Northern Ireland
Fiscal Council
Bringing transparency to NI's public finances

#NIFCAnnualConference

How important is revenue raising in making public finances more sustainable?

Professor Cathy Gormley-Heenan

Dr Andrew McCormick

Professor Graeme Roy

The Independent Fiscal Commission NI

How important is revenue raising in making public finances and public services more sustainable?

Prof. Cathy Gormley-Heenan
Commissioner
Fiscal Commission NI

18 September 2023

The Commission…

The Independent Fiscal Commission NI

Terms of Reference

*"Review the case for increasing the fiscal powers to the NI Assembly, advising the Finance Minister on powers which could enhance the Assembly's fiscal responsibilities, **increase its ability to raise revenues to sustainably fund public services**, and provide additional policy instruments. …"*

Established

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

Commissioners

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

NI unique position, substantial powers over spending, but not over tax

The Independent Fiscal Commission NI

- **NI Executive controls majority of 'identifiable' public spending** on services in NI – almost £9 in every £10 spent (<u>including</u> Social Security)

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

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

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

Key points ahead of further fiscal devolution

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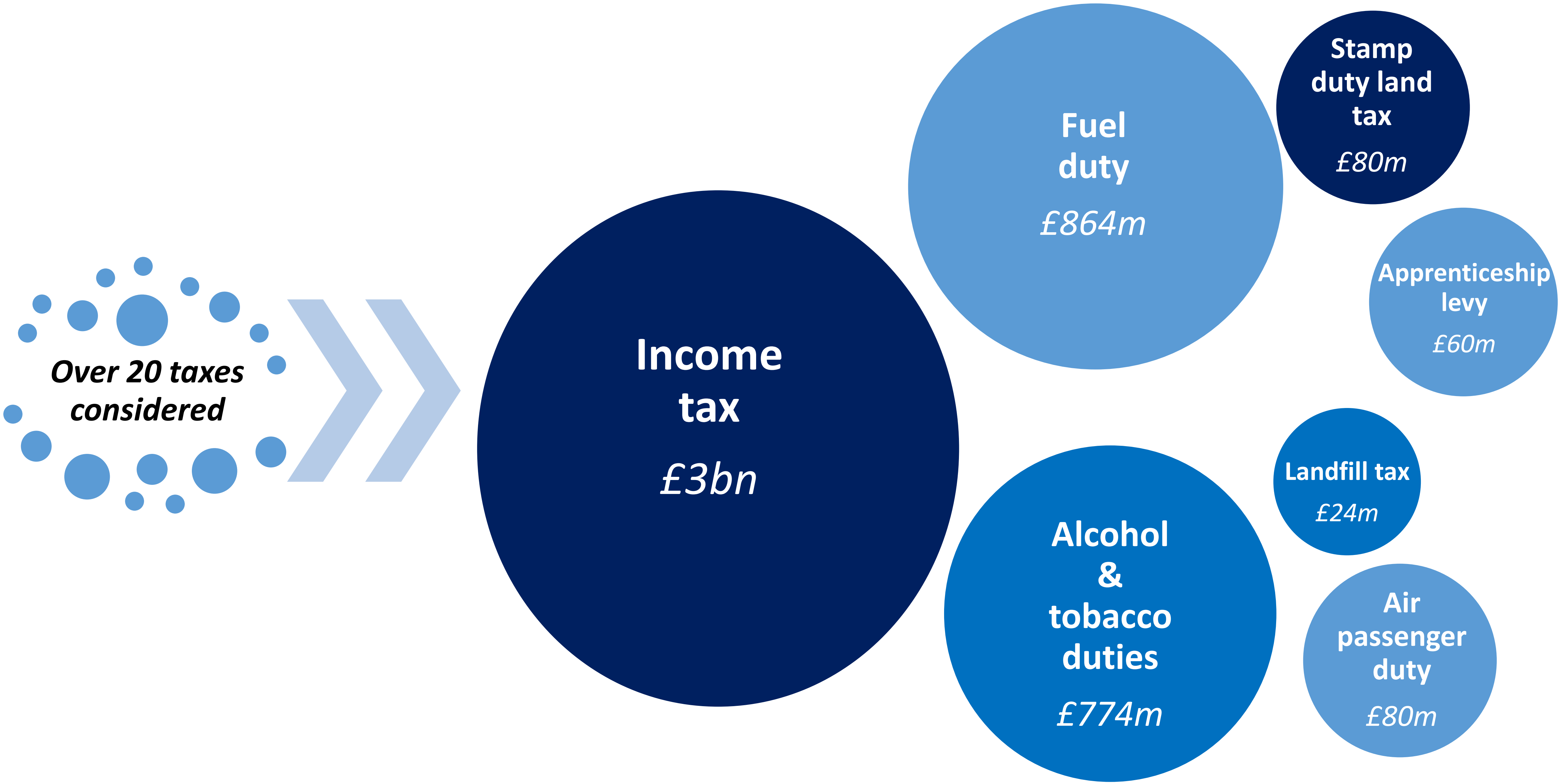
No reason in principle why, in the long term, a substantial fraction of current taxes could not be devolved

