The Independent Fiscal Commission NI

More fiscal devolution for Northern Ireland?

Paul Johnson, Chair
and
Cathy Gormley-Heenan

19 May 2022

Presentation structure…

- Commission and report structure
- The Northern Ireland context
- Our Interim Report
- Implementation for our prioritised taxes
- An NI Fiscal Framework

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Commission and report structure

The Commission…

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Terms of Reference

“Review the case for increasing the fiscal powers to the NI Assembly, advising the Finance Minister on powers which could enhance the Assembly’s fiscal responsibilities …”

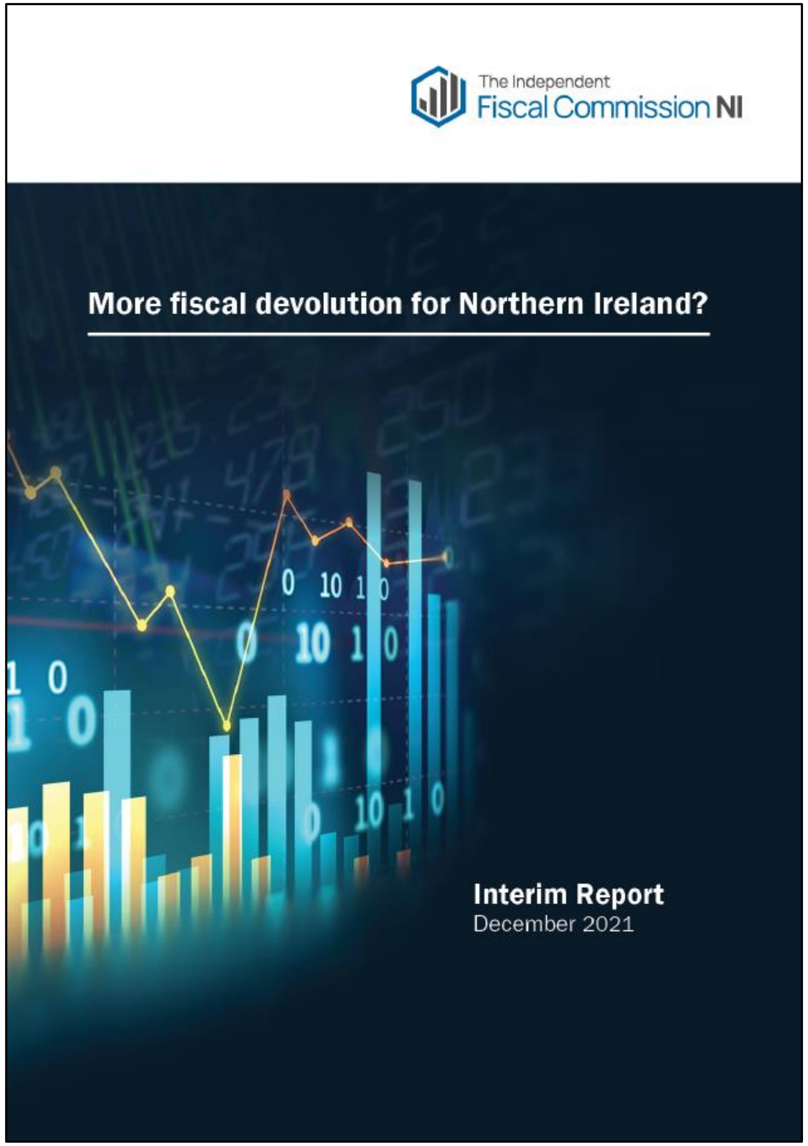
Established

- **By NI Finance Minister, Conor Murphy MLA, March 2021, Ministerial Statement**
- **Report to Finance Minister ahead of new political mandate (elections, May 2022)**

Commissioners

- **Paul Johnson, Chair,** Director, Institute for Fiscal Studies
- **Prof. Cathy Gormley-Heenan**, former deputy V/Chancellor Ulster University;
- **Prof Iain McLean**, Emeritus Professor of Politics at Oxford University; and
- **Dr. Lisa Wilson**, Senior Economist at the Nevin Economic Research Institute.

Our interim report was published in December 2021…



Reporting in two stages

Outline of context and factors for successful fiscal devolution

Assessment of individual taxes in the Northern Ireland context

Shortlist of taxes for further consideration in our final report

…our final report now builds on our interim findings

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Considers shortlist of taxes from interim report further and how devolution could be implemented for each tax

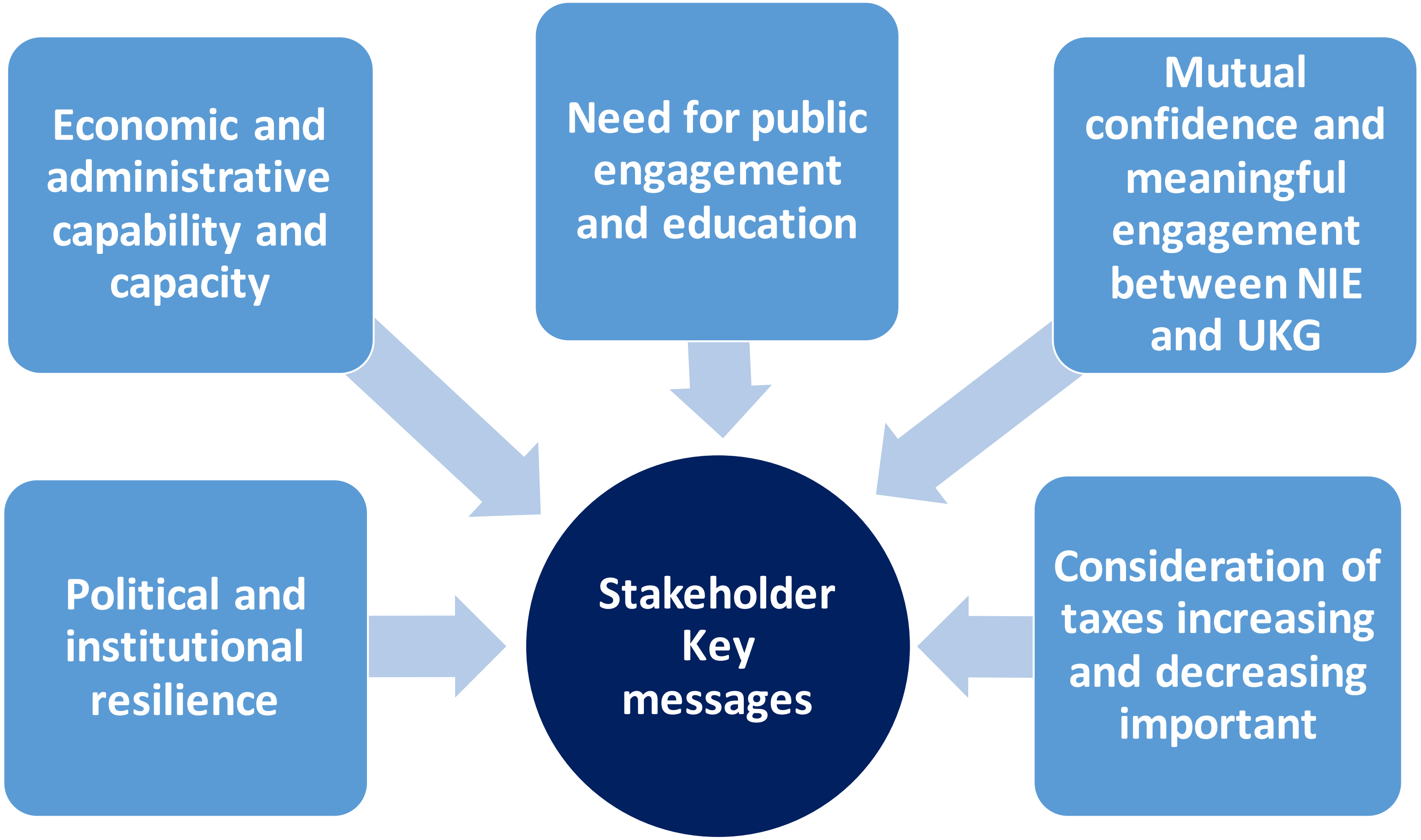
Analysis of the operational aspects of implementation

