provided 93% of Departmental funding according to the Departmental Expenditure Limit (DEL) definition (i.e. 93% of £11.1bn). The Assembly has, as of yet, only limited control of regional tax revenue streams. Changes in public expenditure funding levels operate via the well-known Barnett formula approach. The Barnett formula is a much debated part of the UK's fiscal settlement as it relates to devolution (TRENCH, 2013). Considerations of space preclude an extended technical discussion as there are important convergence implications. However, what has come to be known as the Barnett formula determines the aggregate expenditure on devolved services in each DA (BAILEY and BUDD, 2016).

As part of the UK's fiscal union, the level of public spending is also partly determined by "need", especially to the extent that a large part of spending is classified as Annually Managed Expenditure (AME) and is demand led (42% of the total of DEL plus AME in 2010-11 was AME). Welfare spending falls under AME. Admittedly, in Budget 2013 the Chancellor outlined a cap on the growth of most welfare benefits at the UK level. Another observation is that the total level of spending has in fact, throughout the period since at least the early 1970s, been considerably higher than level of tax receipts generated in the region.[4]

By implication, one of the challenges facing policy makers will be trying to retain whatever advantages follow from being able to access such a large transfer whilst also securing any benefits that may follow from greater fiscal devolution. There are currently three main ways in which the gross spending power available to the Executive can be increased over and above the allocations determined by HM Treasury although the total value of these is small relative to the block grant. These are the Regional Rate, the borrowing power within the Reinvestment and Reform Initiative (RRI) and some funding from the EU. These amount to about £500m, £200m and £450m per annum respectively.

Currently, there is some relatively limited use of charges for public services. If such amounts were increased this would represent a source of increased funding for public spending. An exercise undertaken by the Economic Research Institute Northern Ireland (ERINI) in 2009 identified the potential to maximise income in terms of charging for services currently provided at low or zero price by the public sector (ERINI, 2009). This exercise, while responding to a specific request to identify potential revenue streams, proved extremely contentious. Wider comparisons with governments elsewhere are also of interest (PwC, 2011A).

A range of possible charging possibilities in the area of transport exists. These options include MOT centre charges, road tolls and car parking charges. In respect of public transport, a relevant policy option would be to make more funds available to the rest of the Northern Ireland spending block by reducing the subsidisation of public transport and/or raising fares; or an outright disposal/privatisation. Such an approach could conflict with other policy priorities. In the case of both university tuition fees and water charges, political pressures have shaped policy. Like the other devolved administrations, the Northern Ireland Assembly has refused to follow England's lead in introducing a higher level of tuition fees of up to £9,000. The fees charged to "local/regional" students at the Northern Ireland universities remain at about £3,800 (increasing annually by the inflation rate). One estimate is that the revenues foregone by not increasing fees to about £5,500 (as was recommended in the Stuart Report to the Department for Employment and Learning Minister in 2011) are about £40m annually (STUART, 2011).

In respect of water charges**,** the water industry was privatised in England in the late 1980s, which meant that government in England avoided paying for further infrastructure spending on water and sewerage from public funds. In contrast, funding for Northern Ireland Water's (NIW) capital spending continues to rest largely with allocation out of the general Northern Ireland Budget allocation to DRD and hence to NIW ("largely" because NIW does charge business and farming customers). This implies an opportunity cost that part of the budget which is allocated to water cannot be used to fund, say, schools, hospitals or retraining of the unemployed. Now that the English water system has been privatised, Northern Ireland receives no Barnett consequentials relating to investment in water.

FISCAL DEVOLUTION IN SCOTLAND AND WALES

In principle we could consider examples of fiscal variation from across the world; the focus of this section is on Scotland and Wales because they have institutional geographies the most similar to Northern Ireland.[5] Moreover, these territories all share a common macroeconomic policy framework. In 2008 the Welsh Assembly Government set up the *Independent Commission on Funding and Finance for Wales* (the Holtham Commission) to review the existing largely block granted basis of funding to the Welsh Assembly Government and to identify possible alternative funding mechanisms (including tax varying powers as well as greater borrowing powers) (HOLTHAM, 2009). The Scottish Parliament and the UK Government established the *Commission on Scottish Devolution* (the Calman Commission) which began work in April 2008 (reporting in June 2009) (TRENCH, 2013). The Calman Commission was established against the wishes of the Scottish Government which had initially refused to co-operate. Calman was tasked with reviewing the provisions of the Scotland Act 1998; recommending any changes to the present constitutional arrangements that would improve the financial accountability of the Scottish Parliament, which would continue to secure the position of Scotland within the UK. The outcomes of these reviews informed the potential for further devolution.[6]