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

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

Northern Ireland should take on further powers gradually

We looked in detail at over 20 different taxes…



Reward vs risk

The Independent Fiscal Commission NI

➢ ***Ultimately any potential rewards that may come with further fiscal devolution will also come with additional risk… If Executive wishes to avail of the benefits then must also be willing to take on the risks***

Reward?

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

Risk?

- BGA potential negative impact on Budget. Tax base slower growing than England
- Volatility and uncertainty in budgets/forecasting – Scottish Fiscal Commission has emphasised this in Scotland
- Long-haul APD in NI – NI Executive paying c£2m per annum but no flights
- Scotland – changes to structure of income tax and higher rates introduced, but budget not necessarily better off

Income tax deep dive – most potential to raise revenue

Recommendations 3, 4 & 5

Income tax

- **Extent. Tax Base (**what income is subject to tax, including various allowances and reliefs)**, other than personal allowance, should be reserved**
- **Scope. Taxation of savings and dividends could be devolved (unlike Scotland and Wales).**
- **Scottish model of full devolution of revenues, rates and band setting powers preferable in principle, but brings risks.**
    - NI assembly should be obliged to vote on rates and bands annually
- **Administration should remain with HMRC**

Income tax – revenue raising ability

- **How much revenue could be raised from increasing income tax rates?**
- What would a 1 percentage point change in all rates on all income yield or cost across each band under each approach to devolution?

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

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

- Majority of additional revenue raised would come from basic rate payers – **NI lacks significant numbers of higher rate income taxpayers, they make up a lower share of the tax base compared even to Scotland or Wales.**
- Even devolving income tax powers and raising the rates would unlikely be enough to raise significant revenue to meet current Executive financial pressures and other taxes aren't sufficiently large enough to raise significant amounts of revenue easily.

Other taxes…

Recommendations 8 & 9

SDLT, APD & landfill tax

- Benefits in restructuring these taxes to better suit the Northern Irish context and improving their overall design.
- **Full devolution of revenues and tax powers recommended**.
- **NI Executive should establish a local revenue authority** to administer (accountability, capability and capacity building).

Recommendation 10

Excise duties

- **Value in the NI Executive seeking devolution of excise duties, but over the longer term**
- But costs and complexity could be significant – more work needed

Other ways to raise revenue – 'super-parity' measures

The Independent Fiscal Commission NI

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

University fees… a closer look

- **Northern Ireland has not introduced higher tuition fees for students (as per elsewhere in UK)**

- **Funding directly to NI universities from the NI block grant to help subsidise part of the cost gap**, with the universities making up the remaining shortfall

- Important to be clear that that **simply increasing tuition fees will not directly lead to increased revenues for NIE**
  - Should tuition fees be increased, they would be paid directly by students (via a loan) to the HEIs, not to the NI block.
  - In principle, an increase in tuition fees could allow a comparable reduction in the teaching grant funding paid to the HEIs by DfE.

- **The issue of fee funding and replacing grant funding with increased loans involves many nuances** - significant analysis would be required to arrive at exact estimates.

- **There are particular aspects that need to be considered, including:**
  - the cost of issuing loans;
  - the cost associated with the future write offs of loans;
  - and, from a budgetary perspective, the fact that the cost associated with the write off of loans may be charged to the NI Executive's Resource DEL if it exceeded the HMT ring-fenced DEL Budget for student loan impairment.

- DfE estimates included in the Commission's report indicated that increasing tuition fees to a level similar in England has the potential to raise revenue of between £14.2m to £90.5m per annum **depending if full additional write offs are met.**
  - DfE also presented an example of further analysis to the Economy Committee in January 2022 where it highlighted that raising tuition fees by 59% to about £7,200 a year (rather than raising to the full £9,250) - could raise revenue of £63m.

Conclusion

- **Fiscal devolution has potential to raise additional revenue** – Scotland and Wales are examples of where this could happen but also not happen

- **There are both risks and rewards**. Careful consideration needed.