What a new NI Executive fiscal framework could look like, including block grant adjustments

Recommendations for NI Executive to consider

Valuable input from stakeholder engagement

- Met with **120 individuals** from over **60 organisations**
- Academia; Economists; Business Organizations; 3rd Sector bodies; government; and Trade Unions
- Met with representatives from **all main local political parties**
- Presentations at the **British and Irish Conference; NERI 2021 Donal Nevin Lecture; Finance Committee**



The Northern Ireland context: economy, tax and spending

Key comparisons between NI and UK…

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- **GDP per head is** about 25% lower in NI than that of the UK as of 2019
  - NI tenth out of the 12 UK regions every year since 2008 (above Wales and North East).
- **Earnings in Northern Ireland** (median) are 10% lower than UK average.
  - Combined with lower labour market participation means that **tax revenues per person are 25% lower.**
- **Public spending** (identifiable) is about 20% higher, on a per person basis, than spending in the UK.
- **NI has the largest fiscal deficit of any UK region**
  - Gap in fiscal balance has widened over last 20 years (by over 10% in real terms).

NI has substantial powers over spending, but not over tax

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- **NI Executive controls majority of ‘identifiable’ public spending** on services in NI – almost £9 in every £10 spent (including Social Security)

- **Social Security devolved in legislation**, but spending linked, so powers **limited in practice**

- **Nearly 90% of Executive DEL Budget** (excludes Social Security) **comes from Block Grant**.

- **Main NI Executive tax resource comes from Rates** (domestic and business) - less than £1 in every £20 of tax revenue is raised by the NI Executive.

Also some significantly more generous taxes and charges

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- Examples include:
  - **Domestic Water Charges**
  - **Welfare Mitigations**
  - **Rate reliefs (domestic and non-domestic)**
  - **University Fees**
  - **Prescription Charges**
  - **Housing Benefit Top Up**
  - **Concessionary Travel**
  - **Domiciliary Care Charges**
- Total impact in NI **between £600m and £700m** per annum (2021 estimates)
- **A UK equivalent would be over £21 billion per annum**

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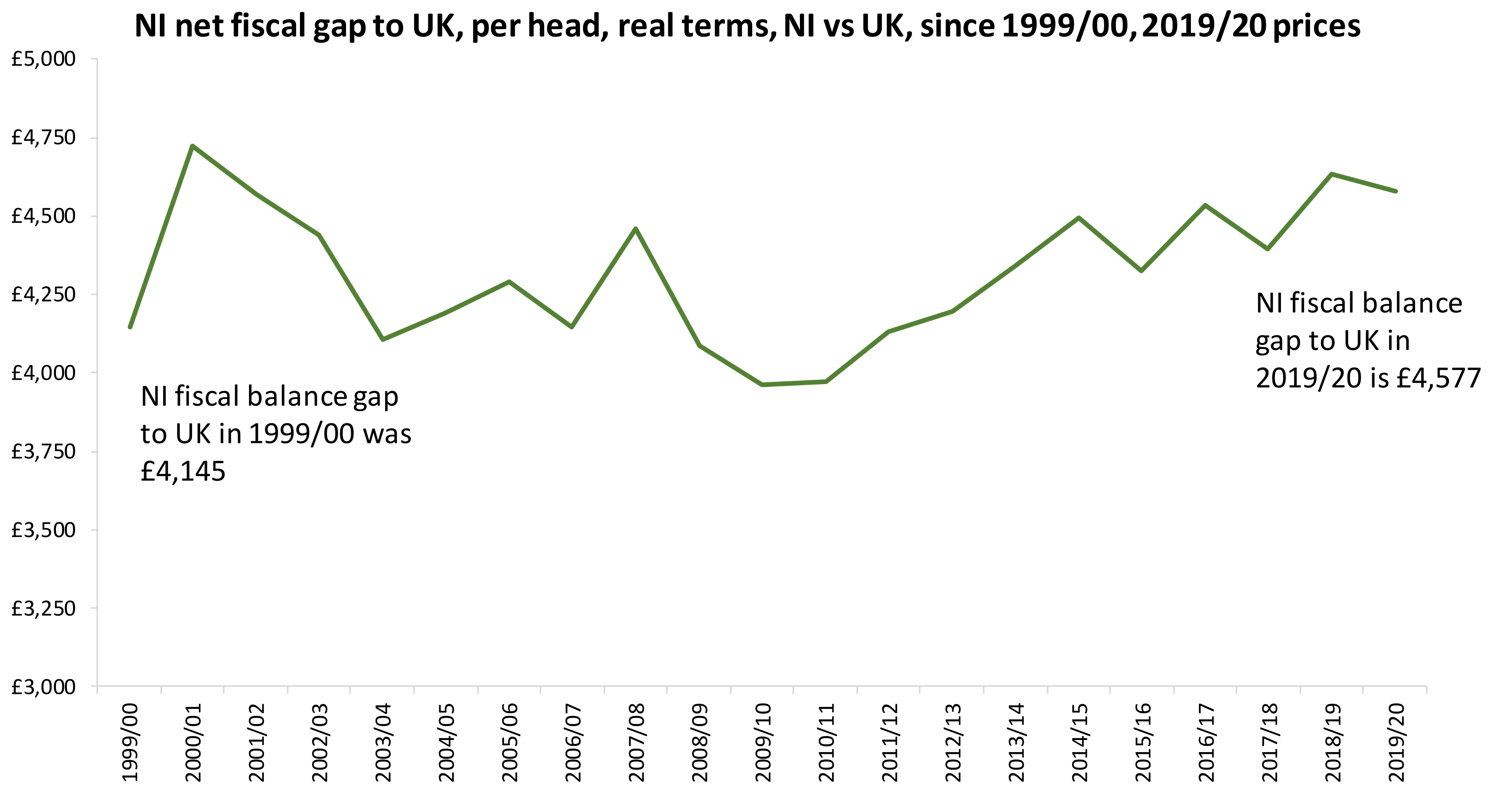
Our Interim Report

