HM TREASURY

Rebalancing the Northern Ireland economy

March 2011

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1 Introduction

1.1 Northern Ireland is unique in that more than 30 years of conflict have taken their toll, and the economy has suffered partly due to the difficultly in attracting foreign investment. Although the Good Friday Agreement is now more than 12 years old it is obvious that, although helpful, peace has not in itself been sufficient to raise Northern Ireland prosperity to the UK average or even to the UK average excluding South East England. Northern Ireland still has one of the weakest economies in the UK. Northern Ireland is also a unique part of the UK in that it shares a land border with the Republic of Ireland rather than another part of the UK.

1.2 In the June Budget 2010, the Government announced a major package of reforms to corporate tax, including four annual one per cent reductions in the main rate of corporation tax, and a decrease in the rate applicable to small profits from 21 per cent to 20 per cent. Budget 2011 announced that the main rate of corporation tax would be reduced by a further one per cent. From April this year, the rate will be reduced to 26 per cent and by 2014 it will be reduced to 23 per cent. This reduction supports the Government's aim of creating the most competitive tax system in the G20 and will benefit Northern Ireland alongside all other parts of the UK. The analysis in this paper reflects this change.

1.3 The current state of the Northern Ireland economy is discussed in Chapter 2, but it is clear Northern Ireland faces a greater challenge than most other parts of the UK in competing in a global market, and attracting investment to grow the private sector and drive economic growth. To meet this challenge, it is necessary to rebalance the Northern Ireland economy by growing the private sector and increasing its capacity to export. A range of options for achieving this rebalancing are discussed in this paper.

1.4 In a challenging global economy, Northern Ireland cannot rely solely on its traditional advantages such as a low cost base and grant assistance to private investors. Indeed, Northern Ireland's ability to offer investment grants is being significantly curtailed under EU rules from the start of 2011 and could be further reduced after 2013. There is a need to develop a more balanced economy in which the private sector plays a greater role and which depends less than in the past on attracting investment in low wage sectors.

1.5 As set out in the Coalition Programme for Government, and at June Budget 2010, the UK Government and the Northern Ireland Executive (NIE) have a common objective to "rebalance the Northern Ireland economy", to increase the size of the private sector and drive faster economic growth in the area. June Budget 2010 stated that, "This will include examining proposals for economic enterprise zones, possible mechanisms for changing the corporation tax rate and other economic reform options." This in turn followed on from a commitment in the Coalition's Programme for Government to "produce a government paper examining potential mechanisms for changing the corporation tax rate in Northern Ireland".

1.6 Rebalancing the economy, with greater emphasis on private sector growth, is a long term objective for the next 25 years.

1.7 The Government is committed to working in partnership with the NIE to achieve this objective together in a spirit of mutual respect and wherever possible sharing expertise and knowledge.

1.8 Rebalancing can only be achieved by coordinated action by the UK Government and the NIE, using a combination of both reserved and devolved policy levers. This paper discusses issues in three areas.

1.9 Firstly, it describes action by the UK Government, using reserved policy levers, which will benefit all areas of the UK. As announced at June Budget 2010 the UK Government has taken action to rebalance the entire UK economy, based around deficit reduction, enterprise and fairness. The Plan for Growth, published alongside the 2011 Budget, set out the Government's overarching ambitions to ensure progress is made towards achieving strong, sustainable and balanced growth that is more evenly shared across the country and between industries. The Government has also published a Green Paper on improving access to finance. The Growth Review and Budget 2011 detailed actions the Government is taking to enable viable businesses to access the finance they need. These actions will benefit Northern Ireland over the longer term, as well as other areas of the UK. These issues are discussed in Chapter 3.

1.10 Secondly, the paper sets out options that could be taken to accelerate rebalancing through the tax system. The main option discussed in this paper is to allow Northern Ireland to vary corporation tax rates, to enable it to attract and expand private investment. Other tax options, including changes to R&D tax credits, annual investment allowance and National Insurance Contributions (NICs) holiday arrangements are also discussed in Chapters 4.

1.11 The Government is committed to a radical decentralisation of power from Westminster, and is examining the potential for devolution of corporation tax rate-setting powers to the Northern Ireland Assembly in this context. The issue of separate corporation tax rates for Scotland and Wales has been considered by the Calman and Holtham Commissions respectively. The Calman Commission's report to the UK Government considered devolution of corporation tax but recommended against a separate rate of corporation tax for Scotland, on the grounds that a separate rate could distort competition within the UK, and that the required legislation would be likely to create significant administrative burdens. The Holtham Commission's report to the Welsh Assembly also considered devolution of corporation tax and recommended that the Welsh Assembly Government should seek discussion with the UK Government and other devolved governments on the feasibility of a separate rate. The report noted a number of legal and implementation issues and the possibility that the fiscal consequences of a separate rate could introduce volatility into the Welsh Assembly budget.

1.12 The issues identified by the Calman and Holtham Commissions are relevant to considering the case for separate, lower corporation tax rate in Northern Ireland. However, Northern Ireland has its own unique set of circumstances, not least a land border with the Republic of Ireland with one of the world's lowest corporation tax regimes, and the implications of a lower Northern Ireland corporation tax rate need to be examined on their own merits.

1.13 Experience from the implementation of the Calman Commission's recommendations on tax devolution suggests the complexities, including legislative implications, associated with devolving a separate rate of corporation tax to the Northern Ireland Assembly mean this would realistically take some years to implement.

1.14 Thirdly, the paper notes a number of reviews and strategies relating to non tax options, including possible action by the NIE using devolved policy powers. The administration has a number of devolved levers that it can use to drive economic growth, including regional and industrial policy, local taxation, innovation and skills and labour market policies. In devolved areas, it is entirely for the NIE to determine its own policies and priorities within its block budget. These issues are outlined in Chapter 5.

1.15 While the UK Government is committed to rebalancing the Northern Ireland economy to help increase economic growth, any action needs to be considered within the overall economic and fiscal context of the UK, and increasing growth overall, rather than simply redistributing growth between regions and countries. The aim of rebalancing the economy includes options for promoting enterprise in Northern Ireland. Hence this paper examines a range of actions that can be used to encourage enterprise in the whole of Northern Ireland. The paper also refers to the Government's Enterprise Zone proposals announced in the Budget, consistent with EU state aid rules.

1.16 This paper sets out a number of possible reforms to the Northern Ireland economy and invites views on the most effective approach to rebalancing the economy. In particular, the Government would welcome views on the following:

- Whether there is a need to rebalance the Northern Ireland economy by strengthening the private sector over the longer term and to increase economic growth and promote significant new investment;
- Where there is most scope for increasing productivity, reducing labour market inactivity and increasing growth;
- The Government would welcome views, in the context of this report, on devolving corporation tax rate varying powers to Northern Ireland. In particular, the Government would welcome views on the following:
    - The importance of the headline corporation tax rate in encouraging investment;
    - The extent to which a reduction in the rate of corporation tax in Northern Ireland could support additional investment, higher growth rates and increased employment in the Northern Ireland economy;
    - The estimated costs arising from a lower corporation tax rate in Northern Ireland;
    - The dynamic impacts on tax receipts arising from a lower corporation tax rate in Northern Ireland;
    - The risks to the NIE arising from a devolved corporation tax rate in Northern Ireland;
    - Potential compliance costs and administrative burdens for business arising from a devolved corporation tax rate in Northern Ireland;
    - The approach that would be taken to adjust the block grant arising from a devolved corporation tax rate in Northern Ireland;
    - The balance of potential costs and benefits of a reduced corporation tax rate in Northern Ireland;
    - The merits of a deferred implementation of a rate reduction in Northern Ireland and its potential impact on investment decisions;
    - The extent to which a phased reduction in the rate of corporation tax in Northern Ireland could support a rebalancing of the economy while allowing the costs of the reduction to be more effectively managed;
    - The impact that restricting any reduction in corporation tax receipts to trading income only would have on the aim of rebalancing the Northern Ireland economy and the value for money of a corporation tax reduction;

    - Whether there are other options to offset the cost to the NIE of a reduction in the rate of corporation tax that would be consistent with the overall aim of rebalancing the Northern Ireland economy; and

    - The extent to which changes to R&D tax credits, annual investment allowances, training credits or a national insurance holiday could provide feasible, effective, affordable and value for money support for the rebalancing of the Northern Ireland economy.

- In relation to other economic reforms in Northern Ireland discussed in this report, bearing in mind the devolved nature of many of these policies, the Government would welcome views on how far:

    - Welfare reform has the potential to reduce economic inactivity in Northern Ireland and increase economic growth;

    - There are lessons to be learned and policy proposals from the recent Sub-national Growth White Paper that are transferable to Northern Ireland. If so which ones?

    - Devolved policies have an important role in rebalancing the Northern Ireland economy.

Responses and enquiries

1.17 Consultation will occur between 24 March and 24 June. When responding please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents, and where applicable, how the views of members were assembled.

1.18 On rebalancing the Northern Ireland economy, responses should be sent to:

Mark Parkinson
Room 1/31
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

1.19 On devolving corporation tax to Northern Ireland, responses should be sent to:

Richard Williams
Room 2/N2
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

1.20 Alternatively, on any question raised in this document, responses should be emailed to:

niconsultation@hmtreasury.gsi.gov.uk

1.21 In addition the Government proposes to consider with the NIE establishing a high-level consultation group to consider the issues raised in this paper, involving representatives from the private sector and others in Northern Ireland. The Government will also liaise closely with the NIE in considering the Government's response to this consultation exercise.

1.22 The NIE will also take account of this paper and the responses to it as they develop their own economic strategy which will be published for public consultation later in 2011.

2 The current state of the Northern Ireland economy

Background

2.1 The Northern Ireland economy has in the past been dominated by manufacturing industry and agriculture but there has been a shift over the last 30 years to a more service based economy including the public sector. The largest private sectors in Northern Ireland are wholesale and retail, manufacturing, and business and professional services (real estate and renting and business activities). However, as the Varney Review[1] argued there are also significant opportunities for the Northern Ireland economy which can be seen in the creation of new markets in other sectors such as information and communication technologies and financial services.

2.2 Northern Ireland is one of the UK's most disadvantaged regions on many measures. It has the lowest wages and one of the lowest labour productivity rates. It has a weak private sector, with strong dependence on the public sector. These weaknesses reflect a number of unique factors, not least the legacy of 30 years of conflict, the demographic structure and the peripheral location of Northern Ireland, as well as issues surrounding deprivation and rurality.

2.3 The Northern Ireland private sector economy is more concentrated on low value-added sectors than other parts of the UK. It has experienced a widening productivity gap with the rest of the UK. Rebalancing of the Northern Ireland economy will depend on high productivity sectors becoming larger and firms within all sectors increasing their productivity. Northern Ireland has built on its strengths to generate and attract new jobs, although some of these have been in low value-added activities.

Strengths

2.4 There has been strong potential for growth in the Northern Ireland economy. The economy benefited from the Northern Ireland peace process, although rapid growth was evident even in the decade before the Good Friday Agreement. Northern Ireland retains a number of strengths:

- a relatively young population and a high quality education and training system by UK standards;
- competitive labour costs , below the UK average;
- an increasingly flexible and responsive skills system;
- a successful track record in attracting inward investment though Invest NI;
- 100 per cent broadband coverage;
- good transport links internally and with Ireland and the rest of the UK;
- a relatively low crime rate for most crimes compared to the UK average; and
- strong tourism potential and an attractive natural environment.

[1] *Review of Tax Policy in Northern Ireland*, Sir David Varney. October 2007.

2.5 Over the past ten years, employment in Northern Ireland increased by 8.2 per cent compared to 1.4 per cent for the UK as a whole.[2] This has been founded on low wages, generous investment grants, and to some extent post-Troubles normalisation. Some aspects of the growth, including the recent retail and construction booms, are not sustainable and as this section outlines, there are concerns on the extent and speed at which the economy is emerging from recession.

2.6 The Government and the Northern Ireland Executive (NIE) are fully committed to the Northern Ireland peace process, including the recent devolution of policing and justice, underpinned by a financial package in excess of £800 million. The success of the peace process will maintain investor confidence in Northern Ireland. More investment will help the private sector to grow. The peace process and strengthening the private sector are mutually reinforcing and complementary policies.

Challenges

2.7 In spite of these strengths there remain substantial challenges. Currently GVA per capita remains significantly lower than that of most of the other parts of the UK, with GVA per capita in Northern Ireland in 2009 at £15,800, slightly higher than Wales and North East England (£14,800 and £15,600 respectively) but significantly lower than England (£20,400) and Scotland (£19,700).[3] This can be attributed to low levels of productivity (GDP per employed person) coupled with high rates of economic inactivity. Productivity remains low, with productivity per filled job being 85.3 per cent of the UK average, lower than all other regions other than Wales.[4]

2.8 Low productivity is largely due to under-representation of high productivity sectors in Northern Ireland, including finance and business services. Northern Ireland tends to be over represented compared to the UK average in low productivity sectors such as agriculture and food processing.