Holtham concluded that the current arrangements for the financing of Wales lacked sufficient, “fairness and accountability”, and that the Barnett formula through which the block grant to the devolved legislatures is determined should be replaced by a formula based on need. It also recommended devolution of limited powers over certain taxes and borrowing. Calman, in turn, recommended, that, “...part of the Budget of the Scottish Parliament should now be found from devolved taxation under its control rather than from grant from the UK Parliament”. There would be reduction in the block grant to correspond to the revenues raised through devolved taxes. Effectively, the outcomes of these initiatives concluded that the devolution of additional tax varying and other powers to the DAs was appropriate.

In the Welsh case, the referendum was favourable leading to the creation of the Silk Commission, with the deliberations of Silk now an integral part of a wider debate relating to the future structures and shape of the UK and the devolved nations (SILK, 2010). Furthermore, Silk, in its first report, recommended the devolution of fiscal powers to the National Assembly for Wales that would grant the Welsh Assembly Government responsibility for setting and raising taxes in Wales rather than being wholly reliant on a block grant.

In addition, the provisions of the Scotland Act of May 2012 will come fully into effect in 2016 and, as a result, the Scottish Parliament will move from raising about 14% of its own budget (mainly through Council Tax and non-domestic rates) to around 35%, replacing part of the UK Income Tax with a Scottish Rate of Income Tax from April 2016 (the likelihood is that additional legislation will further enhance the powers being added by the 2012 Act). This devolution follows on from the (April 2015) devolution of land tax, landfill tax. extensive new borrowing powers and the creation of a Scottish cash reserve to manage volatility in the devolved taxes.[7]

Both the Holtham and Silk Commissions recommended that the Welsh Assembly Government should be granted a power to introduce entirely new taxes (although any such taxes would also have to be agreed by the London government). Both Commissions in Wales agreed that an enhanced power to borrow to cover any temporary shortfall in revenues would be useful. Additionally, Holtham and Silk accepted the principle that the Welsh Assembly Government should be allowed to borrow to finance investment. Silk recommended that such borrowing for investment could be up to £130m annually subject to a cap of £1.3bn on the stock of debt. Silk was also open to the possibility that Wales could issue bonds.

DEVOLVING TAX IN NORTHERN IRELAND

We set out here in Table 2 principles which the Holtham Commission used in the Welsh case to consider what taxes are suitable candidates for devolution. These principles can be applied to the Northern Irish case (it may be worth stressing that we are taking a broader approach than simply considering just one evaluative principle, e.g. impact on economic incentives). A tax will be a strong candidate for devolution if it scores well across the following six principles:

[Insert Table 2]

In terms of the scale of revenues raised by each of the taxes, a distinction can be drawn between 'major' taxes, which yield considerable receipts, and the more 'minor' ones which raise less revenue. This distinction was used by, for example, the Silk Commission. One implication is that major taxes, if devolved, are more likely to contribute to the achievement of greater accountability (there may still be other reasons for devolving some of the minor taxes).

[Insert Table 3]

The data presented in Table 3 for 2010-11 indicates that three taxes are clearly major; VAT (£2.9bn), Income Tax (£2.6bn) and National Insurance Contributions (£1.9bn). As percentages of total tax receipts in Northern Ireland in that year, those three taxes contributed to almost three-fifths in total or 23%, 20% and 15% respectively. A further two taxes are indicated as tending towards major, i.e. Corporation Tax (£0.8bn) and Fuel Duties (£0.9bn). Tobacco Duty, Business Rates and Domestic Rates were each indicated to generate about £0.5bn of annual receipts (though these Rates figures combine the District and Regional elements, only the latter is controlled by the Executive). The remaining taxes were indicated to be relatively minor in terms of revenues raised.

Associated with the question of how much revenues are collected by each tax is the question of is there any trend in those revenues? In other words, whilst there *may* be case to devolve a tax which currently raises a considerable volume of revenues, that case (at least from an accountability point of view) would weaken if revenues were tending to decline over time. As might be expected, the data in Table 3 indicate some correlation between tax revenues raised in Northern Ireland and those in the UK as a whole. However, this association is not complete. For example, and notably, during 2006-7 to 2010-11 revenues raised by Income Tax in Northern Ireland declined by 6% but grew by 4% in the UK; it is likely that the regional economy, e.g. in terms of gross value added/GDP, underperformed the UK average during this period but the extent of the apparent divergence in tax receipts may still be surprising. Corporation Tax receipts declined in both Northern Ireland and UK but by much more in the former. This observation again is consistent with some relative underperformance in Northern Ireland's corporate sector.