Potential for additional reward comes with additional risk



Options / Models for devolution

Possible fiscal devolution models for NI

Model 1	Model 2	Model 3	Model 4
"Do Nothing"	*Block grant plus tax revenue assignment*	*Block grant plus tax devolution*	*Towards full fiscal autonomy*

- **We are not considering full fiscal devolution**
- **Pure tax assignment also not a desirable way forward.**
- **Rather, we are examining the case for devolving powers over individual taxes.**

Commission's criteria for assessing taxes

Key points ahead of further fiscal devolution

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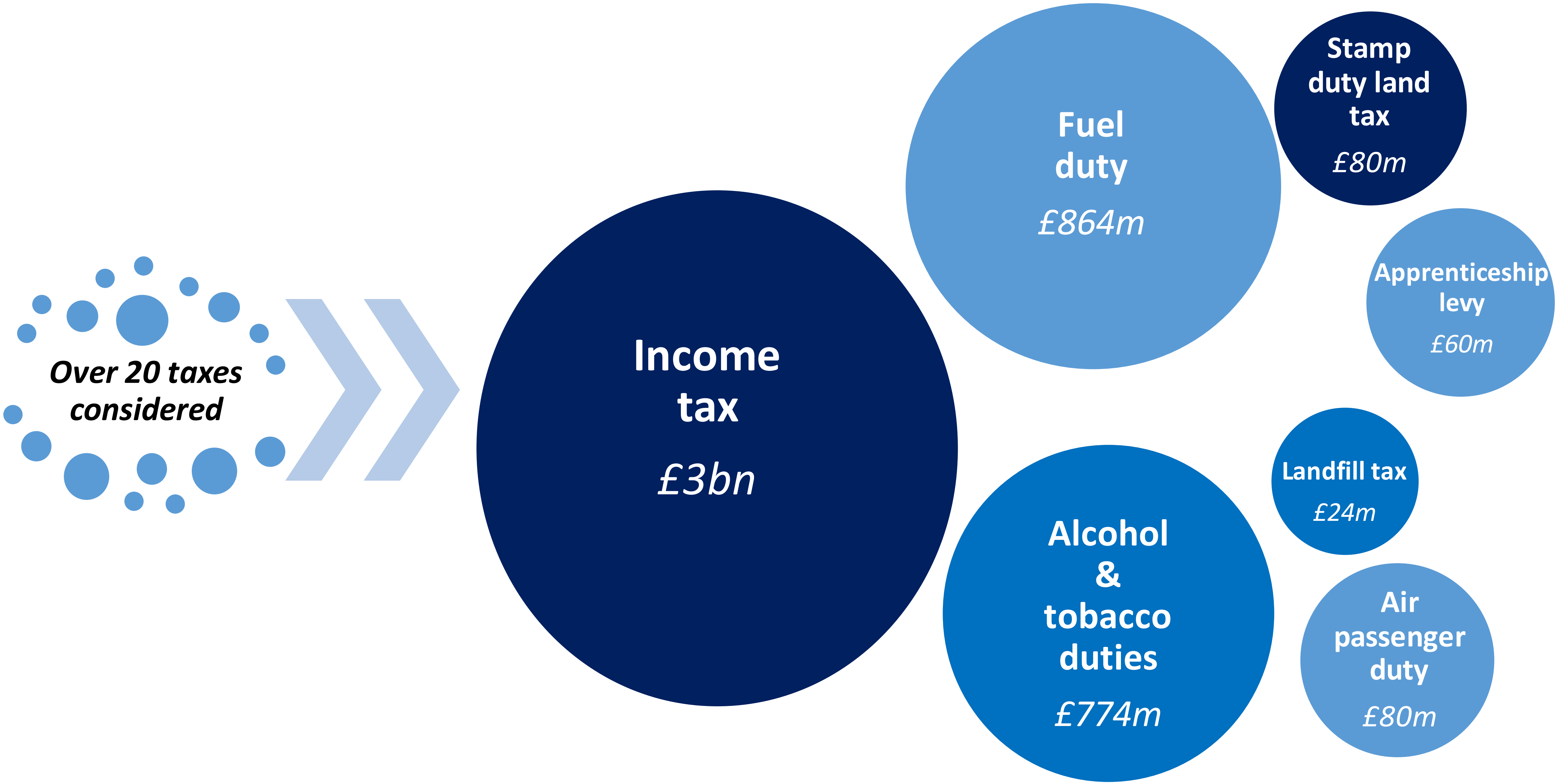
No reason in principle why, in the long term, a substantial fraction of current taxes could not be devolved

Northern Ireland should not seek the devolution of more than one ‘major tax’ at this time

Arguably, Northern Ireland should look to pursue smaller taxes in the first instance

Northern Ireland should take on further powers gradually

We looked in detail at over 20 different taxes…



Implementation for our prioritised taxes

Tax data reliability

Recommendation 1

Tax revenue data reliability

- **We recommend the NI Executive should work with ONS, HMRC and NISRA to improve data on tax receipts in Northern Ireland.**
- Increasing sample sizes; boost response rates; and solve methodology issues (e.g. underreporting issues). Help identify issues e.g. Scotland and VAT assignment.
- Collect, where reasonably possible, administrative/outturn data for any tax that is to be devolved in the years prior to devolution taking place.
- Will help to provide more reliable estimates of the tax prior to devolution and more accurate costs post devolution.

Devolution of corporation tax recommendation

Recommendation 2

Devolution of corporation tax powers

- **Value in completing the devolution of corporation tax.**
- NI Executive should demonstrate how it will maintain the sustainability of its finances.
- **NI Executive and UK Government to work together on the *pre-requisites* for devolution.**

The scope and nature of income tax devolution for NI?

'Extent' of income tax devolution?

Should income tax be fully devolved, with the NI Assembly able to determine parameters such as the **scope and nature of allowances, reliefs, deductions and exemptions?**

'Scope' of income tax powers?

Should Northern Ireland rates (and potentially bands) apply to **savings and dividends income** as well as other taxable sources of income?

'Model' of income tax devolution?