2.9 Northern Ireland attracts proportionately more foreign direct investment (FDI) than other UK regions[5] although some of the jobs in the past have been in contact centres paying below the Northern Ireland average wage. Northern Ireland's rate of attraction of FDI has also been less than a third of that in the Republic of Ireland where FDI also tends to be of a higher quality, although on a per capita basis there is less difference.[6] A priority for Northern Ireland is to expand these levels of foreign investment in high wage sectors. However, since the start of 2011, the maximum rate of assistance allowable for general investment projects has been significantly reduced by the EU with further changes expected from 2013. Levels of venture capital funding are also lower in Northern Ireland than in all other UK regions.[7]

2.10 The small scale nature of most firms currently operating in Northern Ireland means that there will need to be a significant reliance on inward investment projects to deliver the quantity and quality of employment opportunities needed over the next 25 years to rebalance the economy.

2.11 . Northern Ireland has a particularly low level of business expenditure on R&D,[8] and the limited data available suggests that levels of patenting from Northern Ireland companies are also

[2] *Employee jobs estimates from Workforce Jobs*, Office for National Statistics, Sept 2000 to Sept 2010

[3] *Regional, sub-regional and local gross value added 2009*, Office for National Statistics, December 2010 Regional GVA figures do not take account of regional price differentials which might tend to reduce the regional differentials

[4] *Labour Productivity Statistical Bulletin Q3 2010,* Office for National Statistics, December 2010

[5] *Independent Review of Economic Policy in NI (IREP)*, DETI, September 2009, p33

[6] Ibid p33

[7] Ibid p64

[8] *IREP*, op. cit., p35

very low.[9] Northern Ireland expenditure on R&D and innovation is especially low when compared to successful small economies in Europe several of which are in more peripheral locations than Northern Ireland. There was a significant improvement in 2009, when business expenditure on R&D in Northern Ireland increased by 76.0 per cent.[10] This reflects the increased priority given to innovation and R&D in recent years by the NIE. However, notwithstanding this improvement, over the past five years business expenditure on R&D in Northern Ireland has averaged 0.69 per cent of GVA compared to 1.23 per cent for the UK as a whole.[11] In addition, business expenditure on R&D in Northern Ireland is heavily focused on a small number of companies, with just 10 companies accounting for some 57 per cent of all business R&D investment in 2009.[12]

2.12 Skills are particularly important in driving productivity and economic success. Yet the skills profile of the working age population in Northern Ireland remains weaker than the UK as a whole, despite recent improvements. For example, fewer people of working age have high level qualifications (level 4 and above) and proportionately more have no or very low level qualifications.[13] This position reflects an historical educational underachievement, but also a weaker labour market which has resulted in a protracted outward migration of skilled people seeking opportunities elsewhere.

2.13 Northern Ireland has the highest proportion of inactive people of working age at 28.4 per cent, which is 5 percentage points above the UK average.[14] The take-up of all benefits for the working-age people is above the UK average, often by a large margin. Moreover, despite rising employment over the past two decades, inactivity rates have not fallen. The wider welfare reform agenda presents further opportunities to engage the inactive.

2.14 The number of tourists coming to Northern Ireland used to be proportionately higher than in the Republic of Ireland but numbers have never fully recovered from the Troubles. There are opportunities to expand this sector through investment in facilities and accommodation.

Impact of the recession on the Northern Ireland economy and future prospects

2.15 The recent economic recession has had a major impact on the Northern Ireland economy. The ILO unemployment rate in Northern Ireland has risen from 4.3 per cent in the three months to December 2007 to 8 per cent in the three months to December 2010. In the UK the ILO unemployment rate rose from 5.2 per cent to 7.9 per cent over the same period. The economy is also the part of the UK to have experienced the biggest increase in unemployment during the course of 2010. In terms of GVA per capita relative to the UK average Northern Ireland remained at 79.1 per cent in 2009, the same as in 2008.[15]

2.16 The unemployment rate for Northern Ireland is broadly in line with the UK average. But, as explained above, due to the weak private sector, it remains heavily reliant on the public sector for jobs. Over 30 per cent of all Northern Ireland jobs are in the public sector compared to a UK average of around 21 per cent, [16] although there has been some progress; in 1992, the figure was 37 per cent. Currently total public expenditure on services per head in Northern Ireland is 21

[9] *The Characteristics of Patenters*, P. Evans and N. K. N. Khan, Economic and Labour Market Review Vol. 3 No. 12, 2009

[10] *Northern Ireland Research & Development Statistics 2009*, DETI, December 2010

[11] Calculated from *NI Research and Development Statistics,* op. cit,; *UK Business Enterprise Research and Development 2009,* Office for National Statistics; and *Regional, sub-regional and local gross value added 2009,* op. cit.

[12] *NI Research and Development Statistics*, op. cit., p7

[13] *Labour Force Survey*, Office for National Statistics, April – June 2010

[14] *Labour Market Report*, DETI, March 2011

[15] *Regional, sub-regional and local gross value added 2009,* op. cit.

[16] *Public Sector Employment Statistical Bulletin Q4 2010*, Office for National Statistics, March 2011

per cent above the UK level but this is a reduction from 2004-05 where it was 26 per cent above the UK level. [17] Labour market statistics are set out in table 2.A below.

Table 2.A: Labour market indicators (source Office for National Statistics, Labour market statistics bulletin, March 2011)

3 months to January 2011	LFS Employment Rate			ILO Unemployment Rate		
	Actual	Change		Actual	Change	
		QoQ	YoY		QoQ	YoY
Northern Ireland	65.8	0.1	0.4	8.0	0.4	1.7
UK	70.5	-0.1	0.1	8.0	0.1	0.2

2.17 As can be seen from the table above, the LFS employment rate in Northern Ireland is considerably lower than the UK level. Northern Ireland's economic inactivity rate remains high at 28.4 per cent compared to the UK average of 23.3 per cent, and is the highest rate in all of the 12 UK regions. [18]

2.18 The particular impact of the recession in Northern Ireland was mainly due to the construction sector, linked to the collapse of the construction sector in the Republic of Ireland. Northern Ireland has significant linkages with the Republic of Ireland, which accounts for 28.4 per cent of manufacturing exports[19] as well as almost a quarter of construction output, at the peak in 2007. In this context, the measures currently planned by the Republic of Ireland government to reduce public sector borrowing to 3 per cent of GDP by 2014, are expected to have implications for both sides of the border. The most obvious impact on Northern Ireland will be in respect of reduced demand for goods and services. In addition, the Republic of Ireland will need to focus more on external sources of economic growth, which means that the degree of competition for both inward investment and in the tourist market will be much more intense.

2.19 Two of Northern Ireland's four main banks are Irish owned and another has significant operations in the Republic of Ireland. Impairment provisions continue to affect profitability and liquidity and credit availability is constrained. A private sector led recovery requires that business can access the finance they need for investment. Ensuring that Northern Ireland has a banking sector that can meet the needs of businesses and consumers is a continuing aim. Northern Ireland stands to benefit from the economic effects of the recent loan by the UK to the Irish Government.

2.20 At the same time, the NIE's ability to provide support to business will be weakened by expected changes to the EU state aid rules, which limit the extent to which public assistance can be granted to local companies. These rules are designed to avoid any distortion in competition as they set the maximum level of financial support that can be provided to individual projects. The single largest category of state aid in Northern Ireland is Regional Aid. However, since the start of 2011, the maximum amount of regional aid assistance that can be provided to large firms in Belfast has fallen from 30 per cent to 10 per cent. Similar changes are also being applied throughout the rest of Northern Ireland.

2.21 The current state aid rules apply until 2013 when they will be revised, with the potential for a further reduction in the maximum amount of assistance that can be provided. Although the whole of Northern Ireland is defined as an assisted area under the Industrial Development Act 1982, different rates of assistance are allowed for across the region.

[17] *Public Expenditure Statistical Analyses*, HM Treasury, July 2010
[18] *Labour Market Report*, op cit
[19] *Manufacturing Sales and Exports Survey 2009/10*, DETI , December 2010

2.22 In summary, the Northern Ireland economy faces major challenges over the next decade including through the weakness of the Republic of Ireland economy, access to investment finance and changes to EU state aid rules in the face of increasing competition from abroad.

Conclusion

2.23 The Northern Ireland economy has some historical strengths which it can build on, underpinned by the peace process. However, it also has some long standing weaknesses such as the low productivity and low employment rates and an underdeveloped private sector which present significant challenges for the future.

2.24 In response, a priority is to expand the private sector through rebalancing the economy, utilising a range of devolved and reserved economic policies.

Questions

As part of consultation, the Government would welcome views on:

- Whether there is a need to rebalance the Northern Ireland economy by strengthening the private sector over the longer term and to increase economic growth and promote significant new investment
- Where there is most scope for increasing productivity, reducing labour market inactivity and increasing growth.

3 The UK Government's strategy for rebalancing the UK economy

3.1 The issue of rebalancing the economy, while particularly relevant in Northern Ireland, is also applicable to the UK as a whole. The UK economy has become too reliant on growth from a limited number of sectors and regions. Budget 2011 and the Growth Review[1] set out the Government's Plan for Growth. This contains four overarching ambitions: to create the most competitive tax system in the G20; to make the UK one of the best places in Europe to start, finance and grow a business; to encourage investment and exports as a route to a more balanced economy; and to create a more educated workforce that is the most flexible in Europe. This chapter provides an overview of the action the Government has taken to promote growth through the June Budget 2010, the Spending Review, Budget 2011 and the Growth Review.

The June 2010 Budget: The Government's new economic model

3.2 The June Budget 2010 set out three areas where the UK Government will take action in order to rebalance the whole UK economy and provide the conditions for sustainable growth:

- deficit reduction;
- enterprise; and
- fairness.

Deficit reduction

3.3 The June Budget 2010 set out that the most urgent task facing the country is to implement an accelerated plan to reduce the UK's budget deficit. Reducing the deficit is a necessary precondition for sustained economic growth and the Budget and Spending Review took urgent action to eliminate the bulk of the structural deficit, including £81 billion of spending cuts by 2014-15.

3.4 Reducing the deficit and reducing debt as a percentage of GDP will increase household, business and market confidence and provide conditions for sustainable growth in the private sector over the longer term.

Enterprise and Fairness

3.5 If growth is to be sustainable, it needs to be based on an expansion of the private sector, and businesses across all regions and industries need the right conditions to be able to grow. Underpinning the Government's approach is a commitment to fairness. The Budget stated that the Government will ensure that every part of society makes a contribution to deficit reduction while supporting the most vulnerable, including children and pensioners, while also seeking to build over the long term a fair tax and benefit system that rewards work and promotes economic competitiveness.

[1] *The Plan for Growth, HM Treasury and Department for Business, Innovation and Skills, March 2011*

3.6 Measures which are particularly relevant to strengthening the private sector and promoting fairness in Northern Ireland include:

- A scheme to help new businesses in countries and regions outside London, the East and South East. The three-year scheme **will exempt new businesses from up to £5,000 of employer NICs payments**, for each of their first 10 employees hired. Up to 15,000 businesses in Northern Ireland could benefit, freeing up money for investment and expansion.
- The impact of the **employer NICs rate rise announced by the previous government will be largely reversed** by increasing the threshold for employer NICs by £21 a week above indexation. This will lead to a saving of around £80 million in Northern Ireland.
- The **Enterprise Finance Guarantee (EFG) scheme** is being increased by £200 million to support additional lending of up to £700 million for small businesses this year, bringing the total size of the facility since January 2009 to close to £1.7 billion. Since January 2009, 133 eligible cases have resulted in £19.7 million of loan offers made in Northern Ireland enabling businesses to grow and create employment in the local area_
- The **income tax personal allowance** for those aged under 65 will be increased by £1,000 in cash terms, taking it from £6,475 in 2010-11 to £7,475 in 2011-12. As a result, the Government estimates that 23 million basic rate taxpayers will benefit by up to £170. In Northern Ireland over 600,000 basic rate taxpayers will gain from this measure.
- The Government is also committed to reforming the working age benefit and tax credit system so that it is fair and affordable. The Government's **welfare reforms** will reduce benefit dependency and promote work, while protecting those who are most vulnerable and have the highest level of need. The Northern Ireland Economic Reform Group[2] has noted that reform of social security should be one aspect of policy changes aiming to raise employment rates and hence GDP per capita in Northern Ireland. The administration of social security in Northern Ireland is devolved and the Government will work closely with the NIE in taking forward welfare reform.