- **Block grant adjustments and wider fiscal framework** – key issues that need to be agreed, also with risks

- **Other options** include consideration of ‘super-parity’ measures – also have their own downsides

- Its complicated… There are no *‘home runs’*

How important is revenue raising

in making public finances and public services more sustainable?

Andrew McCormick

18 September 2023

Very Important

- Basic reason - devolved administrations have very limited borrowing powers – DEL means what it says
- Tactical reason – Treasury won’t accept a need based case while revenue levels are unfair to GB taxpayers
- Behavioural reason – revenue affects demand management

Barnett determines our Departmental Expenditure Limit

- All spending, net of the level of revenue raised under devolved powers, must be contained within the DEL as set by Treasury
- Executive Ministers have some agency over a fiscal judgement – raising more revenue enables higher spending
- From 1999 onwards, the outcome was that the Regional Rate was usually increased by **less than** inflation, and the local parties reduced the scope or volume of revenues and charges (eg abolition of prescription charges, free transport for over-60s)
- Corporation Tax issue involved a considered choice to forego revenue to secure a radical policy change – nearly but not enacted
- So choice is available, but in practice the issue has always been ducked – high spend, low revenue fantasy has prevailed

Spending Comparisons

- Public Spending here is very high compared to the UK average
- There is clear evidence of greater social need……
- ….but it’s far from obvious to Treasury that we need more
- Key issue of revenue arises **because we are asking for more**