'Scottish model' - devolution of all revenues and rate and band-setting powers

'Welsh' model - devolution of revenues from 10 percentage points of each tax band and rate-setting powers

An alternative model - a variety of other options are available between the 'Welsh' or 'Scottish' models, or even going beyond.

Who should administer?

Should any devolved element of income tax be administered by **HMRC** or by **a separate Northern Ireland tax authority?**

The scope and nature of income tax devolution for NI…

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‘Extent’ of income tax devolution?

We recommend that powers to determine the income tax base remains reserved to the UK Government.

This will **help minimise the additional administration and compliance burdens** generated by tax devolution, while **still providing the key benefits of devolution**. *(Recommendation 3)*

An exception is the personal allowance. *(Recommendation 5)*

The scope and nature of income tax devolution for NI…

‘Scope’ of income tax powers?

We recommend that the taxation of savings and dividends income should be devolved to the NI Assembly.

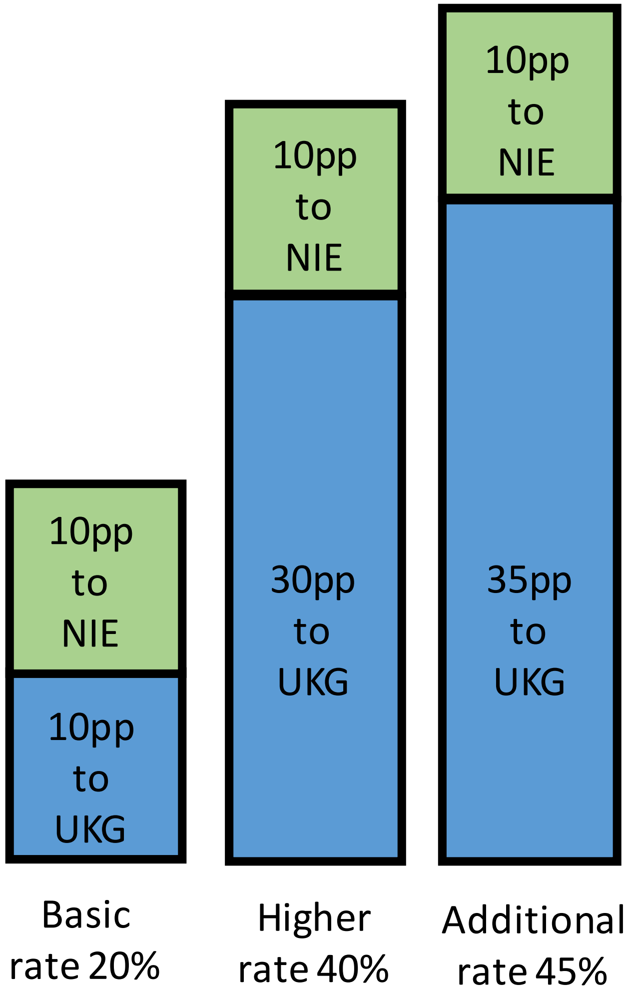
Income tax is no longer deducted at source, hence the main practical impediment to devolution has been removed.

Devolution would bring the administrative, efficiency and equity benefits.

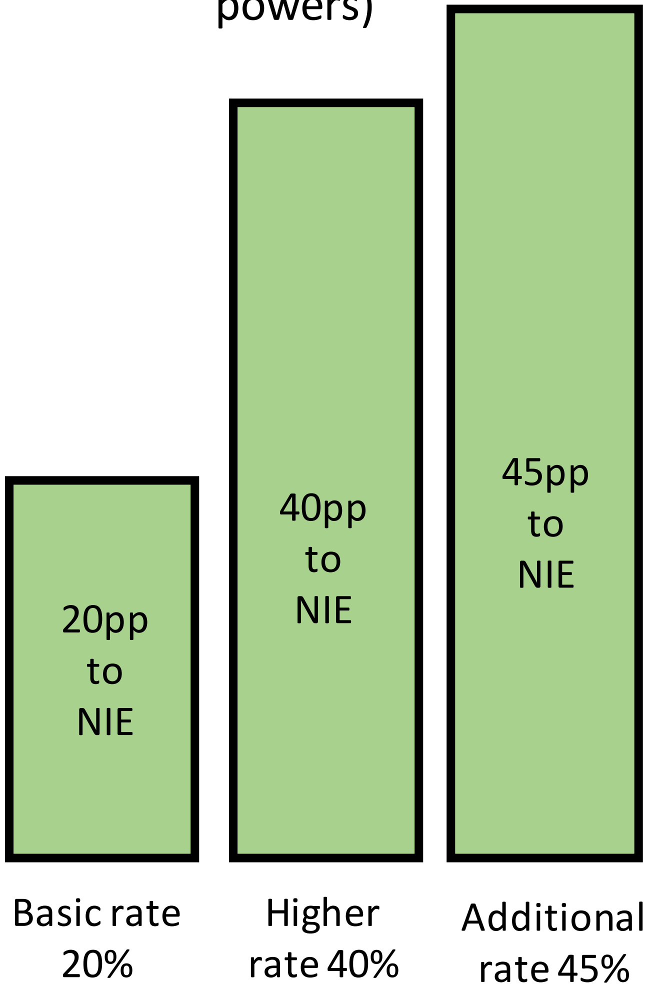
Recommendation would be bolstered if agreement can be reached to also devolve it to the Scottish Parliament and Welsh Senedd. *(Recommendation 4)*

‘Models’ of income tax we considered…

“Welsh” model – 10pp of each band



“Scottish” model – all revenues to NIE (and rate and band-setting powers)



The scope and nature of income tax devolution for NI…

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‘Model’ of income tax devolution?

Scottish model would be preferable to maximize benefits - this would mean **devolving revenues, rates and band-setting powers in full**.

But would also entail **greater risk** of short-term revenue volatility and long-term revenue decline if the Northern Ireland tax base did not keep pace with the English tax base.

Alternative would be the ‘Welsh’ model of partial devolution - **less financial risk, but also provides less flexibility**. Still a significant increase in the accountability of NI Assembly.

The **NI Assembly should be obliged to vote on the agreed rates and bands** on annual basis.

(Recommendation 5)

The scope and nature of income tax devolution for NI…

Who should administer?

We recommend that income tax administration remains reserved (HMRC) at this time.

This will help minimise additional administrative, compliance burdens and significant upfront and ongoing costs for both the NI Executive and taxpayers.

(Recommendation 3)

If powers over income tax are devolved, the **apprenticeship levy should be devolved** in parallel and administered by HMRC - given skills remit of Executive and synergies with income tax administration.

(Recommendation 6 & 7)

Income Tax revenue raising ability…

- What would a 1 percentage point change in all rates on all income yield or cost across each band under each approach to devolution?