Having outlined the principles to determine the feasibility and desirability of devolving each tax, Table 4 considers how they might apply to each of the taxes. We also applied a simple scoring system with each principle being assigned a score of one if it is "yes" for devolution and zero if "no" (and a score of one half if, "maybe or uncertain"). A total across the six principles of 6= strongest suitability for devolution, and 0= weakest suitability for devolution:

[Insert Table 4]

Figure 1 illustrates a more simplified approach than that shown in Table 4. Here we reduce the evaluation to two dimensions. First, if a tax were to be devolved would this have a high or low impact? Major taxes (i.e. those with large revenues) would represent high impact as well as those which would help to further a particular policy objective in a strong way. (Admittedly, there is an element of judgement in combining together these two aspects, i.e. taxes as a source of revenue and taxes as a lever of policy.) Second, how feasible is devolution? Low feasibility is indicated by the likelihood that administrative costs of the tax could be a significant percentage of revenues collected or by incompatibility with EU law. Conversely high feasibility is suggested if the tax is already being devolved elsewhere.

[Insert Figure 1].

According to this approach, the taxes most suitable for devolution are those in the top right hand quandrant, i.e. high impact and high feasibility. Our assessment is that only Income Tax and Air Passenger Duty (APD) fall into this category. Landfill Tax and Stamp Duties probably combine high feasibility with low impact. A caveat is that these assessments of impact are done ahead of a full economic impact assessment or macroeconomic forecasting exercise as to the impact of such tax changes. VAT and National Insurance Contributions represent examples of taxes which would have high impact if they could be devolved but are also characterised by very low feasibility (because of the constraints imposed by EU law and the UK welfare system respectively). Corporation Tax is probably another example of a tax within the high impact, low feasibility category. A large number of taxes fall into the bottom left hand box, i.e. low impact and low feasibility; in these cases the suitability for devolution is indicated to be low.

We now consider in more detail each of the taxes which in Table 4 above were indicated as likely candidates for devolution (i.e. on the zero to six score they got a total of more than three).[8] In the case of Stamp Duty and Land Tax, devolution of this tax would appear to have certain advantages (and it is being devolved in the case of Scotland under the Scotland Act 2012 where it will be known as Stamp Duty and Land Tax). It is a fairly "high visibility" tax which is probably understood by the public, it applies to an "immobile" asset (purchase of homes and land) so minimising the chances of distorting economic behaviour as between Northern Ireland and Britain and it could be used as a lever for both economic (e.g. promote construction industry) and social (e.g. promote affordable homes) policies (though the most affordable houses would already fall below the threshold price for this tax). At the same time, there is the limitation from the accountability point of view that this is a minor tax in terms of the scale of revenue raised.[9] Regarding APD, the Assembly has already had the power devolved to remove the higher rate of duty on direct long-haul flights (because this was where tax competition with Dublin Airport was most pressing) and this has been done. A case could still be made for devolving the rest of APD and, indeed, reducing it.[10]

Income Tax devolution has been advocated in both the Scottish and Welsh cases. devolving Income Tax powers to the Assembly would entail certain dilemmas. For example, how much power would be devolved? Would Northern Ireland follow Scotland (as per the 2012 Act) in having a lockstep, i.e. if rates are varied all the rates have to be varied by the same amount, or the recommendation made in Wales or, indeed, the recent (2015) proposals for Scotland, that the power to alter progressivity would also be devolved? This is turn begs some interesting questions. For example, what might be the economic/behavioural response to any variations in rates, how might such tax varying powers be used and how might any dilemmas between policy goals be resolved?

Inter-regional tax differentials/lockstep have become an issue within the UK as proposals for tax devolution have developed. For example, there has been some discussion of the so-called WILLIEs (Working in London, Living in Edinburgh), many of whom work in the financial sector, leaving Scotland if it was to set a higher top rate of tax that the rest of the UK. Seely and Keep observe that because tax rates on savings and dividend income are not devolved, high earners need not move to avoid such a higher rate: some could incorporate and pay themselves in dividends for instance (SEELY and KEEP, 2015, p.16).