The Plan for Growth and Budget 2011

3.7 The Government's economic policy objective is to achieve strong, sustainable and balanced growth that is more evenly shared across the country and between industries. The Plan for Growth, which was published alongside the 2011 Budget, contains four overarching ambitions that will ensure progress is made towards achieving this economic objective. The new announcements from the Growth Review and Budget 2011 will help to achieve these ambitions. The ambitions are:

1. To create the most competitive tax system in the G20, including through:

    - reducing the main rate of corporation tax by a further one per cent. From April this year, the rate will be reduced to 26 per cent and by 2014 it will reach 23 per cent;
    - reforming the UK's outdated Controlled Foreign Company (CFC) rules;
    - introducing a new 10 per cent rate of corporation tax on income from patents;

[2] *The Case for a Reduced Rate of Corporation Tax in Northern Ireland*, ergNI, February 2010

- reforms to the regime for taxing foreign branches;

2. To make the UK one of the best places in Europe to start, finance and grow a business, including through:

    - support for small firms through an unprecedented moratorium exempting micro and start-up business from new domestic regulation for three years; measures to open up public procurement to SMEs; and increasing the SME rate of R&D tax credit, subject to state aid approval;

    - an extension of the current small business rate relief holiday for one year. In Northern Ireland provision has been made available to the Northern Ireland Executive to facilitate a similar measure if wishes;

    - scrapping plans for regulations that would have cost businesses over £350 million a year; launching a public thematic review to reduce the stock of regulation in which nominated regulations will be removed unless they can be justified; and implementing Lord Young's Review on Health and Safety, including stripping back proposed regulation on dual discrimination and third party harassment from the Equalities Act 2010;

    - radical changes to the planning system to support job creation by introducing a powerful presumption in favour of sustainable development; opening up more land for development, while retaining existing controls on greenbelt land; introducing new land auctions starting with public sector land; consulting on the liberalisation of use classes; and ensuring all planning applications and appeals will be processed in 12 months and major infrastructure projects will be fast-tracked; and

    - finance for new start ups and business growth through an increase in income tax relief under the Enterprise Investment Scheme, subject to state aid approval; a proposed business angel co-investment fund; and doubling the lifetime limit on capital gains qualifying for Entrepreneurs' Relief.

3. To encourage investment and exports as a route to a more balanced economy, including through:

    - support for new capital investment by extending the capital allowances short life asset regime for plant and machinery from four years to eight years, from April 2011, more closely aligning tax and economic depreciation for a greater number of business assets;

    - support for investment across the regions by setting up 21 new Enterprise Zones with superfast broadband, lower taxes and low levels of regulation and planning controls, to be developed with the new Local Enterprise Partnerships, and with all business rates receipts to be held locally. In Northern Ireland provision has been made available to enable the Northern Ireland Executive to introduce a similar policy if it wishes;

    - support for inward investment by developing a more entrepreneurial culture within UKTI which makes better use of private sector expertise, with a clear focus on winning business for the UK. In addition, the Government will provide a bespoke service to key inward investors, giving them direct access to UK ministers and speedy resolution of bureaucratic obstacles to investment;

4. To create a more educated workforce that is the most flexible in Europe, including through:

- promoting skills and employment, especially for the young, through funding for up to 100,000 additional work experience placements for young people and 50,000 additional apprenticeship places over the next four years;
- expanding the University Technical Colleges programme, to establish at least 24 new colleges by 2014, enabling more young people to gain the technical skills that employers need; and
- promoting labour mobility by boosting the supply of housing through support for the house building industry, with a FirstBuy shared equity programme to assist over 10,000 first time buyers to get on the housing ladder, reforms to stamp duty land tax for bulk purchases of residential property and a range of measures to remove barriers to entry for new Real Estate Investment Trusts.

3.8 Each ambition is supported by a number of measurable benchmarks against which the Government expects to be judged. The Government will also constantly benchmark the UK against best practice around the world. The new announcements from the Growth Review and Budget 2011 will help to achieve these ambitions. In devolved areas it will be for the Northern Ireland Executive to determine its own policies and priorities.

3.9 Budget 2011 announced measures to help people this year and make the tax system fairer which will also affect Northern Ireland, including;

- A £630 increase in the income tax personal allowance, and a £630 decrease in the basic rate limit. The higher rate threshold, which is the sum of the personal allowance and basic rate limit, will not be affected by the changes. Over 600,000 taxpayers in Northern Ireland will gain by £48 a year on average in 2012-13, and around 9,000 taxpayers will be taken out of tax altogether.
- The fuel duty escalator will be abolished and replaced by a fair fuel stabiliser. The main fuel duty rate will be cut by 1 penny per litre; and
- The climate change levy exemption for supplies of gas in Northern Ireland will be replaced with a lower rate.

3.10 To avoid placing further burden on the Northern Ireland quarrying industry following the suspension of the aggregates levy credit scheme, the increase in the aggregates levy rate from £2.00 to £2.10 scheduled for 1 April 2011-12 will not go ahead. The Government is legislating to enable the operation of an aggregates levy credit scheme in Northern Ireland until 2021, pending state aids approval.

3.11 As far as supporting economic recovery by investing in infrastructure is concerned, the Government published its National Infrastructure Plan in October 2010. This is UK wide although the plan recognises that decisions in devolved areas are a matter for the devolved administrations. The Government plans for UK infrastructure investment to be some £200 billion over the next five years. The Government is keen to involve the devolved administrations in this work in order to dovetail our respective areas of responsibility to our mutual benefit.

3.12 Additional provision of £45 million has been made available to the Northern Ireland Executive as consequentials of increased spending by UK departments announced in the Budget.

3.13 The Budget announcements on corporation tax are discussed in the next chapter.

Improving availability of finance in Northern Ireland

3.14 Ensuring that businesses can access a wide range of sources of finance is essential if they are to invest and reach their full growth potential. Small and medium-sized enterprises (SMEs),[3] in particular, tend to experience greater difficulties in accessing finance because of longstanding market failures such as a lack of track record or collateral.

3.15 The Government has set out a clear set of measures to enable viable businesses to access the finance they need in its response to the *Financing a private sector recovery* consultation last November.[4] These measures are detailed in the Growth Review and Budget 2011, along with new actions that Government is taking to promote improved access to finance.

3.16 Both the Government and NIE recognise the need for improving stability and competition in the UK banking sector, and the need for businesses to consider a wider range of financing options. Banking is a reserved matter but the Government will take account of all representations on this subject.

3.17 The Government also announced on 9 February that the banks have stated a capacity and willingness to lend £190 billion of new credit to business in 2011, up from £179 billion actual lending in 2010. If demand exceeds this, the banks will lend more. £76 billion of this new lending capacity will be to small and medium-sized Enterprises (SMEs). This is a 15 per cent increase on the amount actually lent in 2010 (£66 billion). The banks have also announced additional support of £1 billion to support regional growth.

Conclusion

3.18 The Budget, the Spending Review and the Growth Review set out the Government's overall strategy for rebalancing the UK economy. This action will have benefits for Northern Ireland, as well as other parts of the UK, in the long term. However, there is further more specific action that the UK Government and NIE could take to rebalance growth. These are discussed in subsequent chapters.

[3] Businesses with an annual turnover of up to £25 million.

[4] The *Financing a Private Sector Recovery* consultation (July 2010) and its response, *Financing Business Growth* (November 2010), can be found at: www.bis.gov.uk/businessfinance

4 Corporation tax in Northern Ireland

Introduction

4.1 This chapter considers the issues involved in devolving the power to vary the corporation tax rate for profits in Northern Ireland. The aim of this stage of consultation is to gain a fuller understanding of the costs and benefits that a separate rate would involve, for Northern Ireland and for the rest of the UK, and to consider potential mechanisms for introducing a separate rate. This stage of consultation seeks views on the policy principles of devolving corporate tax rate setting powers to the Northern Ireland Executive (NIE), rather than on the details of the policy design. Further consultation on implementation will be undertaken if the Government and NIE decide to pursue this policy further. Additionally, experience, especially from the implementation of the Calman Commission's recommendations on tax devolution, suggests that the complexities associated with devolving a separate rate of corporation tax to the Northern Ireland Assembly mean this would take several years to implement.

4.2 In the June Budget 2010, the Government announced a major package of reforms to corporate tax, including four annual one per cent reductions in the main rate of corporation tax, and a decrease in the rate applicable to small profits from 21 per cent to 20 per cent. The Budget announced that the main rate of corporation tax would be reduced in the UK by a further one per cent. From April this year, the rate will be reduced to 26 per cent and by 2014 it will be reduced to 23 per cent. This reduction supports the Government's aim of creating the most competitive tax system in the G20 and will benefit Northern Ireland alongside all other parts of the UK. The analysis in this paper reflects these announcements.

4.3 The purpose of this chapter is to inform the consultation discussion. In order to do this, estimates of the expected costs and benefits of a lower corporation tax rate in Northern Ireland are presented. However, estimates of costs and benefits are necessarily uncertain, and if the Government and NIE decide to pursue this policy further it will be necessary to reassess these costs by monitoring Northern Ireland corporation tax receipts in future years. The fiscal costs borne by the NIE if the policy is implemented will ultimately depend on further analysis including outturn corporation tax receipt data. The costs and benefits presented in this chapter should therefore be treated as illustrative and part of the consultation.

The case for reducing the corporation tax rate

4.4 A competitive and stable tax system can help provide business with the confidence to invest and expand. The Government's aim is to create the most competitive tax system in the G20 and it has set out a programme of reform for corporate tax in the UK as a whole. This includes a reduction in the main rate of corporation tax to 26 per cent from April this year followed by three annual reduction of one per cent to bring the rate down to 23 per cent by 2014. This will benefit businesses across the UK.

4.5 A lower corporation tax rate would, on its own, be likely to have a positive effect on local private sector investment and foreign direct investment (FDI) by increasing the return on capital to investors. In addition, a lower corporation tax rate means that businesses may have more post-tax profits available for internal investment. Increased investment, other things being equal, typically leads to increased growth and employment.

4.6 Northern Ireland is one of the UK's most disadvantaged regions and has a small private sector, which has led to a strong dependence on the public sector. The recent economic recession has had a serious impact on the Northern Ireland economy and Northern Ireland has had a larger increase in its unemployment rate over the last year than the rest of the UK. A reduced corporation tax rate could play a significant role in helping to rebalance the Northern Ireland economy, especially over the longer term, by encouraging private sector investment and growth.

Lessons from other countries

4.7 Across the EU, main corporation tax rates vary from 10 per cent in Cyprus to around 34 per cent in Belgium. In a world of increasingly mobile capital, business taxes are an important determinant of the attractiveness of a country to foreign investment.[1] However both academic research and consultants' surveys identify a number of non-tax factors which also determine investment levels across countries. These include, for instance, the size of the domestic market, existing infrastructure, labour costs and skills in the workforce, the state of the global economy, regulatory factors, currency risks and access to international markets.[2]

4.8 The recent global downturn saw a dramatic reduction in FDI flows across advanced economies, with inward investment to developed economies falling by over 40 per cent in 2009 although the decline in some low tax countries was less than this. The UNCTAD World Investment Report 2010 predicted a recovery throughout 2010 followed by increases in the medium term. The report also suggested a greater proportion of investment will go to developing and transition economies. The continued rapid growth of many emerging economies in contrast to relatively slow growth in advanced economies suggests this trend is likely to be maintained. Within the total going to advanced economies, however, there is little reason to expect that low corporation tax will not continue to be a factor attracting FDI.

4.9 The Republic of Ireland provides an important comparator in judging the potential impact of a lower corporation tax rate in Northern Ireland. From the mid 1990s until the recent recession the Republic of Ireland enjoyed a period of very strong economic growth, supported by large inflows of FDI. Different explanations can be, and have been, offered for the Republic's performance. Prominent among these is the Republic's corporation tax regime which has recently been described by the Republic's then Minister for Finance as the, "cornerstone of Irish industrial policy".[3] Although the Republic enjoys a very low rate of corporation tax on trading

[1] *How are Plant Location Decisions and Capital Flows Affected by Corporate Income Taxes*, M. Devereux and B. Lockwood, European Tax Policy Forum, April 2006

[2] See for instance *Ernst and Young European Investment Monitor 2009* and the *Ernst and Young European Attractiveness Survey 2007*

[3] Ministerial Statement by Brian Lenihan, Department of Finance, Dublin, 1 October 2010.

profits, at 12.5 per cent, its tax rate on non-trading profits is, at 25 per cent, higher than the rate will be in the UK.

4.10 The Republic's corporation tax system differs from the UK's in respects other than headline corporation tax rates, which may result in companies paying less tax than the headline rate implies. In addition to an entirely different system of reliefs and allowances, significant differences between the corporation tax systems in the UK and the Republic relate to rules governing Controlled Foreign Companies, transfer pricing, thin capitalisation and the taxation of dividends.

4.11 Because of differences in effective corporate tax rates, and due to the large range of factors that determine investment levels, it is necessary to be cautious in assuming that a lower corporation tax rate would have the same effect in Northern Ireland as it had in the Republic.

Benefits of reducing corporation tax rates in Northern Ireland

4.12 Academic literature on corporation tax suggests that the most significant benefits of a reduction in the corporation tax rate in Northern Ireland would come through additional investment in both new foreign-owned firms and in existing firms. Increased investment, other things being equal, typically leads to increased growth and employment.

4.13 Some foreign-owned firms may also shift profits from the rest of the world into Northern Ireland to benefit from the low tax regime, and a lower corporation tax rate in Northern Ireland may enable some profit to be retained in the UK from companies that would otherwise shift it abroad, though a proportion of increased investment in Northern Ireland would be at the expense of investment in other parts of the UK.

4.14 The impact of changes in corporation tax rate will depend upon other components of the corporation tax system, such as capital allowances and any tax credits available for Research and Development (R&D). When investing it is likely that firms will take both their overall tax rate into account (the average effective tax rate) as well as the tax rate on the particular investment project they are considering (the marginal effective tax rate). The statutory or "headline" rate also has a role to play in terms of the signals it sends to overseas investors.