Devolution scope	Revenue raised from 1pp raise on all bands £m	Share of revenue raised from each band			% of NI Resource DEL 2018/19
		Basic rate (20%)	Higher Rate (40%)	Additional Rate (45%)	
All income tax (All, half or 10pp)	126	105 (84%)	17 (13%)	4 (3%)	1%

Note: Data 2018/19, the latest year of data when analysis was conducted

Recommendations… other taxes

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Recommendations 8 & 9

SDLT, APD & landfill tax

- Benefits in restructuring these taxes to better suit the Northern Irish context and improving their overall design.
- **We recommend full devolution of revenues and tax powers relating to stamp duty land tax (SDLT), air passenger duty (APD) and landfill tax**.
- If pursued and implemented, the **NI Executive should establish a local revenue authority** to administer.

Recommendations… other taxes

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Recommendation 10

Excise duties

- **In our view there could be value in the NI Executive seeking devolution of excise duties, over the longer term, but there are barriers to overcome first.**
- Our investigations have not been enough to persuade us whether the costs and complexity would be readily manageable, or not.
- **Recommend a full study working alongside HMRC / HMT to agree on how excise duties could be administered and what the costs involved would be**.

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An NI Executive fiscal framework

Elements of a new fiscal framework

- Tax devolution would require a new fiscal framework between NIE and UKG covering:

1. How should the block grant be adjusted?
2. What budgetary management tools are required?
3. Who should forecast tax revenues?
4. Compensatory payments
5. Dispute Resolution
6. Review of the Fiscal Framework

Our principles for implementing fiscal devolution… Rec 11

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i. Neither the budget of the NI Executive nor of the rest of the UK should be immediately better or worse off simply as a result of the devolution of a tax.

ii. That, as far as possible, following tax devolution the NI Executive should neither gain nor lose from fiscal risks or trends that can reasonably be predicted in advance, and which it has limited capacity to meaningfully influence.

iii. That the NI budget should capture, as far as possible, the full revenue impacts of its tax policy decisions, whether they be to raise or reduce revenue.

iv. That, as far as possible, the NI budget should not be exposed to the effects of tax policy changes made by the UK Government, for taxes that have been devolved to the NI Executive. And nor should rUK be exposed to the consequences from changes to devolved taxes in Northern Ireland.

v. That, as far as possible, the UK Government should bear the risks of tax revenue shocks that impact the whole of the UK equally.

*Can such principles be achieved? – In broad terms, yes, but in practice, it is not possible to fully satisfy all these goals, **some trade-offs are required**!*

Block Grant Adjustments… how do they work?

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Example of NI Budget and Block Grant Adjustment calculations

Barnett determined block grant − **Adjustment to reflect revenues foregone by UK Government (BGA)** + **Revenues raised from devolved tax in NI** = **NI budget**

- **Tax devolution implies a deduction to the block grant to reflect revenues foregone by UKG. Two parts:**
  - <u>Initial deduction</u> (revenues raised from devolved tax in NI in year prior to devolution)
  - <u>Indexation</u>: a measure of the growth in revenues of ‘comparable tax’ in rUK / England (tax depending)

Options for indexing the block grant adjustments…

- **Option 1: Indexed Per Capita (IPC) – the 'Scottish model'**

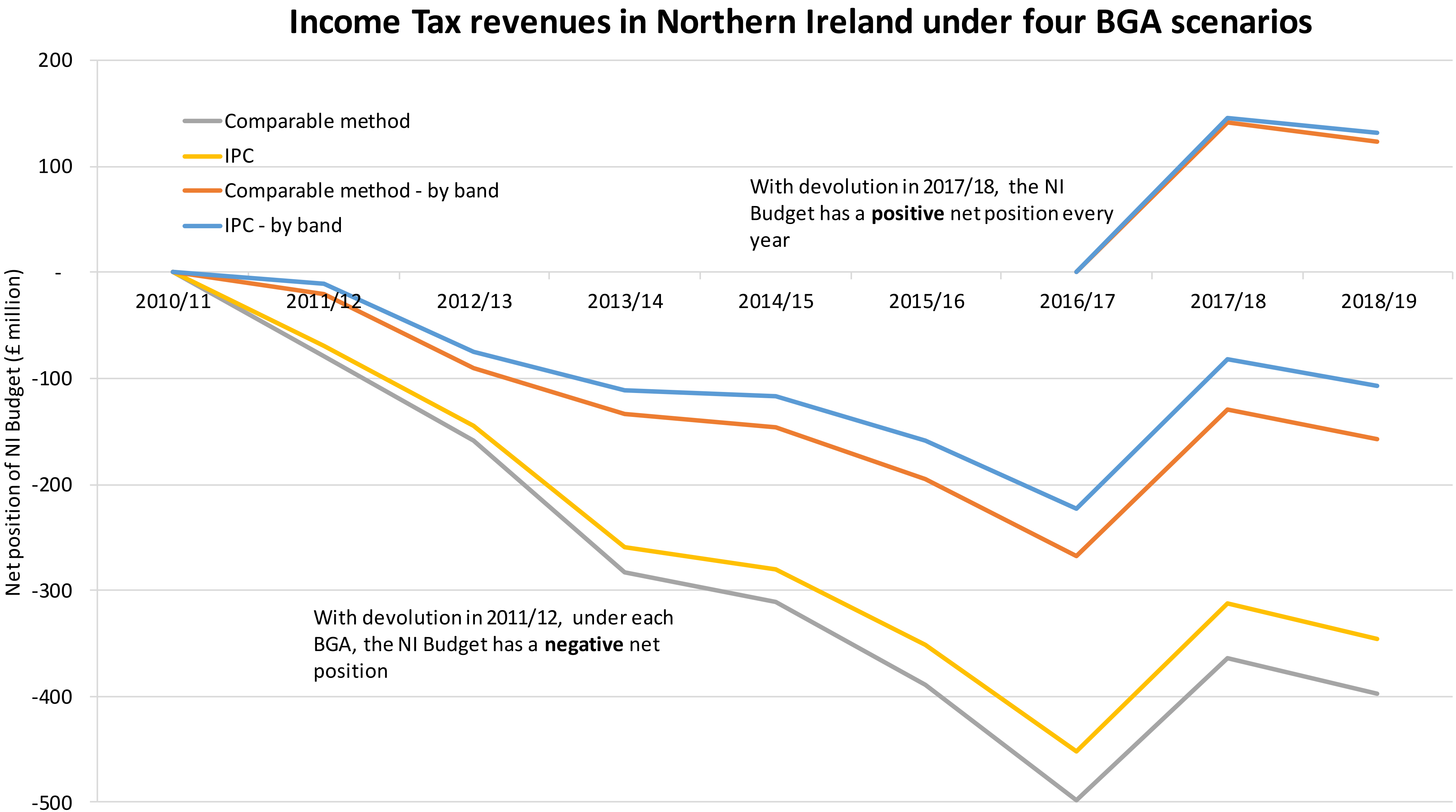
BGA increases in line with the growth in revenues per capita in England, adjusted for population growth