The issue of inter-regional tax differentials/lockstep is particularly important for regions with DAs, such as Wales or Northern Ireland, which are also heavily dependent on fiscal transfers. However, it has been suggested by some economists that inter-regional income tax differentials will not necessarily induce inter-regional migration (BELL and

EISER, 2014). In particular, it has been suggested that the extent to which tax (or indeed tax and spend) competition induces migration depends in part on the extent to which high income earners will respond to a higher tax by working less (rather than migrating) and the extent to which any inter-regional income tax variations are reflected in house price differentials.

None of the Commissions in Scotland and Wales recommended devolution of excise duty on tobacco even though an increase in Tobacco Duty could represent an interesting supplement to existing policies to discourage smoking (assuming the Duty was raised). Again tax competition on the island of Ireland has important implications. By way of illustration, if the Duty was raised it could provoke an increase in cross-border shopping (i.e. shoppers travelling across the border to buy tobacco in the lower tax regime in the Republic of Ireland) or even smuggling.

Neither of the Commissions in Scotland and Wales recommended devolution of Fuel Duties. They considered there was too much scope for harmful distortion of the economic relationship between Scotland/Wales and England. In Northern Ireland there is unlikely to be such diversion of sales to/from GB but there is existing tax competition with the Republic of Ireland. This might imply a case for fiscal devolution but only if the power was then used to reduce the margin of tax between Ireland north and south. A further reason to reduce Fuel Duties relative might be to reduce the incentive for fuel laundering and smuggling. Again issues of tax competition and negative externalities are important in the case of Alcohol Duty. Neither the Scottish nor Welsh commissions recommended devolution of excise duty on alcohol even though an increase in Alcohol Duty represents an interesting alternative to suggested policies of a minimum price for alcohol. If the objective was to try to use the tax to discourage abuse of alcohol and consequent negative health and social consequences then the

Duty would be raised but in Northern Ireland there is, again, the dimension of possible tax competition.

For Landfill Tax, whilst this tax received a middling score of three, this tax is being devolved in the case of Scotland. If it were devolved it would allow the NIA to set it at a rate appropriate to regional environmental priorities, e.g. it could set it at a higher level than the UK average in order to give extra incentives for energy from waste schemes, for example. There are restrictions on the "export" of waste beyond the UK but past experience suggests that if the margins are high enough illegal displacement across the tax border would occur. This is a constraint that policy makers would have to consider.

Since at least the early 2000s there has been a sustained campaign in Northern Ireland to reduce Corporation Tax rates relative to Britain. This campaign has become the main focus of debate on regional economic policy. The campaign has been spearheaded by a range of business leaders and, at the time of writing, has the support of Northern Ireland's five largest political parties. There are substantial obstacles of UK Government and EC approval, and the proposal has been criticised by some economists; yet the campaign has not lost momentum. Indeed, the Westminster Parliament has legislated so that the devolved power can, in principle, be transferred in April 2018 subject to the Assembly demonstrating that such a policy would be sustainable from the point of view of balancing the Assembly's budget. Arguments in favour of varying (and hence lowering) Corporation Tax have focused on the incentive impact on levels of business investment and FDI in particular (the OECD and others have attempted to measure such effects and they are implied as the justification of the government's policy of reducing UK wide rates from 28% in 2010 to a planned 18% in 2020) (OECD, 2007).

In particular, Northern Ireland is in tax competition with a neighbouring low tax regime. Equally, some commentators have recognised that a lower Corporation Tax by itself would not be a game changer to transform regional competitiveness (PwC, 2011B; TRENCH, 2013). The analysis provided in this paper would give credence to a sceptical perspective.[11] Speculating on why so much attention has been placed on the proposal of reducing Corporation Tax, despite the administrative obstacles and intellectual weaknesses of such a proposal, we may charitably observe that the persistent regional economic weakness has encouraged political and business leaders focus on this relatively simple to understand lever.

A Public Choice interpretation would look to the relative concentration (diffusion) of prospective benefits (costs) to actors: this would imply that political leaders in Northern Ireland do not want to devote time developing (electorally unrewarding) policy alternatives to a proposal that has substantial support within the business community. Likewise, the potential concentrated benefits to a range of actors within the private sector (such as greater profitability) of reduced Corporation Tax arguably explains the commercial popularity of the proposal. Moreover, the possible losers from such a proposal - for instance those who would suffer from the reduced public spending that would follow from devolving Corporation Tax - are in any case are a far less well organised group than the potential corporate beneficiaries. Devolution in the 1990s arrived without sufficient policy capacity (HEALD, 2003, p.75). This weakness remains. It is particularly noteworthy that Northern Ireland in 2016 lacks any independent economic think tank to analyse the potential costs and benefits of devolving taxation.[12]