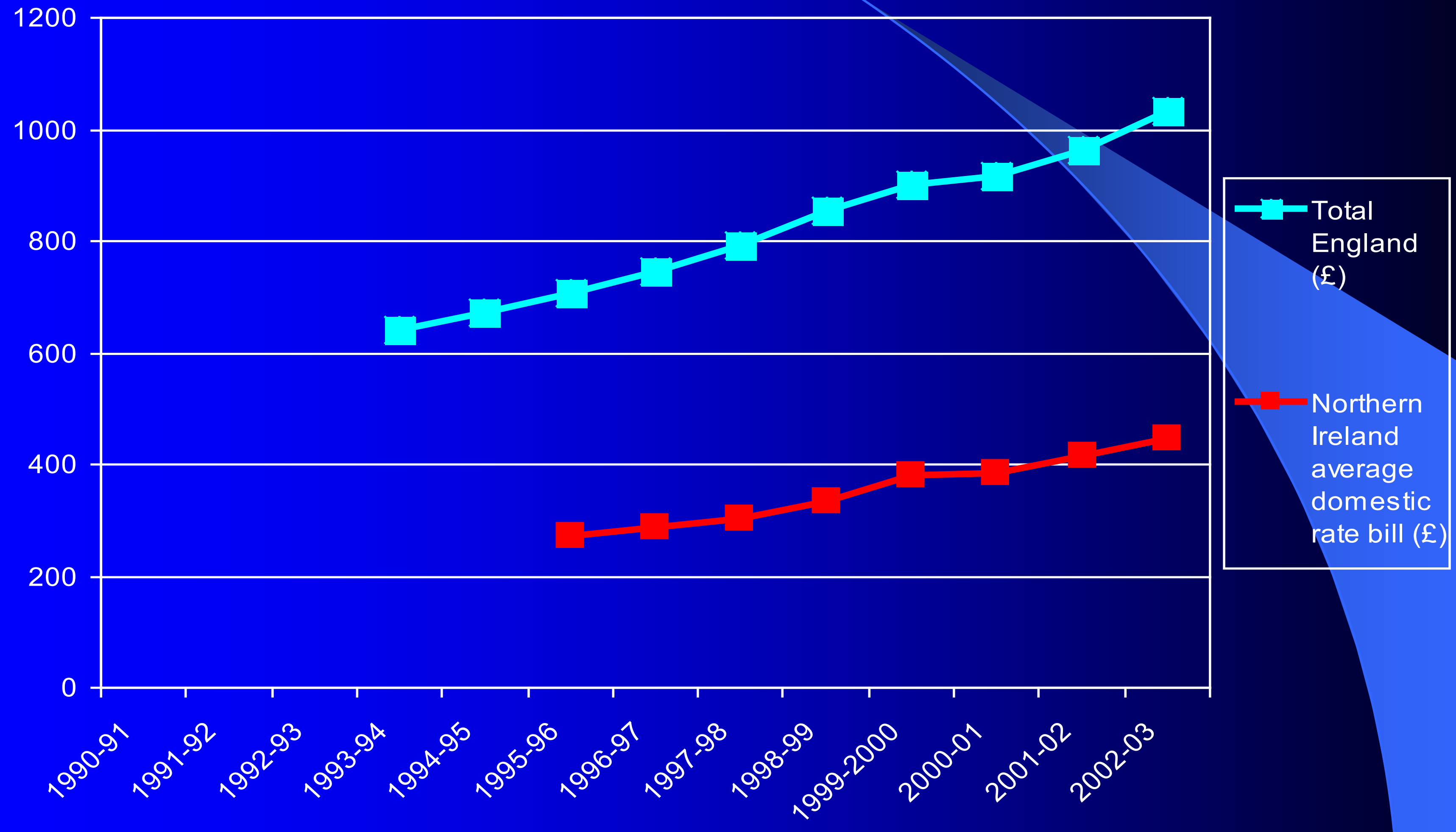
Treasury Reaction

- “You have the highest spending per person and the lowest revenue per person”
- “NI is no longer the worst off on many economic indicators”
- “Why should people in England see their tax revenues flow to Northern Ireland”
- “Why do you have such high costs of administration”

Summary on Needs Comparison

- Spending levels were well above English standards for many decades.
- This assessment makes no allowance for costs unique to Northern Ireland
- Convergence means we have a clearer case than before that spending levels could be well below English standards
- But Treasury can argue that around half the gap could be closed if we raised revenue at parity

Treasury's Likely Comparison of Revenue/Charges



Fair Comparisons?

Treasury will look for:

- Local revenues that are defensible to taxpayers in GB – best we can hope to argue for would be *circa* £610 a year
- Charges that cover the costs of the Water Service here. E&W average is c £228 a year per household, but that could only be achieved here with major reform in Water Service.

Total **extra** – around £400-£450 a year per household – under £10 per week on average

How can that be fair?

- Treasury will point out that these amounts are being paid now, by poor households in areas of England that are less prosperous than here
- **We are saying spending is unfair** – but that carries no weight with Treasury while the revenue disparity is so great

Conclusions

- Treasury has made it clear that there is no possibility of getting a hearing on Barnett without clear commitments that the low level of revenue here will be addressed
- We have the option of ignoring the revenue disparity – if we are also happy to accept Barnett

These Slides were from 2002

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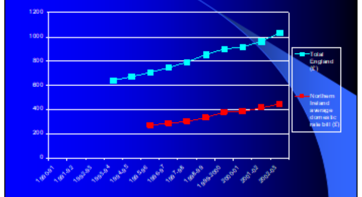

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7

And in July 2010, DFP told the Executive that …on average, households here pay much less than similar households in England and Scotland...

£ 2010/11	Average Council Tax / Regional Rate	Average Water and Sewerage Charge	Average Household Bill
England	1,195	339	1,534
Scotland	985	324	1,309
Northern Ireland	754	0	754

And in 2014, DFP highlighted the following Super-parity Measures to Ministers (figures are for 2014-15)

Student Fees	38
Free Prescriptions	30
Concessionary Travel Fares	8
Water Charges	180
Domestic Rates	150
Housing Benefit Top Up	10
Housing Rent Differential	88
Total	**504**

In February 2015, DFP asked the Party Leaders:
Could we raise more revenue from the regional rate...

- A 10% increase in the regional rate would raise **£70m**
- A 10% pa increase for 3 years would raise approx. **£210m**
- The current average household bill would rise by around **£125** (**15%**) to around **£960** after three years (as approx. half of the regional rate is accounted for by the domestic rate)
- This would still be **lower** that 2013-14 average household bills (water and Council tax) in England (£1,433), Scotland (£1,322) and Wales (£1,613)

Tactical Reason for the importance of revenue raising

- Treasury attitude is the same as 2002 or maybe stronger
- The spending case for NI is also much stronger – but won’t be heard without credible action
- The choice hasn’t changed – in simplified terms - “tax and spend” or “low tax, low spend”
- The case for efficiency and radical public sector reform is also essential whatever else is done

Borrowing

Gordon Brown 2 May 2002: *"The Northern Ireland Executive will, for the first time, have new powers to borrow on its own account – raising spending power and offering greater economic freedom to make important decisions about new investment in infrastructure and public services. And in the spirit of devolution, it will be for the Executive to decide how far and how fast to make use of this new flexibility."*

Statement by FM and DFM, 7 May 2002: *"The issue of the revenues that we raise from the domestic sector was inevitably going to arise in the spending review. It has been said many times that it is impossible to expect the Treasury to accept our arguments for money to sustain the same standards of public services as in England if our revenue levels are much lower. Without this initiative, we might have had to increase rates in the longer term to make ends meet for basic services.* ***The reinvestment and reform initiative has given us an opportunity, and we can use additional revenue to lever in major investment in infrastructure."***