As part of consultation, the Government would welcome views on the importance of the headline corporation tax rate in encouraging investment.

Estimating the benefits

4.15 Estimating the benefits of a corporation tax rate cut is necessarily uncertain, as investment choices depend on a broad range of factors. The benefits of a corporation tax rate cut could be more substantial if other factors, such as infrastructure, skills or the state of the global economy, also encourage investment. The estimates below are based on a set of assumptions about these broader factors which may vary in reality, and are intended to inform the debate. Opinions may vary about the expected benefits of a corporation tax rate reduction, and as part of consultation, the Government would welcome views on estimating the potential benefits of a reduction in the rate of corporation tax in Northern Ireland.

4.16 The NIE is currently undertaking research which, in part, seeks to estimate the impact of lower corporation tax rates on FDI flows. This work is due to report in spring 2011 and will be considered as part of the consultation.

4.17 It is not possible to calculate the expected benefits of a corporation tax rate cut accurately in advance, and it is appropriate to look at an estimated range of effects on FDI and domestic investment, rather than producing a single estimate for the relationship between corporation tax rates and investment. Estimates below indicate the likely range of impacts on investment if a 12.5 per cent corporation tax rate were introduced by the Northern Ireland Assembly, assuming a UK main corporation tax rate of 23 per cent and small profits rate of 20 per cent.

4.18 The impact on domestic investment of a reduction in the corporation tax rate is estimated using findings from the academic literature. Changes to domestic investment are modelled by estimating the change in the cost of capital as a result of the reduction in corporation tax, which is estimated via a standard model,[4] and then applying elasticity assumptions, derived from the

[4] The model, based closely on the methodology set out in Kind and Fullerton (1984), calculates the cost of capital for a range of hypothetical investments which vary according to the asset type, sources of finance and type of investor. Using suitable weights this gives an estimated average percentage change in the user cost of capital as a result of a change in the rate of corporation tax.

literature, to give an estimate of the size of the consequential increase in investment.[5] FDI is modelled separately. Results from a comprehensive survey of the empirical literature are used to estimate how strongly FDI will react to a change in the (effective average) tax rate.[6] The effective average tax rate change is modelled on a country by country basis depending on whether they operate a credit or exemption regime, and the resulting range of estimates is then combined with the elasticity and an estimate of the current amount of FDI in Northern Ireland.[7]

4.19 The following are estimates of increased domestic investment and FDI:

- It is estimated that domestic investment would increase by between £50 and £65 million in the first year (around 2 per cent of the total level of domestic investment in Northern Ireland). By year 10 the mid-point estimate is of higher annual investment amounting to around £110 million.
- It is estimated that net FDI (after taking account of the displacement of FDI from the rest of the UK of around 12.5 per cent of the total increase in FDI) would increase by between £105 and £175 million in the first year. A central estimate therefore represents around 50 per cent of the current level of estimated FDI in Northern Ireland. Not taking account of displacement, the gross effect on FDI would be an increase of between £120 and £200 million in the first year, with a mid-point of £160 million. By year 10 the mid-point estimate is of higher investment of around £310 million.

4.20 In total, it is estimated that the level of investment in Northern Ireland would be around 6 per cent higher each year than it would have been in the base case where the Northern Ireland corporation tax rate is not devolved and reduced to 12.5 per cent.

4.21 As stated above, there is however a degree of uncertainty in predicting future investment increases, and the actual amount of investment could be higher or lower than estimates indicate. The impact of reducing the rate of corporation tax could be greater than the estimates presented above, driven by the following:

- Absorptive capacity of the Northern Ireland economy: how an economy adjusts to an increase in investment is critical in determining the outcome of a reduction in corporation tax. Lower adjustment costs would increase any economic benefits.
- Long-term flexibility: a lower corporation tax rate would help increase the flexibility of the Northern Ireland economy and help it respond more effectively to external shocks (both positive and negative). For instance, we might expect the benefits of improvements in technology to be enhanced or the economy to be more insulated from negative factors that might affect investment.

4.22 The outlook for output, growth and jobs may therefore be more favourable, depending on the ability of the Northern Ireland economy and in particular the local labour market to adjust to an increase in investment resulting from a corporation tax rate reduction. The extent to which the local economy is able to generate job growth to accompany an increase in investment will affect the size of the impact on employment and growth.

[5] Academic literature implies a 'user cost of capital' elasticity estimate of -0.4, meaning a 1 per cent reduction in the user cost might be expected to generate a 0.4 per cent increase in investment.
[6] Empirical literature implies an effective average tax rate elasticity of -5.9 for FDI, meaning a 1 per cent reduction in the tax rate might be expected to generate a 5.9 per cent increase in FDI.
[7] The methodology used to calculate effective average tax rates is based on Devereux and Griffith (1999) and incorporates the tax treatment in the host and home country of the multinational making the FDI, as well as allowing for the fact that the investment may earn economic rents.

Broader economic benefits

4.23 Estimating the broader economic benefits is also uncertain. The growth and employment impacts of increased investment will depend on the type of investment that is undertaken as well as broader economic factors.

Effect on GDP growth

4.24 Higher levels of investment would have a positive impact on private sector growth rates in the short term, leading the Northern Ireland economy to a higher steady state level of GDP in the long term than in the base case where the Northern Ireland corporation tax rate is not devolved. The peak increase in the GDP growth rate would occur in initial years following a substantial increase in investment.

4.25 It is possible that a higher level of investment each year could increase the growth rate of the Northern Ireland economy in the long term. This will depend on the type of investment that occurs. Investment in technology for example could have a more protracted impact on the growth rate.

4.26 More broadly, a differential rate of corporation tax in Northern Ireland could affect the efficiency of resource allocation within the UK, if resources were diverted to less efficient use in Northern Ireland for tax reasons. However it is also the case that a low corporation tax rate in Northern Ireland might lead firms considering a move to the Republic of Ireland or other low tax jurisdictions to remain within the UK.

4.27 Lower public spending following a reduction in the block grant[8] could also dampen the positive growth benefits of increased private sector investment. However the impact of lower public spending on growth will depend on the type of spending that is reduced; reducing Government investment, for example on infrastructure projects, is more likely to have a negative impact on growth.

Effect on employment

4.28 As the economy expands, firms would require more labour to produce greater levels of output. Estimating long term job creation with accuracy is extremely difficult since the exact number of new jobs created is dependent upon a wide range of factors, for example the availability, productivity and skill base of the local labour force, as well as how competitive it is internationally within the global economy. New job numbers would additionally be dependent on the type of FDI that occurs and the sectors in which it occurs, e.g. some sectors, such as manufacturing, are more labour intensive than others, such as high-tech, which are more capital intensive. Lower public spending following a reduction in the block grant could also affect the net impact on employment, though this impact would depend on spending decisions taken by the NIE.

As part of consultation, the Government would welcome views on the extent to which a reduction in the rate of corporation tax in Northern Ireland could support additional investment, higher growth rates and increased employment in the Northern Ireland economy.

[8] See following section - Costs of reducing corporation tax rates in Northern Ireland

Costs of reducing corporation tax rates in Northern Ireland

4.29 Devolving any tax rate varying power must satisfy the European Court of Justice (ECJ) decision on the "Azores Case", which set out the criteria which would need to be met for regional differences in direct taxation not to involve State Aid, and to be compliant with EU law.[9] These conditions are:

- The decision to introduce the regional difference in direct taxation must have been taken by the region which has a political and administrative status separate from that of the central government (*institutional autonomy*)
- The decision must have been adopted without the central government being able directly to intervene as regards its content (*procedural autonomy*)
- The full fiscal consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government (*fiscal autonomy*)

4.30 It is expected that Northern Ireland would meet the Azores criteria of institutional, procedural and fiscal autonomy:

- The NIE already has institutional autonomy as the Northern Ireland Assembly is elected by a separate process to that of the UK Government and has autonomy over a wide range of spending and policy issues.
- The Northern Ireland Assembly would also have procedural autonomy, as the NIE and Assembly would have the power to decide whether to raise or lower the rate of corporation tax. HRMC (the UK wide tax administration) could continue to collect receipts.
- In order to meet the fiscal autonomy condition, the NIE would need to bear the full fiscal consequences of changes in tax revenues resulting from a new Northern Ireland corporation tax rate. This means that Northern Ireland's block grant would be adjusted to reflect the fiscal costs of a reduction in the rate of corporation tax.

Estimating the costs

4.31 The actual fiscal cost to the NIE of reducing the corporation tax rate would depend on further analysis including outturn data on Northern Ireland corporate tax receipts. As such, the estimated costs presented below should be used to inform the discussion, but do not represent definitive final costs to the NIE. If this policy were taken forward, it would be necessary to continue to monitor and update forecasts in order to provide an accurate assessment of likely costs.

4.32 The costs presented below are estimated using established methodology approved by the independent Office for Budgetary Responsibility (OBR). They are based on the OBR's 5 year fiscal forecast where year 1 represents 2011-12, and where year 5 represents 2015-16. The costs are based on the OBR's latest corporation tax forecasts and take account of the reduction in corporation tax rates announced at June Budget 2010 and at this year's Budget. Actual costs would depend on the UK corporation tax rate in force at the time of implementation. Throughout this section, estimates have been made on the basis that Northern Ireland's corporation tax rate would be reduced to 12.5 per cent.

[9] Commission v Portugal C88/03

4.33 The starting point for considering the fiscal impacts of a reduction in corporation tax rates in Northern Ireland is to quantify the amount of existing corporation tax paid in Northern Ireland. HMRC does not collect corporation tax receipts by location of activity and therefore does not currently hold accurate data on the size of the corporate tax base in Northern Ireland. Analysis of the net tax liabilities of companies with a Northern Ireland postcode over a number of financial years provides a proxy for this amount. This analysis does not include branches of UK firms based in Northern Ireland, and as such underestimates the true size of the Northern Ireland corporation tax base. Costs could therefore be higher than presented here.

4.34 The analysis of Northern Ireland postcodes implies that Northern Ireland corporation tax receipts excluding North Sea oil and gas, and also excluding branches, varied between 1.3 per cent and 1.6 per cent of UK corporation tax receipts between 2002-3 and 2007-8, broadly averaging 1.5 per cent. In 2008-9 (the latest available data), the Northern Ireland tax base dipped to 1.1 per cent of UK corporation tax receipts. Given the historic data, on the basis of currently available evidence it is the Government's assessment that 1.5 per cent is the appropriate steady state percentage. However, given the current economic environment it is possible that the Northern Ireland corporate tax base will remain low. As such, while the main costing presented in table 4.A is based on the estimate of a 1.5 per cent Northern Ireland corporation tax base, illustrative costings based on a 1.25 per cent base are also provided in table 4.B below.

4.35 Future Northern Ireland corporation tax receipts are estimated by applying the estimated 1.5 per cent of UK corporation tax receipts to the OBR's forecast of future UK corporation tax receipts. The value of corporation tax receipts in Northern Ireland in 2009-10 is estimated at around £465 million, rising to around £685 million by 2015-16.[10] The difference between these amounts and the amount of tax that would arise from applying a 12.5 per cent rate to the base provides an estimate of the direct tax cost of the proposed cut.

4.36 The above approach gives the results in tables 4.A and 4.B below.[11] The assumptions underlying this costing are subject to the approval of the OBR and are prepared in line with guidance on the UK main rate reduction issued at the June Budget 2010 and Budget 2011.[12]

[10] The OBR forecasts of future corporation tax receipts are based on their growth estimates for the UK as a whole. However, NI is recovering from the recession more slowly than the rest of the UK, and it is possible that growth rates in NI will be slower than the UK average in future years. If this is the case the direct costs of the reduction in corporation tax may potentially be lower than the estimates presented here

[11] The figures here for the main rate and marginal SPR are based on corporation tax return data to 2008-09, calibrated to an estimate of 2010-11 accruals based on latest tax receipts. The figures here for the small profits rate are based on corporation tax data to 2007-08, calibrated to an estimate of 2009-10 profits based on latest tax receipts. These bases are then projected in line with economic determinants from the Budget Fiscal Forecast 2011 provided by the independent Office of Budget Responsibility. The baseline for the main rate includes the phased reduction in the corporation tax main rate to 23 per cent by 2014-15. The baseline for the small profits rate is 20 per cent from 2011-12. The figures are also adjusted to reflect predicted inflation.

[12] The Marginal SPR costs are based on the MR change only. The marginal SPR cost of changing the SPR is including in the SPR costing.

Table 4.A: 1.5 per cent assumption - direct costs to NIE of reduced corporation tax rate

£ million (National Accounts basis)	Year 1 [13]	Year 2	Year 3	Year 4	Year 5
Direct effect:					
a) Main rate	-105	-180	-185	-180	-180
b) Small profits rate (SPR)	0	-45	-65	-70	-75
c) Marginal SPR[14]	0	-10	-15	-15	-15
Total Direct Effects[15]	-110	-235	-265	-265	-270
per cent of NI block grant	1.0	2.3	2.5	2.6	2.6

4.37 Table 4.B below provides illustrative costs, were the Northern Ireland tax base smaller than 1.5 per cent of the UK corporation tax base in future years.