Moreover, the cost-benefit calculus of tax devolution is not symmetrical: the costs are more predictable that the benefits. The “cost” in terms of the adjustment to the block required in terms of EU law (an implication of the Azores Judgement) would be considerable and upfront or fairly immediate. The certainty of this part of the total cost of tax devolution stems from the institutional settlement that requires the Executive to satisfy the legal (Azores) requirements concerning fiscal autonomy. There would be less predictable, but very concrete administrative and compliance costs, which again reflect underlying institutional arrangements, as there would be complexities in applying inter-regional variations in this tax. In contrast, the induced economic benefits are less certain. In any case they would probably take a number of years to realise (and some, indeed, would be felt in terms of other tax streams which might not be devolved). In short, as the analysis of Rodríguez-Pose and Gill predicts, the precise institutional geography of any future fiscal settlement will shape the economic outcomes.[13]

CONCLUSIONS

Four key policy conclusions emerge. First, application of the six principles used by Holtham in Wales produces a broadly similar outcome for Northern Ireland to what has happened so far in Scotland and Wales in terms of the taxes which are likely to be most suitable to be devolved, e.g. Income Tax, Stamp Duties, Landfill Tax and APD. Of those four taxes, only Income Tax is as major tax in terms of the scale of revenues raised. Income Tax devolution could therefore contribute to increasing the accountability of the Northern Ireland Assembly. Any argument for devolving the three minor taxes (Stamp Duties, Landfill Tax and APD) is less about an impact on the economy in general and more about having policy levers covering particular sectors.

Second, at the same time, there are other significant considerations relating to whether Income Tax should be devolved. The Northern Ireland Executive is in a long term, strategic relationship with the Treasury in terms of negotiating the size of the funding block. This prompts the question whether early adoption of wider fiscal powers would encourage the Treasury to reduce the funding block further or whether it is the case that such reductions are coming anyway so it is sensible to do as much now to be prepared? Third, greater fiscal powers could conceivably bring benefit in terms of improving the accountability, and possibly quality, of policy making and providing additional policy levers. Any move towards further fiscal devolution is not without risk. Enhanced fiscal powers should be viewed not as a game changer, or as a solution in its own right, but as a potentially useful supplement to a broader economic strategy focused on boosting competitiveness. There are also a range of other technical issues that tend to further complicate matters. Lack of space prevents extensive discussion of these issues, but it is worth noting that Northern Ireland or Wales lack the per capita tax base of Scotland. Moreover, the (untaxed) shadow sector is arguably larger than in Britain. This has arisen as combination of a legacy of the Troubles, an international border and low wages.[14]

Last and certainly not least, as transition economists have long identified, sequencing is an important policy consideration regarding tax devolution. Drawing on the ideas of institutional economists such as Rodrik, who have highlighted the 'second best' nature of economic-policy-making, transition economists have concluded that the speed and order as well as the content of policy reforms are crucial in determining the likelihood of successful outcomes (RODRIK, 1992). This conclusion is consistent with the focus on 'institutional geography'. Transition economists conclude that that as each economy is unique institutionally so the sequencing and speed of reforms must be considered in the light of location-specific institutional factors (NSOULI et al, 2002).

The sequencing argument tends to further undermine 'silver bullet' arguments. As the quality of inward investment that can be attracted to a location depends on the underlying conditions prior to any reduction in corporate taxes. Merely reducing Corporation Tax, without first tackling the long-standing distortions underpinning region's competitiveness weaknesses, including any managerial weaknesses, will not inevitably close any economic gap. Indeed, it is possible that any 'footloose' inward investment projects attracted by a reduced tax rate, while boosting employment, may do very little to shift the economy towards the higher skills and productivity equilibrium needed to close any gap. It would hence be sensible to introduce reforms to strengthen the supply side first so that both the strength to exploit any future fiscal powers is maximised alongside more resilience to any reductions in the funding block. The narrow focus on regional Corporation Tax variation appears to be yet another example of the simplistic 'economic dividend' model. The sequencing argument further tends to reinforce the importance of tackling the enduring institutional weakness of low regional policy capacity.

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[1] During the period of Direct Rule (1972-99) the region's devolved political institutions were suspended and instead Direct-Rule ministers made political decisions without local electoral accountability. For more on the associated economic problems see (GIBSON, 1996).