- **Option 2: Comparable Method (CM) – the 'alternative model in Scotland'**

Increases BGA in line with a *tax-capacity adjusted population share* of the change in England revenues

- **Option 3: IPC or CM… 'by band'?**

The IPC & CM and 'by-band' approach…



Conclusions on BGA methods…

Recommendations 12 & 13

BGA mechanisms

- **BGA mechanisms should control for the budgetary risks arising from Northern Ireland's different starting distribution of taxpayers.**
- **This applies to income tax and to SDLT, although not the other taxes** – due to highest income earners and the highest valued properties – of which NI has relatively few.
- **Fiscal frameworks should not penalise the NI Executive from it having lower tax capacity at the point of devolution**.
- **The NI budget should not, as a result of tax devolution, be exposed to the risk of differential population growth relative to England.**

Insurances and resets…

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Recommendation 14

Fiscal insurance

- **Why? Risks to the NI budget will remain**. Principally, NI tax base does not keep pace with that in England for reasons **outside the NI Assembly's control**.
- **A 'floor'** - predetermined limits on the gap between revenues and the corresponding BGA.
- **A 'reset'** - periodic resets of the BGA. E.G. resetting the clock after every five years, protection from the risks of permanently slower growth in its tax base.
- **We recommend building in some, limited, element of fiscal insurance into tax devolution arrangements.** We do not have a strong view on what form.

Commission recommendations – borrowing & forecasting

Recommendation 15 - Borrowing for forecast errors and reconciliations

- The NI Executive should be able to borrow to cover negative forecast errors in full (if a 'cap' Wales a better guide)

Recommendation 16 - Borrowing for discretionary resource expenditure

- The NI Executive should be able to borrow a modest amount to fund discretionary resource spending (e.g. 1% of DEL), to offset temporary falls in revenue, even if forecast, and unforeseen events.

Recommendation 17 – A Northern Ireland Reserve

- A Northern Ireland Reserve should replace the Budget Exchange mechanism, to provide flex to respond to additional revenue risks (good case for no overall cap, annual drawdown limit, but if so, Wales a better guide).

Recommendation 18 – Forecasting arrangements

- Forecasts will be needed for any taxes devolved to Northern Ireland (and the associated BGAs). Essential they are made by an independent body. The NI Fiscal Council should be tasked.

Commission recommendations – broader issues

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Recommendation 19 – Compensatory transfers

- Should be provision for compensatory payments to be made in both directions between the UK Government and NI Executive, when policies related to the taxes we propose are devolved, have spillover effects. Evidence published.

Recommendation 20 - Dispute resolution

- Dispute resolution processes should have access to and be embedded within the new Intergovernmental Relations system.

Recommendation 21 - Changing and reviewing the framework

- Framework should be reviewed if further tax powers are devolved and/or on a periodic basis.

Recommendation 22 – New taxes for Northern Ireland

- The NI Executive should work with the UK Government to agree a transparent process to clarify design for the process for the introduction of new taxes.

Wider implications for the UK….

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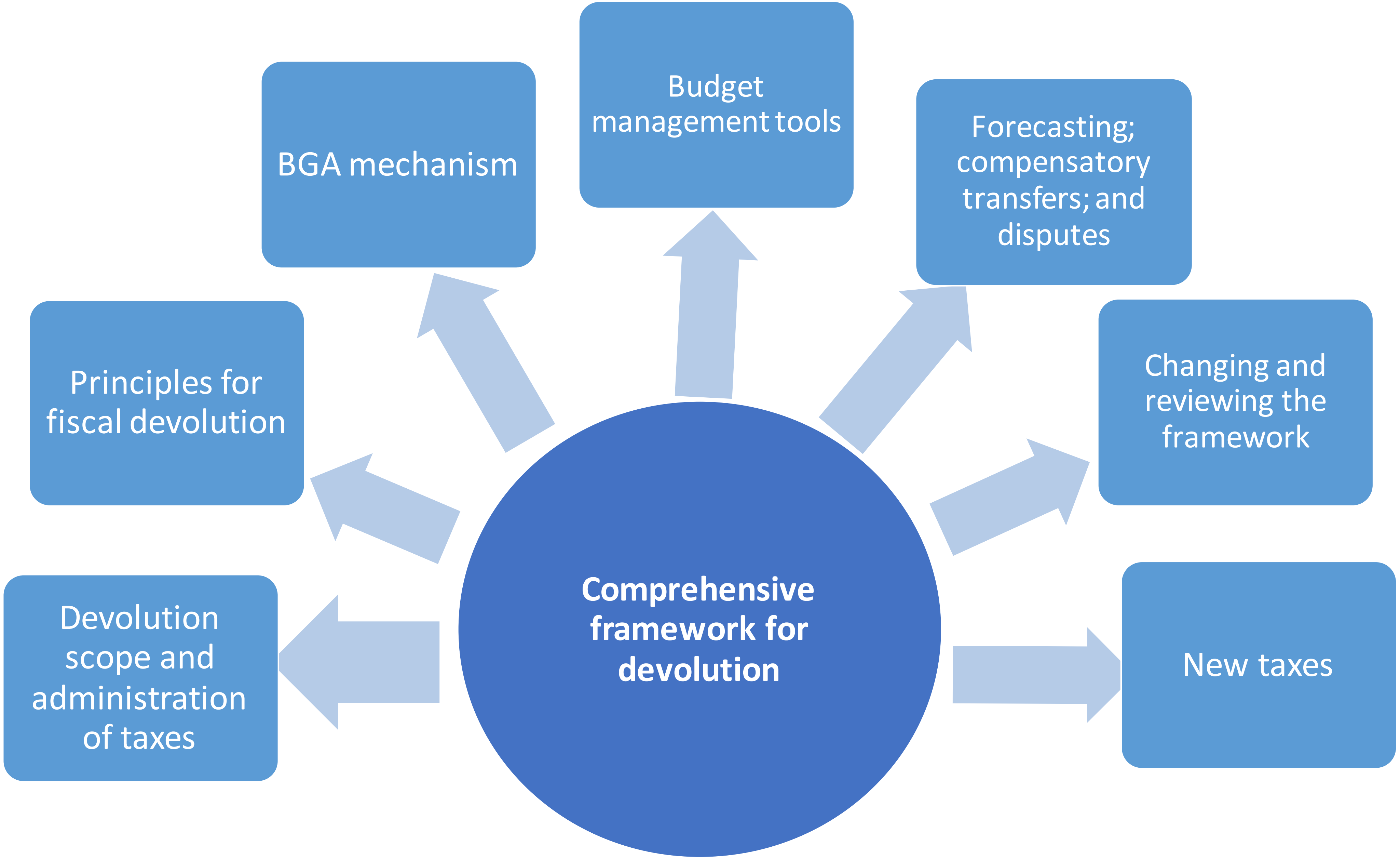
Recommendation 23