Table 4.B: 1.25 per cent assumption - direct costs NIE of reduced corporation tax rate

£ million (National Accounts basis)	Year 1 [13]	Year 2	Year 3	Year 4	Year 5
Direct effect:					
a) Main rate	-90	-150	-155	-150	-150
b) Small profits rate (SPR)	0	-35	-50	-55	-60
c) Marginal SPR[14]	0	-10	-15	-15	-15
Total Direct Effects[15]	-90	-200	-220	-220	-225
per cent of NI block grant	0.9	1.9	2.1	2.1	2.2

4.38 As well as the direct costs associated with a reduction in corporation tax, there will be a number of behavioural effects. These are more difficult to assess than the direct fiscal costs.

4.39 The behavioural effects discussed below arise because of the difference in corporation tax rates between Northern Ireland and the rest of the world, between Northern Ireland and the rest of the UK and because of the difference between tax paid by employed and self employed individuals and companies. The first two effects are known as profit shifting and the latter as tax motivated incorporation.

- Profit shifting arises where companies artificially manipulate transactions so that their taxable profits arise in low tax jurisdictions, while the activities generating those profits remain in a high tax jurisdiction. The assumptions that are used to estimate profit shifting from the rest of the world into Northern Ireland are based on OBR approved methodology.[16] This effect results in additional corporation tax being paid in Northern Ireland and serves to reduce the direct cost of the rate reduction. A similar methodology, consistent with the Varney Review, is used to

[13] The 2011-12 figures are lower than those for other years due to the initial timing impact of the introduction of new rate on corporation tax receipts. For the majority of companies, the first accounting period in which the new rate applies will also involve liabilities arising in the 2010-11 fiscal year and therefore not covered by the new rate, reducing the proportion of liabilities within that accounting period to which the reduced rate applies. For main rate payers the majority of these reduced liabilities will be paid within the 2011-12 fiscal year, although a proportion will not be paid until 2012-13 as a result of paying through Quarterly Instalment Payments. For other rate payers, who pay nine months after the end of their accounting period, almost all 2011-12 liabilities will be paid in 2012-13.

[14] Resulting from main rate change only.

[15] Totals are rounded to the nearest £5m and individual components may not sum to these.

[16] At Budget the OBR approved an assumption of around 40 per cent for the portion of profits in the tax base that are mobile for the UK economy. An elasticity of 2 has been applied to these profits so that for every 1 percentage point decrease in the corporation tax rate the result is a 2 per cent increase in the size of the mobile profit base.

estimate the effect of profit shifting from the rest of the UK to Northern Ireland. This cost is additional to the direct cost of the reduction in the corporation tax rate, because the overall level of corporation tax paid within the UK is reduced.

- A lower rate of corporation tax would apply to the Northern Ireland profits of all companies, including small and medium sized ones. This would increase the tax differential between incorporated and unincorporated businesses, which would lead to more unincorporated businesses, with activity in Northern Ireland, incorporating to reduce their tax bill. Tax motivated incorporation (TMI) assumptions are as agreed with the OBR at the June Budget 2010. TMI would increase as the corporation tax rate falls and the differential between income tax and corporation tax rates increases. An increase in TMI results in higher corporation tax receipts although this will be more than offset by falls in income tax and NICs receipts and therefore result in a cost additional to the direct cost.

4.40 It is likely these effects would need to be factored in to the block grant adjustment.

Table 4.C: 1.5 per cent assumption - behavioural response

£ million	Year 1	Year 2	Year 3	Year 4	Year 5
Behavioural Response:					
a) Profit shifting from the rest of the world to NI	20	35	40	35	35
b) Profit shifting from GB to NI	-40	-75	-75	-70	-70
c) Tax Motivated Incorporation	-10	-25	-35	-45	-50
Total behavioural effect	-30	-65	-70	-80	-85

4.41 Table 4.D below provides illustrative behavioural costs, were the Northern Ireland tax base smaller than 1.5 per cent of the UK corporation tax base in future years.

Table 4.D: 1.25 per cent assumptions - behavioural response

£ million	Year 1	Year 2	Year 3	Year 4	Year 5
Behavioural Response:					
a) Profit shifting from the rest of the world to NI	15	30	30	30	30
b) Profit shifting from GB to NI	-35	-60	-65	-60	-55
c) Tax Motivated Incorporation	-10	-25	-35	-45	-50
Total behavioural effect	-30	-55	-70	-75	-75

4.42 The direct costs and profit shifting effects presented in this section are roughly scalable to the size of the Northern Ireland corporation tax base – i.e. if this were 10 per cent smaller or larger the costs would fall or rise by around 10 per cent. TMI numbers are modelled separately on the basis of the number of new incorporations within Northern Ireland and therefore are not dependent on the size of the Northern Ireland corporation tax base.

As part of consultation, the Government would welcome views on the estimated costs arising from a lower corporation tax rate in Northern Ireland.

Estimating dynamic impacts on tax receipts

4.43 These growth effects may not be fully realised over the forecast period, but an initial estimate, consistent with the analysis in this paper on the estimated investment benefits of a reduction in corporation tax, is that this would raise an extra £10-20 million a year in additional corporation tax revenue over the forecast period. This would be likely to continue, and possibly increase marginally, in the long run.

4.44 If corporate income increased this should in turn lead to higher consumption, which might be expected to increase revenue from VAT and excise duties. National insurance contributions and income tax revenue may also increase as greater corporate earnings were distributed to labour via higher wages and employment. These taxes are not devolved and would accrue to the UK Exchequer. However, indirect tax effects could be considered carefully when calculating the adjustment to the block grant as long as doing so complied with the Azores criteria and the UK fiscal framework. An initial estimate is that the effect of the dynamic responses of other tax revenue may yield £35 million to £55 million a year.

4.45 In total, the estimates suggest that additional revenue from other taxes could recover **15-21 per cent of the foregone corporation tax receipts** in each year of the forecast period.

Table 4.E: Estimates of second-round tax effects

£ million[17]	Year 1	Year 2	Year 3	Year 4	Year 5
Second-round corporation tax effect	10	10	20	20	20
Second-round effects on other tax receipts	20	40	50	50	50

As part of consultation, the Government would welcome views on the dynamic impacts on tax receipts arising from a lower corporation tax rate in Northern Ireland.

Uncertainty and risk

4.46 These costings represent the Government's estimate of the cost to Northern Ireland of the corporation tax cut. However, as with any estimate, there is a degree of uncertainty. Should the tax cut result in more investment than estimated here, then the extra corporation tax associated with this increase would be passed on to the NIE. Conversely, if the tax cut failed to attract as much investment, the NIE would need to make up the difference. Similarly, the risk associated with profit shifting from the rest of the UK would lie with the NIE.

4.47 Since company profits tend to fluctuate over the economic cycle, corporation tax revenues also fluctuate by a significant margin. For instance UK corporation tax revenues fell from £38 billion in 2006-07 to only £31 billion in 2009-10. Such fluctuation would be expected to continue if responsibility for the tax was transferred to the Northern Ireland Assembly. The risks that accompany such fluctuations are heightened in a region such as Northern Ireland with its relatively small corporate base.

4.48 Furthermore, by potentially increasing the proportion of receipts in Northern Ireland from large companies, a reduction in the corporation tax rate is likely to increase the volatility of Northern Ireland corporation tax receipts. Where a significant share of corporation tax receipts derive from a small number of companies, this would increase the fiscal impact on the NIE if these companies were to experience a significant downturn in profitability or, given the UK's relief rules, had significant losses to set against profits.

[17] Due to the inherent uncertainty in these numbers they are rounded to the nearest £10m.

As part of consultation, the Government would welcome views on the risks to the Northern Ireland Executive arising from a devolved corporation tax rate in Northern Ireland.

Implementation Issues

4.49 This section outlines a number of issues that the Government would need to address for a separate corporation tax rate in Northern Ireland to be successfully introduced.

Costs of administration

4.50 At this stage it is not possible to assess exactly what the HMRC costs of administering any devolved Northern Ireland tax would be.

4.51 While HMRC does not breakdown administration costs on a regional basis, for illustrative purposes, corporation tax cost £340 million to administer across the UK in 2008-9, with just under 70 per cent of that cost relating to compliance activity. Northern Ireland would not be expected to bear the proportion of that amount that relates to administering the current system in the province, but would have to bear the extra costs above and beyond that relating to a new regime.

4.52 Those extra costs would arise under three main headings:

- Start-up costs – e.g. changes to HMRC IT and operational systems and online filing services to enable a new regime to commence
- Ongoing costs – costs arising from maintaining new systems and procedures (both IT and operational) to administer a new regime
- Additional anti-avoidance compliance resource – ensuring that only "genuine" economic activity within Northern Ireland benefitted from any new regime

Other implementation issues

4.53 Defining the scope of a separate rate would require a decision on both the forms of activity that should benefit and the level of connection with Northern Ireland that such activities should have in order to benefit.

4.54 The best way of quantifying Northern Ireland profits and losses in a company with activities across the UK would be to allocate profits and losses between Northern Ireland and the rest of the UK, as is currently done for foreign branches of UK companies. This approach would require companies to separately apportion income and expenditure between activity in Northern Ireland and activity in the rest of the UK (and also between types of activity if a reduced rate were limited to trading profits).

4.55 Reducing the rate of corporation tax in Northern Ireland should encourage businesses to shift existing economic activity and move their investment to Northern Ireland, with the result that greater profits would actually be realised there. The Government would need to consider appropriate and proportionate revenue protection safeguards such as transfer pricing to prevent businesses from artificially attributing a greater share of their taxable profits to Northern Ireland.

4.56 The Government is committed to achieving simplicity in the tax system. It will only provide a separate rate of corporation tax in Northern Ireland if additional compliance burdens can be shown to be manageable and justified by overall economic benefits to most of the companies affected.

4.57 Businesses benefiting from a lower rate or a separate regime in Northern Ireland and with operations in both Northern Ireland and the mainland could face increased administrative burdens. These burdens could arise in relation to the rules defining what profits would be subject to the preferential rate, by reference to their location and perhaps their nature, and ensuring that profits were not artificially shifted.

4.58 Depending on what the NIE decided on the operation of the regime, additional administration costs associated with the operation of the regime would need to be met by the NIE. There is currently an exemption from transfer pricing rules for small and medium-sized enterprises within the UK. To protect Exchequer revenue from avoidance following the introduction of a differential corporation tax rate within the UK, the Government might need to consider removing this exemption.

4.59 Initial estimates suggest that additional administrative burdens on businesses might be up to £50 million a year or more, although exact figures are uncertain and will depend on the policy design. Sufficiently profitable firms in Northern Ireland stand to gain more than this from lower corporation tax rates and would be net beneficiaries. Some companies of course may not be sufficiently profitable to offset the additional cost of compliance.

As part of consultation, the Government would welcome views on potential compliance costs and administrative burdens for business arising from a devolved corporation tax rate in Northern Ireland

Block grant adjustment

4.60 If decisions on varying corporation tax rates were devolved to the NIE, the NIE would adjust its spending to reflect the changes in corporation tax receipts arising from its decisions. If the NIE had rate varying powers, NIE's spending would increase or decrease to reflect the fiscal consequences of the variable rate. There would need to be a reconciliation between planned and outturn receipts.

4.61 There are a range of possible devolved tax scenarios including:

- A tax varying power up or down by 11 per cent from the 23 per cent UK rate (somewhat similar to the Scottish Variable Rate of income tax in Scotland)
- Setting the UK rate in Northern Ireland at 12.5 per cent and allowing NIE to vary the rate upwards
- Setting the UK rate in Northern Ireland at zero and allowing the NIE to vary the rate upwards

4.62 The details of the block grant adjustment would need further discussion with NIE in the light of the policy design of the devolved tax system, but in outline the main principles would be:

- NIE would bear the fiscal consequences of devolution including upside and downside risks if tax receipts were more or less than forecast. Given the volatility of corporation tax in a relatively small private sector base like Northern Ireland this may be a significant risk
- NIE and the Government would need to develop and agree both an Northern Ireland corporation tax forecasting and outturn tax receipts identifying capacity, liaising with the OBR as appropriate
- Appropriate adjustments would need to be considered to ensure that Northern Ireland met the full fiscal costs of this measure including profit shifting and TMI which would decrease overall UK receipts. In addition, careful consideration would need to be given to any dynamic effects on other tax receipts when determining the adjustment to the block grant, subject to complying with the Azores criteria and the UK fiscal framework

- There would need to be a reconciliation between forecast and outturn receipts. This could potentially be quite complex given the gap between corporation tax rate setting and capture of corporation tax receipts data.[18]

4.63 As in the case of the Calman proposals in Scotland it may be prudent to have an initial transitional phase in order to test the new system in which the UK Government bears the risk of differences between plan and outturn.

4.64 If the Government made changes to the UK tax system which affected the size of the Northern Ireland tax base, or changed the UK corporation tax rate, this would affect the adjustment to Northern Ireland's block grant.