[2] Note that the observed empirical relationships run counter to the theoretical claims that Ashcroft made for devolution in the 1990s (ASHCROFT, 1998, 1999).

[3] Since 2007 the Assembly has introduced two new taxes; the Large Retail Levy and the Plastic Bags Levy. It should be noted the Northern Ireland Act 1998 qualifies that power by saying such taxes cannot have similar characteristics to taxes which already exist at the national level.

[4] The official figures record the 'net fiscal balance'. This figure shows the difference between total public sector revenue and expenditure. In recent official figures (2011-12), Northern Ireland recorded a negative figure of £9.6 billion (or equivalent to 33.1 per cent of GVA). The UK national equivalent for 2011-12 was 10.1 per cent (DEPARTMENT OF FINANCE AND PERSONNEL, 2014).

[5] Further examples could include the Crown Dependencies, i.e. the Isle of Man and Channel Islands.

[6] For a comprehensive overview of the devolution of financial powers to the Scottish parliament see (SEELY and KEEP, 2015).

[7] The 2012 Act granted a power to create entirely new taxes, albeit subject to agreement by the UK Government. Prior to 2009, the Scottish Government did have a limited ability to borrow to assist cash flow. Calman recommended that power be increased and also recommended a right to borrow to fund investment subject to prudential limits. The Scotland Act 2012 adds a "prudential power" to invest in infrastructure and capital projects and to allow for variability in Scottish Rate element of income tax revenues. The Act permits Scottish borrowings of up to £2.7bn (£2.2bn of these to fund capital spending). This limit represents the additional burden of risk that Treasury judged was appropriate given that borrowing by the Scottish Government contributes to increased UK public sector net borrowing (PSNB) and public sector net debt (PSND).

[8] There is one anomalous result arising from this scoring system; National Insurance Contributions had the third highest indicated score but, given the nature of the UK benefits system, which is partly though not wholly linked to contributions, it would almost certainly be impractical to introduce a lower rate of Contributions in Northern Ireland.

[9] SDLT in Scotland, while not on slab basis as Stamp Duty (SD) was formerly, remains a transaction rather than an annual tax (based on capital/rental value). SDLT has a number of problems. First, the yield will hence follow the property market cycle; second, there may be the enforcement issues experienced with SD. In the Northern Irish (or Welsh) case, house prices are generally lower than Scotland, so a transaction-based tax may affect Northern Ireland more. Again thanks to an anonymous referee for making this observation.

[10] For a contrary view that focused on the possible public finance effects see UUEPC (2015).

[11] Moreover, the Republic of Ireland experience was a more 'slow burn' than is often recognised. Profits were taxed lightly as early as the mid-1950s. The great leap in terms of levels of FDI did not happen until approximately three decades later (BARRY, 2007). In reality, the *effective* rate of Corporation Tax in the Republic of Ireland may be even lower- one estimate is that it could be in the range 8.4% to 10.4% in 2012 (COFFEY, 2014).

[12] For the most recent forecast of the possible impact (albeit one predating the changes in the 2016 budget), see UUEPC (2016). That study assumed that the rate of inward investment into Northern Ireland would very rapidly rise to high international levels and that the productivity of such investment would be similar to the (generally extremely high) level of output per employee in the Republic of Ireland.

[13] Regarding borrowing powers, some of these issues have already been considered as we outlined the development of fiscal powers in Scotland and Wales. Again interested readers should consult BAILEY and BUDD (2016).

[14] Likewise, issues of indexation of reduction in the block grant and the practicality of varying bands and rates, particularly given parity in social security benefits are complex issues that are acknowledged. More details on these topics can be found within (TRENCH, 2013; SEELY,2015; SEELY and KEEP, 2015).

Figure **Error! Main Document Only.**: Feasibility and impact of devolution of each tax

	Low impact#	**High impact#**
High feasibility*	Landfill Tax Stamp Duties	APD Income Tax
Low feasibility*	Betting & Gaming Duties Insurance Premium Climate Change Levy Vehicle Excise Duty Aggregates Levy Capital Gains Tax Inheritance Tax	Corporation Tax Tobacco Duty Fuel Duties Alcohol Duties VAT National Insurance Contributions Customs Duties

*Note: e.g. "Low feasibility" could mean tax devolution is prohibited by EU Law or that the administrative costs are likely to be a significant % of revenues.

#: e.g. "High impact" means that either this is a major tax or a tax where devolution could strongly assist some particular policy agenda (e.g. economic, social, health or environmental).

Please note the position on the list is not indicative of relative feasibility.