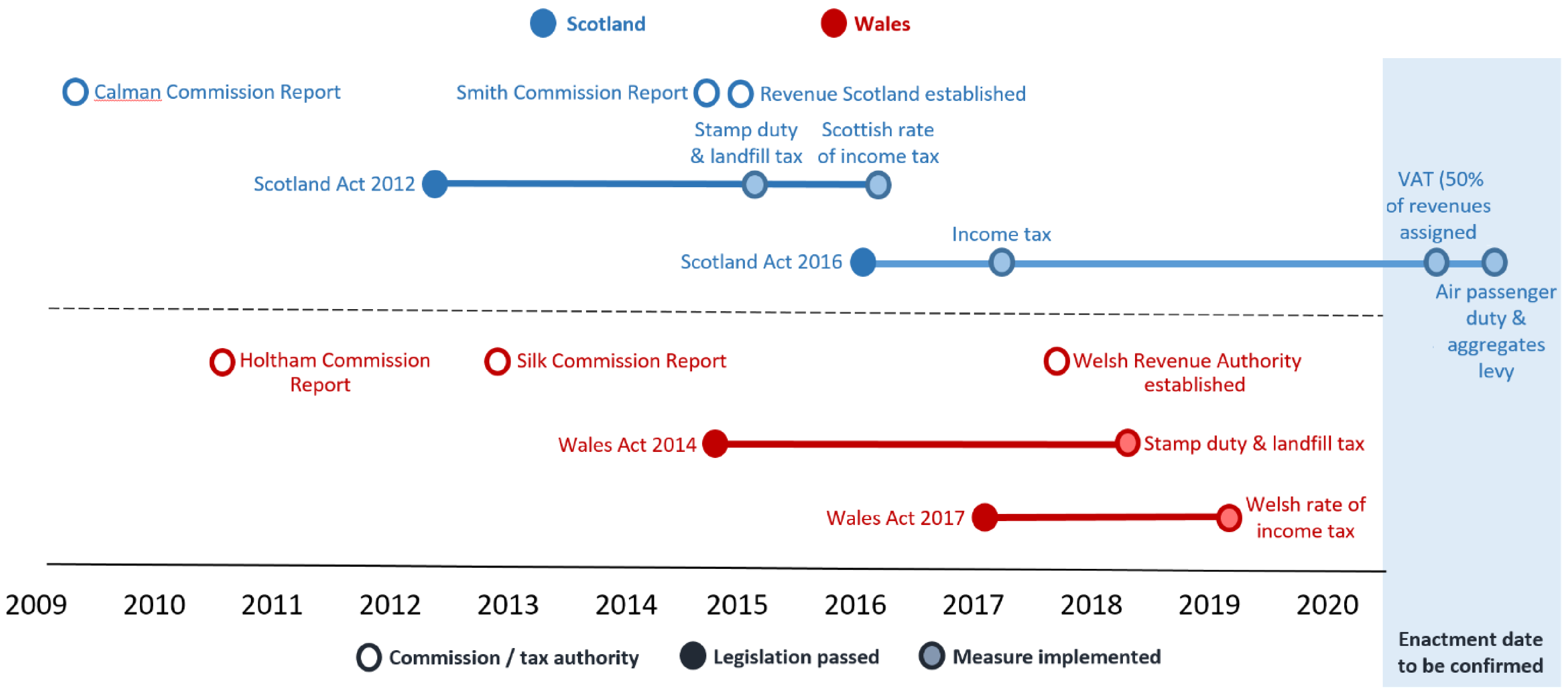
Wider implications

- Learning from our work relevant to fiscal devolution elsewhere in UK.
- **We recommend that the UK Government instigates a review to consider developing and implementing a shared institutional framework for fiscal devolution across the UK.**
- Shared principles and the establishment of shared processes/infrastructure particularly in the area of dispute resolution and the use of independent analysis.

A comprehensive framework… 7 Areas / 23 Recs…



Potential timescales for fiscal devolution....



Potential timescales for fiscal devolution….

- **Northern Ireland is at the beginning of a potential fiscal devolution journey.**

- Political considerations will ultimately decide whether any fiscal devolution occurs, as well as its scale and pace.

- **There are no set timeframes when considering timescales for tax devolution**.

- We believe the constituent parts can be in place to realise significant increased fiscal devolution to Northern Ireland, as per the framework outlined in our final report, by 2027/28.

- **This is choice remains one for politicians in both NI and UK, and the people they represent.**

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Panel Discussion / Questions?