4.65 If the whole tax base were devolved, the tax would become like the Northern Ireland regional rate[19] where the NIE spends the taxes it raises. There would need to be an initial downward reduction in the block grant to reflect the existing level of tax receipts transferred to NIE, which might be subject to subsequent review. As with rate varying powers, there would need to be an adjustment for profit shifting and TMI.

As part of consultation, the Government would welcome views on the approach that would be taken to adjust the block grant arising from a devolved corporation tax rate in Northern Ireland.

[18] Corporation tax rate is normally set a year in advance to assist companies within the Quarterly Instalment Payment regime but companies have until a year after the end of their business year to submit a corporation tax return

[19] The Northern Ireland regional rate is the Northern Ireland equivalent to council tax and business rates.

Summary of benefits and costs

4.66 The estimated costs and benefits presented in this section provide an illustration of the potential outcome of a lower corporation tax rate in Northern Ireland. The broad costs and benefits of a reduction in corporation tax rates in the Northern Ireland economy are summarised in table 4.F.

Table 4.F: Outline of benefits and costs of reduced corporation tax in Northern Ireland

Benefits	Costs
• Additional investment by new foreign owned firms • Additional internal investment by existing firms • Increased economic growth and a stronger private sector to help contribute to the rebalancing of the Northern Ireland economy • Potential long term employment benefits as a result of stronger private sector • Positive indirect impact on tax receipts as a result of growth • Potential downward pressure on long term unemployment and welfare costs as a result of stronger private sector	• Fiscal cost borne by NIE as a result of lower corporate tax receipts and associated impact on Northern Ireland economy of lower public spending • UK exchequer risk from artificial profit shifting to benefit from a lower corporation tax rate in Northern Ireland • Increased NIE budget volatility due to dependence on potentially volatile corporate tax receipts • Additional administrative and collection costs borne by NIE • Administrative burden for businesses operating in both Northern Ireland and the rest of the UK

As part of consultation, the Government would welcome views on the balance of potential costs and benefits of a reduced corporation tax rate in Northern Ireland.

Alternative mechanisms for reducing the rate of corporation tax in Northern Ireland

4.67 The previous section considers the possible effects of a straight reduction in the rates of corporation tax in Northern Ireland to 12.5 per cent. This analysis suggests that there may be issues of affordability in respect of this option. This section considers alternative models, with the intention of identifying whether there are options which could reduce or defer the cost to the NIE without significantly affecting the benefits to the Northern Ireland economy. In this context, there are a number of options to reduce the upfront cost, which are considered in detail below:

- Deferral of the reduction
- Phased approach
- Exclude non-trading profits

4.68 The Government would welcome views on whether any of these suggested approaches could achieve this.

Deferral of the reduction

4.69 It would be possible for the NIE to announce its intention to reduce rates in Northern Ireland some years in advance, say 2-3 years. This could be applied to a one-off reduction to 12.5 per cent or to the alternative options discussed below. Assuming the rate cut was of the same magnitude, the long-term steady state costs and benefits would not differ from the assessment given in the preceding section.

4.70 However, if businesses acted upon the announced rate cut in advance of its implementation, then the Northern Ireland economy could start to benefit from additional investment made in anticipation of the rate reduction before it had to meet the cost to corporation tax receipts. The strength of this reaction would depend on how far business viewed the deferred reduction as a certain commitment on which it could base investment decisions. This could also mean there was a behavioural response and cost from additional TMIs made in response to an announced but not yet implemented reduction. Additionally, a deferred reduction could also allow more time to adjust to the necessary public spending reductions.

4.71 There are also likely to be practical considerations which may mean that an element of deferral would be required (for example the need for further evidence gathering to support the block grant adjustment mechanism or the time taken to procure the necessary IT systems to support a separate Northern Ireland corporation tax system).

> As part of consultation, the Government would welcome views on the merits of a deferred implementation of a rate reduction in Northern Ireland and its potential impact on investment decisions

Phased approach

4.72 An alternative to a straight rate cut, which would help manage the initial costs and impact on the block grant, would be to commit to a phased reduction over a number of years. The cuts to the main corporation tax rate announced last year take this approach, with a phased reduction over four years to bring the rate down to 23 per cent by 2014-15.

4.73 A phased reduction could align the cost of the reduction more closely with the level of additional activity, as investment decisions will not all be made as soon as a rate reduction is announced and the benefits in terms of additional receipts are likely to grow over time. By more closely targeting the reduction on new activity, a phased approach could potentially offer better value for money. In addition, it would allow the NIE more time to adjust to the associated public spending reductions.

4.74 The longer term receipt implications and adjustment needed to the block grant would be the same as those for a straight rate cut of the same magnitude. However, over the short term the impact could be significantly less. For example, on average over the first 5 years of implementation, each 2.5 percentage point decrease in the main corporation tax rate in Northern Ireland would be likely to have a cost (including behavioural impacts) around £30m - £50m and a cost for each 2.5 per cent reduction in the SPR (including behavioural impacts) around £30m - £40m. Equally, the economic benefits would likely be realised over a longer timescale, though this approach could allow the private sector to grow more before the full impact of public spending cuts were felt, and as such could reduce the net impact on employment in the early years. A phased reduction could thus provide a better long term value for money alternative to the Northern Ireland economy.

4.75 An illustrative example is given below. This example supposes that the main rate of corporation tax in Northern Ireland were reduced by 2.5 per cent a year over six years and that the small profits rate was also reduced alongside the main rate once it falls below 20 per cent, so that by the end of this period, all profits in Northern Ireland were subject to a 12.5 per cent rate.

4.76 In this scenario, the behavioural effects would be realised on a slower timetable. For example modelling suggests that there will be an additional 1,000 TMIs in each year from year 2 up to year 4 in Northern Ireland increasing to an additional 3,000 TMIs in year 6 as the tax incentives increase.

Table 4.G: Estimated fiscal impact of a phased reduction in Northern Ireland corporation tax[20]

£ million	Year 1	Year 2	Year 3	Year 4	Year 5
All direct effects	-10	-30	-55	-85	-150
Behavioural effects from profit shifting and TMI	neg	-10	-15	-20	-40
Total[21]	-10	-35	-70	-110	-185

4.77 In this scenario the direct and behavioural costs in year 4 would be substantially lower than those of an immediate reduction in the rate to 12.5 per cent. However at this stage there would be no direct effect from a reduction in the SPR. The SPR reductions would begin in line with the continued reductions in the main rate from year 4, however due to the lag in receipt collection[22],

[20] Modelling based on OBR's corporation tax forecast beginning in 2011-12. Figures should be treated as an indicative assessment only and have not been approved by the OBR.

[21] Totals are rounded to the nearest £5m and individual components may not sum to these.

[22] See footnote 13

the cost of reductions to the SPR would not be reflected until year 5, at which point costs would increase more quickly. Under this scenario it is important to recognise that the costs would be the same as in a straight reduction once both rates had been reduced to 12.5 per cent.

As part of consultation, the Government would welcome views on the extent to which a phased reduction in the rate of corporation tax in Northern Ireland could support a rebalancing of the economy while allowing the costs of the reduction to be more effectively managed.

Exclude non-trading profits

4.78 The 12.5 per cent rate in the Republic of Ireland is applied to trading profits only (non-trading profits are taxed at 25 per cent). It has been suggested that by applying a lower rate solely to trading profits in Northern Ireland, the direct fiscal costs of this measure could be reduced. Profits from non-trading income (e.g. property rental, chargeable gains or interest) would continue to be taxed at the main UK rate.

4.79 The impact of such a restricted lower rate on receipts is difficult to predict as it would depend on how companies chose to distribute their losses across the UK and between trading and non-trading income in response. Rules would need to be introduced to prevent or restrict losses being transferred between trading and non-trading income. However, even allowing for this there would be considerable scope for companies to limit the amount of losses that they claimed against Northern Ireland trading profits and offset them against profits arising elsewhere.

4.80 Recent data suggests that around 25 per cent of corporation tax receipts are from non-trading income. However because of the behavioural response outlined above, it is likely that the proportion of trading profits in Northern Ireland would increase. This means that the overall reduction in costs in reality is likely to be less than 25 per cent. This implies the potential impact on costs of such a measure would be a reduction of up to £85 million. Such a distinction would also add significantly to compliance costs, both for business and for the tax collection authorities and could restrict the benefit to groups in particular industries.

As part of consultation, the Government would welcome views on the impact that restricting any reduction in corporation tax receipts to trading income only would have on the aim of rebalancing the Northern Ireland economy and the value for money of a corporation tax reduction.

Other options for reducing the costs

4.81 Costs would also be lower if the main rate were reduced to a rate greater than 12.5 per cent. However this could have a smaller impact on investment and growth than a reduction to 12.5 per cent.

4.82 Partially funding the reduction through changes to the available reliefs and allowances could mean businesses being denied relief on legitimate and desirable expenditure. For example, current capital allowances rates broadly reflect rates of economic depreciation and substantial reductions could disincentivise economically valuable investment. Further changes are also likely to require greater levels of devolution.

As part of consultation, the Government would welcome views on whether there are other options to offset the cost to the NIE of a reduction in the rate of corporation tax that would be consistent with the overall aim of rebalancing the Northern Ireland economy.

Box 4.A: Managing the of costs of a reduction in Northern Ireland corporation tax rates

The cost to the NIE budget of a one off immediate reduction in the Northern Ireland corporation tax rate from 23 per cent to 12.5 per cent could be significant. However in practice there would be a number of options for managing costs including:

Option	Impact
Deferral	NIE could announce an intention to reduce the rate without doing so immediately, with no immediate cost
Phasing	Would reduce costs in early years and give Northern Ireland more time to adjust to the necessary budgetary changes - each 2.5 percentage point reduction in the main rate would cost around £30–50 million and around £30-40 million for the small profits rate
Exclude non-trading profit	This could reduce the overall costs of this measure by up to £85m
Reduce corporation tax rates by smaller amount	Would reduce costs - each 2.5 percentage point reduction in the main rate would cost around £30–50 million and around £30-40 million for the small profits rate

A combination of some of the above approaches could be adopted to reduce costs further. If the Government decided to devolve corporation tax rate setting powers to NIE, it would be for the NIE to decide its rate setting policy and how to manage the cost within the NIE budget.

Other tax options

4.83 In addition to reducing the main rate of corporation tax, other tax policies may support rebalancing of the Northern Ireland economy.

4.84 It is likely that most of the policy options below would create new State aids, and as such would have to be explored with the EU Commission. More generally, any measure that moves Northern Ireland away from the UK tax system increases complexity and administrative burdens for both the NIE in implementing the policy and for businesses complying with a new regime, particularly those operating across Northern Ireland and the rest of the UK.

4.85 Some of the options below would only be possible if further powers were devolved to Northern Ireland beyond those directly relating to corporation tax discussed above. The Government would need to consider this further and the discussion below does not signify that a decision has been reached on the possibility of such powers being devolved.

R&D tax credits

4.86 Research and Development (R&D) activity can play an important role in driving productivity across an economy and evidence suggests that firms in Northern Ireland undertake comparatively less R&D than counterparts across the UK[23].

4.87 The UK currently has a scheme of R&D tax credits to support R&D by UK companies. R&D tax credits play a valuable role in supporting innovation and productivity in the UK. It has been suggested that separate R&D tax credits specifically targeted at Northern Ireland could lead to greater investment in R&D in Northern Ireland. Enhanced R&D tax credits could incentivise additional investment in R&D activity by Northern Ireland companies. This could have a positive impact on productivity in the private sector, and as such could contribute to the rebalancing of the Northern Ireland economy.

4.88 The Varney Review considered enhanced tax reliefs for Northern Ireland and noted that there would be significant difficulties in terms of State aid, complexity and distortion of the tax credits' basic market failure premise. While some of the State aid issues could be resolved through a devolution of responsibility akin to that discussed in relation to corporation tax above, there would remain significant State aid issues which would need to be resolved. A further issue to consider would be the additional compliance burdens involved, for example, where companies were undertaking R&D activity on more than one site or subcontracting R&D work into or out of Northern Ireland.

4.89 The Government has recently undertaken a consultation on the existing UK R&D tax credits schemes to ensure they are effective in supporting R&D investment by companies undertaking genuinely innovative activity. Recognising the need to further incentivise R&D investment by SME companies, Budget 2011 announced that the Government will increase the SME scheme rate of relief from 175% to 200% from 1 April 2011, and then increase the rate to 225% from 1 April 2012, subject to State aid approval. This will benefit innovative companies across the UK, including in Northern Ireland. The Government will publish a full response to the consultation in May.

[23] For example, notwithstanding a welcome improvement in performance in 2009, over the past five years business expenditure on R&D in NI has averaged 0.69% of GVA compared to 1.23% for the UK as a whole. Figures derived from: *NI Research and Development Statistics 2009*, DETI; *UK Business Enterprise Research and Development 2009*, Office for National Statistics; and *Regional, Sub-Regional and Local Gross Value Added 2009*, Office for National Statistics

Enhanced Annual Investment Allowance (AIA)

4.90 Reliefs for capital expenditure play an important role in ensuring the tax system provides the appropriate incentives for capital investment. Such incentives can be particularly important to capital intensive industries such as manufacturing – a sector of particular importance to Northern Ireland. Compared to the UK, the manufacturing sector is a larger contributor to output, is one of its higher productivity sectors and is also an important contributor to the region's exports and R&D performance.

4.91 June Budget 2010 announced a reduction in the rate of writing-down allowance on the general pool of plant and machinery, from 20 per cent to 18 per cent and reduction in the rate of writing-down allowance on the special rate pool of plant and machinery, from 10 per cent to 8 per cent. It also announced a reduction in the AIA to £25,000. It has been suggested that in Northern Ireland these reductions could be reversed or that capital allowances could be enhanced beyond the previous level.

4.92 Additional capital allowances in Northern Ireland could encourage greater levels of business investment. However, more than 95 per cent of businesses already have all of their qualifying expenditure relieved in full by the AIA and, even after the reductions announced in the June Budget 2010 are implemented, the rates of allowances remain broadly in line with economic depreciation for plant and machinery assets.

4.93 Budget 2011 announced that the Government will work with Local Enterprise Partnerships to consider the scope for introducing enhanced capital allowances in the newly announced Enterprise Zones, to support zones in assisted areas where there is a strong focus on high value manufacturing. However, enhanced capital allowances for the whole of Northern Ireland would raise significant State aid issues as not all of Northern Ireland is classified as an assisted area. The scheme would need to be notified to the EU Commission for approval.

Training credits

4.94 Training and the acquisition of skills are important drivers of growth and productivity. The skills profile of the Northern Ireland working age population, while improving, continues to lag behind other countries of the UK. There are fewer who hold higher level qualifications and more with no or low level qualifications. Those that are in work report that they are less likely to have experienced recent work based learning than elsewhere in the UK[24]. The need to increase the skills of the Northern Ireland workforce is reflected in the draft NI Skills Strategy, Success through Skills 2, which was consulted on recently.

4.95 It has been argued that Government has a role to play in encouraging businesses to invest more in training. Some other EU states, including France, Belgium and Malta, allow firms to enhance expenditure on training that is offset against profits for tax purposes in the form of training tax credits. A training tax credit could incentivise additional investment in training activity in Northern Ireland. Increasing the Northern Ireland skills base could have a positive impact on growth and could also encourage FDI in Northern Ireland.

4.96 However, it is not clear that tax credits would be the most effective measure to achieve an increased level of investment in training. Providing support via a tax credit would result in deadweight costs and increased tax complexity of compliance. There would also be a significant timing issue, with a delay between paying for the training and receiving the credit. As a result, a tax mechanism may not be as effective as a direct grant mechanism, which could deliver the

[24] 8.8% of all Northern Ireland employees aged 16-64 received training in the last 4 weeks, compared to the UK average of 14.3% of employees (Source: LFS, Oct-Dec 2010)

subsidy to any firm in a simpler, faster and more targeted way. Grant mechanisms would be devolved.

4.97 Training tax credits would have State aid implications and would need approval from the EU Commission.

National Insurance Holiday

4.98 The Government also announced a temporary regional employer National Insurance Contributions (NICs) holiday for new businesses in the June Budget 2010 to last for three years. The holiday applies to eligible businesses set up in target regions and countries, including Northern Ireland, where there is the greatest dependence on public sector employment. By reducing the costs of employing staff the holiday helps new businesses in these areas to create jobs. It might be possible in principle to consider an enhanced or additional scheme in Northern Ireland. However, such proposals raise a range of questions. Any significant extension risks distorting competition and breaking the State aid thresholds under which the existing scheme operates. The precedents established and impact on complexity would need to be considered carefully. The costs involved, and the mechanisms through which these would be financed, would also need to be taken into account.

4.99 Bearing in mind these factors and the uncertainties around impacts, including administrative costs, in the Northern Ireland context, it may be more prudent to assess the effectiveness of the NICs holiday measures which were announced in the June Budget 2010 before considering whether a more generous scheme would be appropriate for Northern Ireland.

As part of consultation, the Government would welcome views on extent to which changes to R&D tax credits, annual investment allowance, training credits or a national insurance holiday could provide feasible, effective, affordable and value for money support for the rebalancing of the Northern Ireland economy.

Questions

The Government would welcome views, in the context of this report, on devolving corporation tax rate varying powers to Northern Ireland.

In particular, the Government would welcome views on the following:

- The importance of the headline corporation tax rate in encouraging investment;
- The extent to which a reduction in the rate of corporation tax in Northern Ireland could support additional investment, higher growth rates and increased employment in the Northern Ireland economy;
- The estimated costs arising from a lower corporation tax rate in Northern Ireland;
- The dynamic impacts on tax receipts arising from a lower corporation tax rate in Northern Ireland;
- The risks to the Northern Ireland Executive arising from a devolved corporation tax rate in Northern Ireland;
- Potential compliance costs and administrative burdens for business arising from a devolved corporation tax rate in Northern Ireland;
- The approach that would be taken to adjust the block grant arising from a devolved corporation tax rate in Northern Ireland;
- The balance of potential costs and benefits of a reduced corporation tax rate in Northern Ireland;
- The merits of a deferred implementation of a rate reduction in Northern Ireland and its potential impact on investment decisions;
- The extent to which a phased reduction in the rate of corporation tax in Northern Ireland could support a rebalancing of the economy while allowing the costs of the reduction to be more effectively managed;
- The impact that restricting any reduction in corporation tax receipts to trading income only would have on the aim of rebalancing the Northern Ireland economy and the value for money of a corporation tax reduction;
- Whether there are other options to offset the cost to the NIE of a reduction in the rate of corporation tax that would be consistent with the overall aim of rebalancing the Northern Ireland economy; and
- The extent to which changes to R&D tax credits, annual investment allowances, training credits or a national insurance holiday could provide feasible, effective, affordable and value for money support for the rebalancing of the Northern Ireland economy.

5 Northern Ireland reforms to strengthen the private sector

5.1 The previous chapter set out a number of tax incentives that could potentially be used to promote enterprise in Northern Ireland. However, many of the non-tax levers that could be used are devolved to the NIE.

5.2 This chapter briefly outlines the approach and scope being taken for non-tax reforms which are aimed at rebalancing the Northern Ireland economy including:

- The report on Northern Ireland's competitiveness by Sir David Varney;
- The Independent Review of Economic Policy, commissioned by the Minister for Enterprise, Trade and Investment, and which reported in September 2009;
- Progress with developing the NIE's economic strategy;
- Lessons from the UK Government's review of regional economic strategy; and
- Support from outside Northern Ireland, including from the Irish Government, the EU and the US.

Varney Report

5.3 In April 2008, Sir David Varney published his report '*Review of the Competitiveness of Northern Ireland*'. The terms of reference were to explore how to expand the private sector and to enhance Northern Ireland's competitiveness.

5.4 The previous government accepted the recommendations of the Varney report on competitiveness, many of which remain relevant to the task of expanding the private sector.

5.5 The Varney Report provided an assessment of policies to increase Northern Ireland's competitiveness in the global economy including by:

- promoting innovation, investment, enterprise, competition and skills e.g. including through improving basic skills; identifying the business sectors in which it can be demonstrated that Northern Ireland has an internationally competitive offer; and considering whether more should be done to support clusters based on world-class expertise and support for university excellence
- labour market reforms including welfare reform; and looking at how the NIE could use the public sector pay process to reduce the public-private sector pay differential over time, so that public sector pay reflects better the local labour market
- public sector reforms including disposal of assets to the private sector and greater use of the private sector in delivering public services . These might include further asset disposals where there is no clear economic or social case for retaining them, in order to deliver more efficient services as well as releasing extra funds for investment; and how public services might be more efficiently delivered through different types of delivery model, including the potential for greater contestability

- whether some services, currently delivered by the public sector, could be more productive if they were in the private sector.

5.6 However, it is important to note that the NIE has not agreed the recommendations from the Varney Review, while the change in economic circumstances over the past three years, including the significant decline in the Northern Ireland property market, means that some of the recommendations may no longer be appropriate.

Independent Review of Economic Policy (IREP)

5.7 The IREP panel, headed by Professor Richard Barnett, was commissioned by the Minister for Enterprise, Trade and Investment to assess whether the Department of Enterprise Trade and Investment (DETI) and Invest Northern Ireland's policies and programmes were sufficient to help deliver the productivity goal contained in the NIE's Programme for Government[1].

5.8 The report also considered other factors which may hamper the ability of Northern Ireland to strengthen private sector productivity over the medium to longer term. In particular, issues such as the planning system, infrastructure and skills were considered as part of the IREP report.

5.9 Since the publication of IREP there has been significant progress in many areas, not least with regard to the planning system in Northern Ireland. For example, recent changes has resulted in a significant increase in the speed and predictability of decision making.

5.10 For example, employing pre-application discussions with developers has resulted in 90 strategic applications being processed to approval, resulting in excess of £2 billion investment. Since April 2009, 34 economically significant applications have been processed, the majority within 6 months. The introduction of streamlined council consultation has also been successful in speeding up the processing of non-contentious applications. The impact of these measures means that 60 per cent of all applications are now being processed and approved, on average, in just 40 days.

5.11 Recently legislation to transfer the majority of planning powers from the Department of the Environment to district councils was passed in the Northern Ireland Assembly. This will make the planning system more democratic, and the legislation also provides for streamlining the process with faster decision making.

5.12 IREP also made clear that efforts to raise living standards and productivity in Northern Ireland cannot lie solely at the door of DETI / Invest NI, or the NIE as a whole. The NIE believes that it is ultimately the responsibility of companies in the private sector to invest in areas such as skills, exports, R&D, and innovation, to boost competitiveness.

5.13 There are four main areas under which the IREP recommendations are being progressed:

- Improving the co-ordination of economic policy in Northern Ireland, with DETI, the Department of Education and Learning (DEL) and Invest NI working together to ensure that demand and supply of skills are aligned to the needs of business;
- Strengthening DETI and Invest NI assistance to industry, particularly in terms of supporting greater investment in Innovation and R&D;
- Increasing the autonomy, flexibility and decision-making powers of Invest NI, alongside the need to simplify its support to the private sector; and
- Establishing an Executive sub-committee on the economy (chaired by the Minister for Enterprise, Trade and Investment but comprising Ministers from other

[1] The goal aims to halve the private sector productivity gap with the UK average (excluding the Greater South East) by 2015

departments with an important role in economic development) to build on the findings of IREP and to produce an economic strategy and implementation plan (see below).

5.14 The Minister for Enterprise Trade and Investment made a statement on IREP (21 March 2011) to the Northern Ireland Assembly, which outlined the progress made to date. Many of the main IREP recommendations have now been implemented and the strategic policy direction set out by the Panel has influenced the thinking of the Executive sub-committee on the economy, particularly as it has been developing a new Economic Strategy for Northern Ireland (see below).

Northern Ireland Executive Economic Strategy

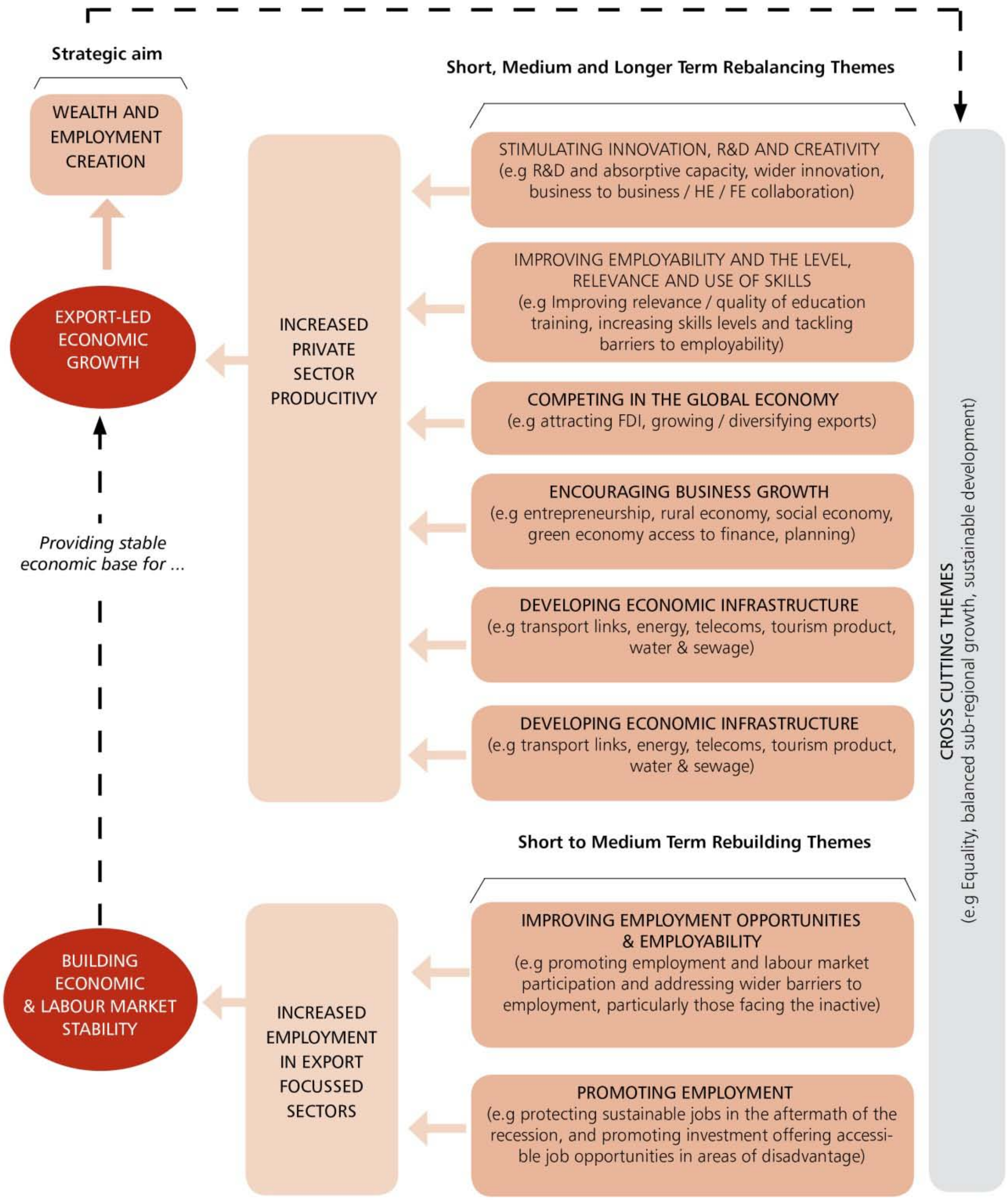
5.15 Earlier this year, the Minister for Enterprise, Trade and Investment launched (on behalf of the NIE sub-committee on the economy) an initial consultation document on a proposed framework for economic growth[2]. The framework (outlined below) emphasises the importance of developing and diversifying the export base in Northern Ireland as a means of promoting growth.