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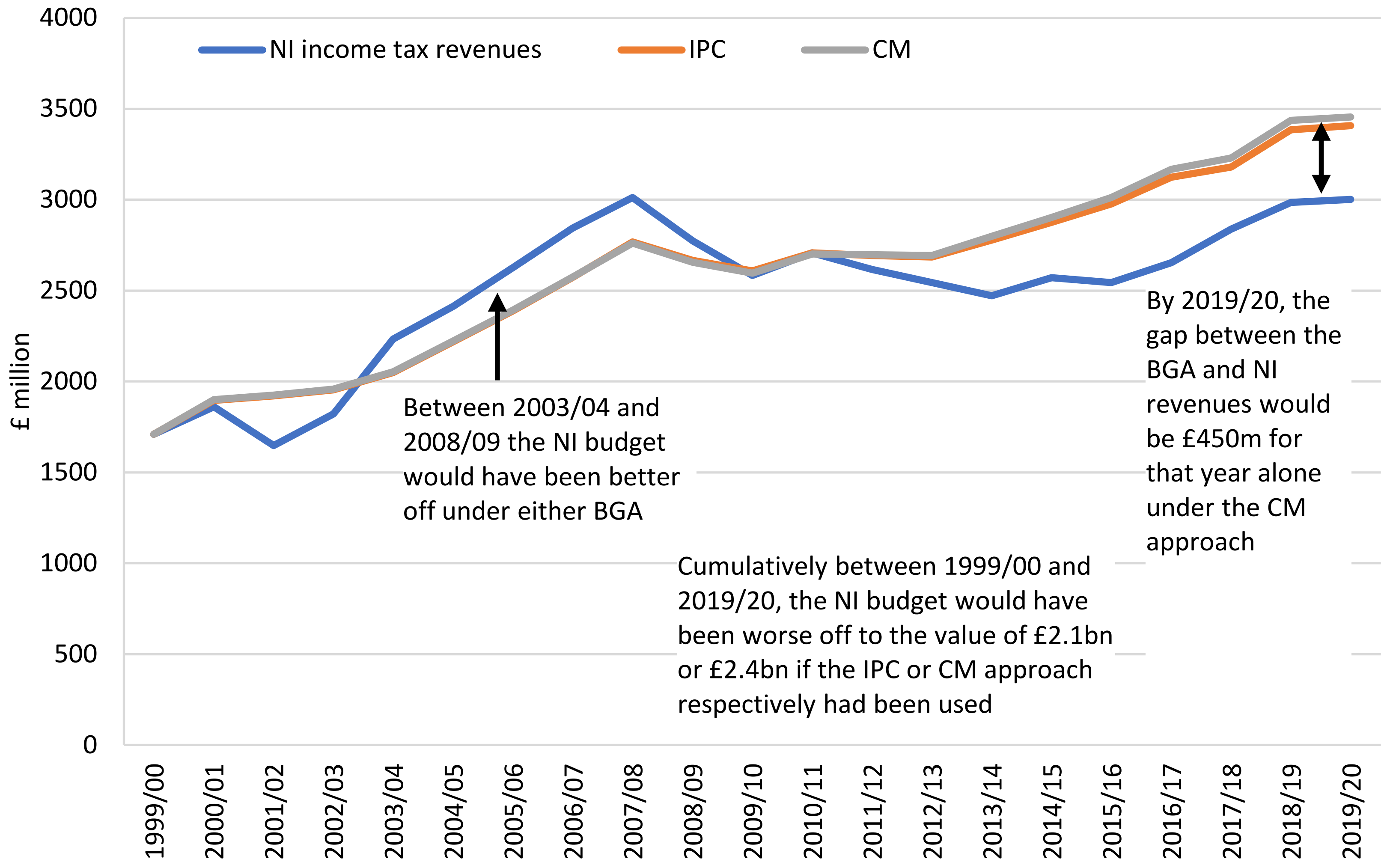
Annex

Implications of the IPC and CM in a historical perspective…



- **Why the negative impact?**
- NI more negatively affected by the financial crisis and its aftermath than was the case in England.
- Tax policy changes introduced at UK level had a more significant impact given the different structure of the NI tax base.
- Rises in the personal allowance and increases in tax rates for higher earners, impacted to narrow or shrink the tax base in NI relative to England.

Implications of the IPC and CM in a historical perspective…

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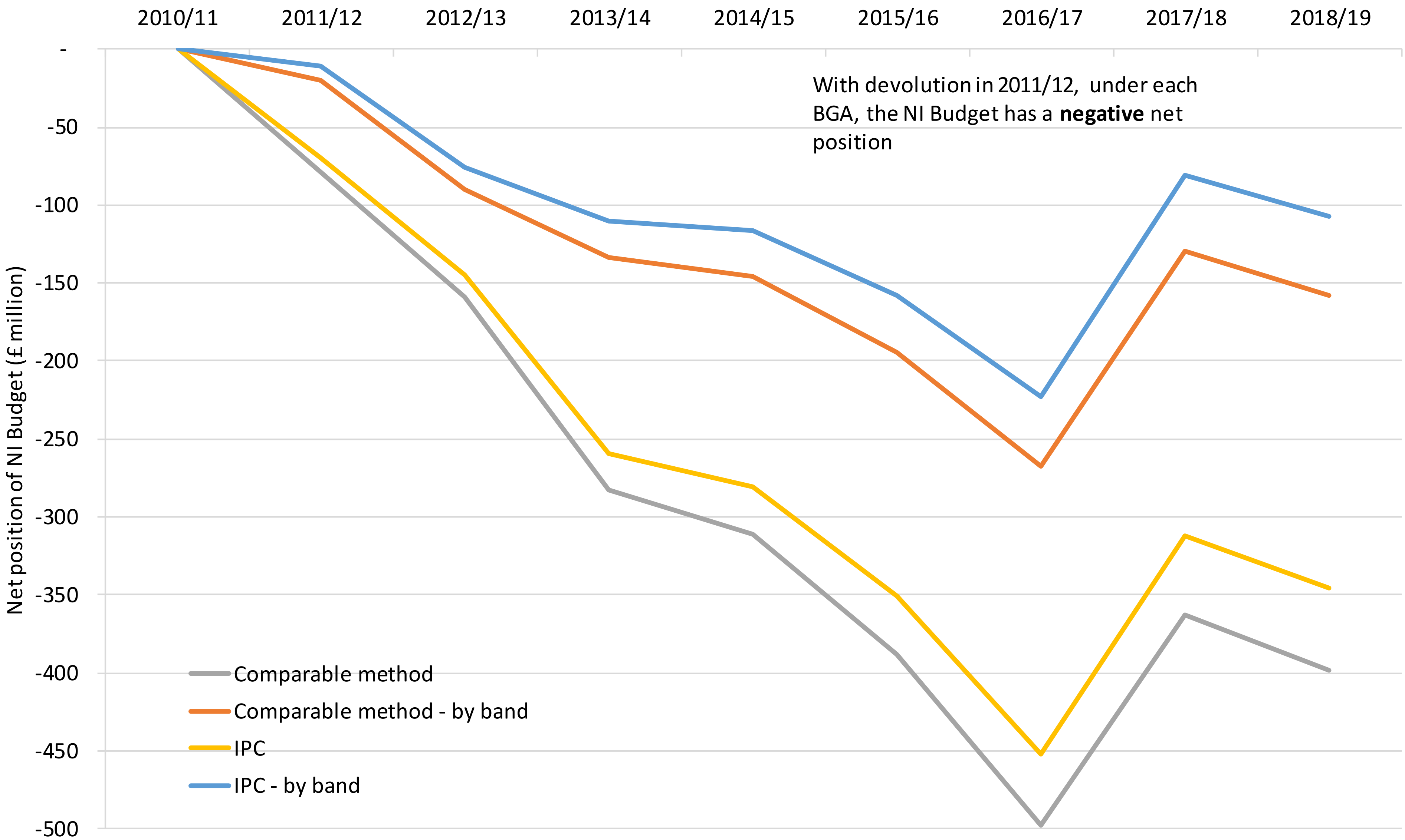

Potential for additional reward comes with additional risk

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Reward?

- Improved ability to spur economic activity
- Potential to make different choices more suited to NI (e.g. Scotland on Income Tax)
- Could raise additional revenue / lower taxes
- Example of Wales – budget better off under devolution

Risk?

- BGA negative impact on Budget. Tax base slower growing than England
- Volatility and uncertainty in budgets/forecasting
- Long-haul APD in NI – NI Executive paying c£2m per annum but no flights
- Scotland – increased income tax rates but budget not any better off