5.16 The consultation document proposes the twin goals of rebuilding the economy in the aftermath of the recession (recognising the very significant impact of the downturn on the local labour market) and also rebalancing over the medium to longer term.

5.17 The sub-priorities to rebuild the economy include the need to increase employment levels and also strengthen employability by working to remove any barriers to employment. The rebalancing themes include the importance of promoting innovation and R&D, alongside the complementary issues of enabling the economy to compete more effectively in world markets, skills development, business growth and strengthening the economic infrastructure.

[2] The consultation document can be accessed at http://www.nidirect.gov.uk/northern_ireland_economic_strategy_-_initial_consultation_paper__priorities_for_sustainable_growth_and_prosperity.pdf

Chart 5.A: Draft Strategic Framework for NIE Economic Strategy



5.18 The consultation document on the priorities for economic growth recognises that progress that has been made to date on these priorities. For example, it highlights the significant growth in spend on innovation and R&D by the NIE (up by over 80 per cent since 2007-08 although it still comprises a relatively small proportion of total spend on the economy). This reflects the importance attached to innovation as part of the Executive's Programme for Government, which has the economy as its top priority. Publication of the economic strategy is scheduled for later in 2011.

The UK Government's sub national growth strategy

5.19 The Government published a Sub-national Growth White Paper on 28 October 2010, which sets out its approach to building a new, fairer and more prosperous economy. Although this mainly applies to England, the principles are relevant to Northern Ireland and certain policy proposals may also be transferable.

5.20 Previous approaches to sub-national development have been based on a centrally driven target, which sought to narrow the growth rates between different regions. Not only did this approach lead to policies, which worked against the market, it was also based on English regions, an artificial representation of functional economies. This therefore missed the opportunities that come from designing policies around functional economical areas, particularly areas of high growth such as cities, and ensuring these are based on the knowledge and expertise of the private sector and local communities.

5.21 The paper sets out the Government's new approach to sub-national growth which focuses on three central themes:

- Shifting power to local communities and businesses – those who understand their economies best should lead their development and enable all places to fulfil their potential;
- Increasing confidence to invest - create the right conditions for growth through Government allowing market forces to determine where growth takes place and provide incentives, which ensure that local communities benefit from development;
- Focused intervention – tackling barriers to growth that the market will not address itself, supporting investment that will have a long term impact on growth and supporting areas with long term growth challenges manage their transition to what is appropriate for the local area. Government policies should work with the market, not seek to artificially create growth.

5.22 The UK already has a dynamic, skilled and flexible labour market. Building on these strengths and further increasing mobility will be central to ensuring that everyone can benefit from employment opportunities.

5.23 The White Paper lists a number of policy proposals which mainly apply to England although the Northern Ireland Executive may wish to examine them and see which could apply to Northern Ireland.

5.24 An important aim is to promote economic development activity including through the introduction of Local Enterprise Partnerships (LEPS). LEPs are aimed at tackling local labour market issues and strategic market failures, co-ordination failures on issues such as transport, planning and housing.

5.25 Another aim is to increase confidence to invest which can be done through planning reform and local authority incentives. The importance of the planning system is to encourage growth by co-ordinating infrastructure investment and development and providing certainty to developers and investors involving communities and neighbourhoods in decision-making. Introducing local authority incentives ensures that the local authorities and neighbourhoods see the benefits of economic growth. Although planning is a devolved matter a more efficient and effective planning system can better balance competing economic, social and environmental priorities by creating a place where communities, business and infrastructure providers can come together to make the decisions that shape the places where they live. A more predictive and responsive planning system can give developers and investors the certainty and confidence needed to invest in growth, including for housing, transport, regeneration and business.

5.26 The Government also aims to provide focused investment such as the Regional Growth Fund. This is a challenge fund allowing regions to put forward ideas and bid for funding. The NIE could if it wished establish a similar fund.

Role of the Irish Government

5.27 The Irish Government plays an important supportive role in promoting the competitiveness and development of the Northern Ireland economy. The Irish Government supported the St Andrews Agreement and the subsequent financial and economic package in May 2007, providing £400 million for investment in joint infrastructure funding in Northern Ireland. Through the North South Ministerial Council, it also jointly funds and supports the work of Inter*Trade*Ireland and Tourism Ireland. These organisations contribute respectively to trade and business development across the island of Ireland, and to the development of tourism on the island of Ireland through the promotion of both parts of Ireland as a tourist destination throughout the world. The NIE has also worked well with the Irish Government under the 2004 All-island Energy Market Framework to put in place a competitive single wholesale electricity market. Joint action continues on electricity grid infrastructure modernisation and developing common arrangements for gas transmission and trading set within wider regional EU energy goals. This seeks to bring mutual benefits to the respective economies and consumers. In addition it jointly supports the work of the Special EU Programmes Body and funds the PEACE and INTERREG programmes along with the UK Government and the EU.

Support from the EU and US

5.28 The EU has supported Northern Ireland over many decades including through European Structural Funds, the PEACE programme for community development and the International Fund for Ireland (along with support from the US). In May 2007, a European Commission Task Force was established to support efforts to underpin change and improve competitiveness by helping Northern Ireland embed more firmly into European networks. In December 2010, the First Minister and deputy First Minister committed jointly with President Barroso to a renewal of the Task Force. Northern Ireland's engagement with European funding programmes, policies and networks is being re-aligned with the Europe 2020 strategy. Regional priorities are consistent with Europe's response to the global economic and financial crisis and efforts at EU and national level to achieve smart, sustainable and inclusive economic growth that will deliver high levels of employment, productivity and social cohesion.

5.29 The US has also been consistently supportive of Northern Ireland, both in terms of the peace process and efforts to encourage and grow levels of private investment. For example, the region has been able to attract American investment from companies such as Terex, Seagate, Dupont, NYSE, Allstate, Caterpillar and Citi. Furthermore, in September 2009 the Obama Administration appointed a Special Economic Adviser for Northern Ireland - the only such appointment to have been made since President Obama came into office in January 2009. This appointment has provided a high-profile platform for promoting the region throughout the US. One output from this appointment has been the Northern Ireland economic conference (held in Washington in October 2010), which was hosted by the US Secretary of State, Hillary Clinton. There is opportunity and potential for attracting further US investment into Northern Ireland (eg more recently in the form of technology companies and in the production of television and film production).

Conclusions

5.30 This chapter has provided an overview of various policy initiatives in Northern Ireland to promote economic growth. Taken together they suggest that there is scope for increasing the size of the private sector in Northern Ireland through a range of policies, while recognising that in devolved areas that these decisions are a matter for the NIE. The Government will continue to work closely with the NIE to take forward non-tax policies to strengthen the economy.

Questions

In relation to other economic reforms in Northern Ireland discussed in this report, bearing in mind the devolved nature of many of these policies, the Government would welcome views on how far:

- Welfare reform has the potential to reduce economic inactivity in Northern Ireland and increase economic growth;
- There are lessons to be learned and policy proposals from the recent Sub-national Growth White Paper that are transferable to Northern Ireland. If so which ones?
- Devolved policies have an important role in rebalancing the Northern Ireland economy.

6 Conclusions

6.1 This paper has considered rebalancing the Northern Ireland economy by increasing the size of the private sector in relation to the public sector. The conclusions that can be drawn from this paper are as follows:

- Chapter 2 describes the current state of the Northern Ireland economy. It notes that the Government and the NIE share the same objective to rebalance Northern Ireland's economy highlighting the need to increase productivity and reduce economic inactivity, but lists the greater challenges facing Northern Ireland compared with most other UK regional economies;

- Chapter 3 describes how the June Budget 2010 set out the new economic model to rebalance the British economy. It argued that the economy had become too reliant on growth from a limited number of sectors and regions. The June Budget 2010's aims were to reduce the fiscal deficit while promoting enterprise and fairness. The Plan for Growth, published alongside Budget 2011, set out the Government's overarching ambitions to ensure progress is made towards achieving strong, sustainable and balanced growth that is more evenly shared across the country and between industries;

- Chapter 4 examines the possible mechanism for reducing corporation tax rates to 12.5 per cent in Northern Ireland and assesses the potential impact of such a measure. Reducing the corporation tax rate in Northern Ireland would have a positive impact on both domestic investment and FDI, which could lead to increased economic growth and a stronger private sector. However in order to meet the EU Azores criteria on State Aid, the NIE would have to meet the conditions of institutional, procedural and fiscal autonomy. As part of this Northern Ireland would have to bear the full fiscal consequences of a reduction in the corporation tax rate. This would be achieved by a reduction in the Northern Ireland block grant. Various options to manage the fiscal cost are explored, including deferring or phasing implementation. This chapter also examines the benefits and costs of granting Northern Ireland other tax reliefs. However these options face various difficulties and could run into State aid issues; and

- Chapter 5 looks at non-tax measures for rebalancing the Northern Ireland economy and contains a large spectrum of possibilities. Many of these levers lie with the NIE. The Government will work closely with the NIE as it develops its new economic strategy.

6.2 Government would welcome views on the following:

- Whether there is a need to rebalance the Northern Ireland economy by strengthening the private sector over the longer term and to increase economic growth and promote significant new investment;

- Where there is most scope for increasing productivity, reducing labour market inactivity and increasing growth;

- The Government would welcome views, in the context of this report, on devolving corporation tax rate varying powers to Northern Ireland. In particular, the Government would welcome views on the following:
    - The importance of the headline corporation tax rate in encouraging investment;
    - The extent to which a reduction in the rate of corporation tax in Northern Ireland could support additional investment, higher growth rates and increased employment in the Northern Ireland economy;
    - The estimated costs arising from a lower corporation tax rate in Northern Ireland;
    - The dynamic impacts on tax receipts arising from a lower corporation tax rate in Northern Ireland;
    - The risks to the NIE arising from a devolved corporation tax rate in Northern Ireland;
    - Potential compliance costs and administrative burdens for business arising from a devolved corporation tax rate in Northern Ireland;
    - The approach that would be taken to adjust the block grant arising from a devolved corporation tax rate in Northern Ireland;
    - The balance of potential costs and benefits of a reduced corporation tax rate in Northern Ireland;
    - The merits of a deferred implementation of a rate reduction in Northern Ireland and its potential impact on investment decisions;
    - The extent to which a phased reduction in the rate of corporation tax in Northern Ireland could support a rebalancing of the economy while allowing the costs of the reduction to be more effectively managed;
    - The impact that restricting any reduction in corporation tax receipts to trading income only would have on the aim of rebalancing the Northern Ireland economy and the value for money of a corporation tax reduction;
    - Whether there are other options to offset the cost to the NIE of a reduction in the rate of corporation tax that would be consistent with the overall aim of rebalancing the Northern Ireland economy; and
    - The extent to which changes to R&D tax credits, annual investment allowances, training credits or a national insurance holiday could provide feasible, effective, affordable and value for money support for the rebalancing of the Northern Ireland economy.

  In relation to other economic reforms in Northern Ireland discussed in this report, bearing in mind the devolved nature of many of these policies, the Government would welcome views on how far:

    - Welfare reform has the potential to reduce economic inactivity in Northern Ireland and increase economic growth;
    - There are lessons to be learned and policy proposals from the recent Sub-national Growth White Paper that are transferable to Northern Ireland. If so which ones?
    - Devolved policies have an important role in rebalancing the Northern Ireland economy.

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