Borrowing

- In 2002, we negotiated a borrowing power, so that the Executive had a clear incentive to increase revenue, as that would fund capex funded by borrowing.
- Later, the DUP persuaded UKG to allow the borrowing to continue without additional revenue being raised – and so the incentive never applied

Behavioural Reason

- Revenue and charges can contribute to demand management – if cost is zero, demand is infinite
- Fairness and progressivity are vital aspects of revenue policy making – NI rating system is fairer and more progressive than Council Tax
- Protection for those least able to pay is both essential and possible – but big issues of process management

Conclusions (2023)

- Revenue raising is one club in the bag – alongside:
  - Radical action on cost reduction (efficiency, service transformation, reform)
  - Prioritisation of spending including stopping lower priority functions
  - Making the case on Barnett etc
- In a power sharing coalition, agreement to act together and defend the outcome of a negotiation process on the Budget and PfG is the only way hard political decisions will stick
- So it is possible to avoid raising more revenue, if Ministers could agree very radical reforms of and cuts to public services
- Realism and honesty are vital

18 September 2023

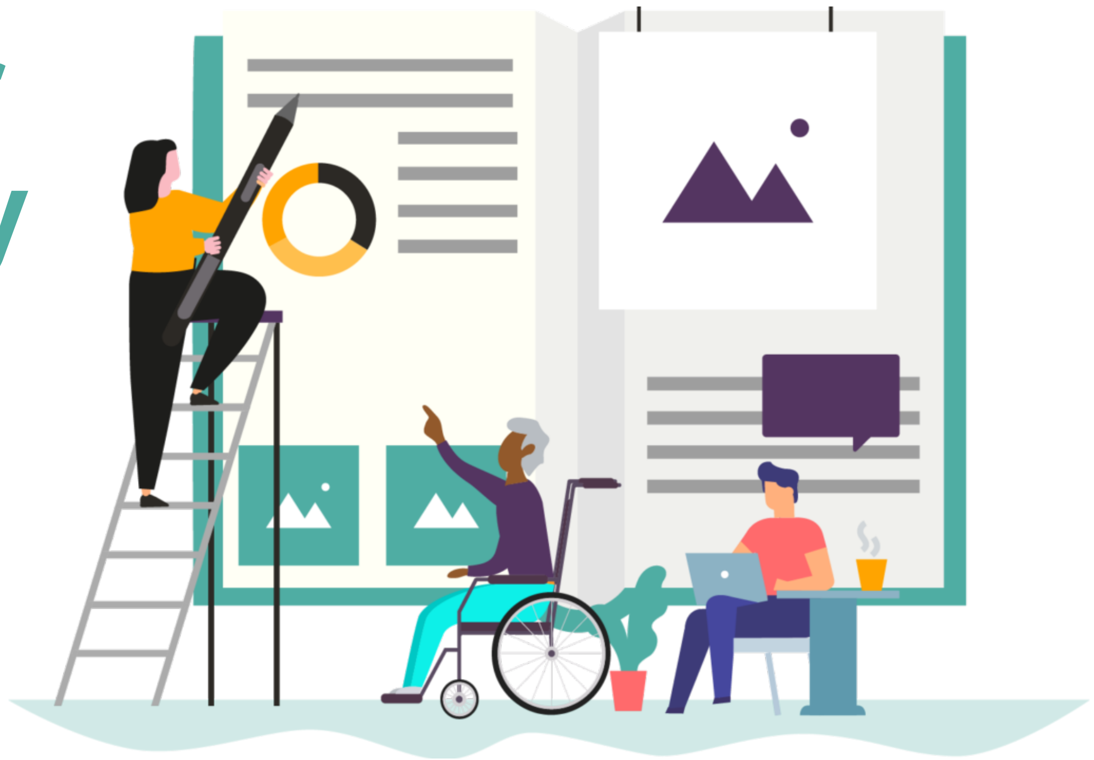
Scottish Fiscal Commission

Importance of revenue raising for fiscal sustainability

Prof Graeme Roy

Chair

Scottish Fiscal Commission



Introduction

Scottish Fiscal Commission

- Independent forecasts for the Scottish Budget
- Projections of devolved finances over the next 50 years
- Highlight long-term challenges and the scale of adjustment required to be fiscally sustainable

Devolution - spending

Scottish Fiscal Commission

- Scottish Budget covers spending on **devolved areas**.

Health and social care

Education and skills

Justice and policing

Housing, Local Government, and planning

Transport

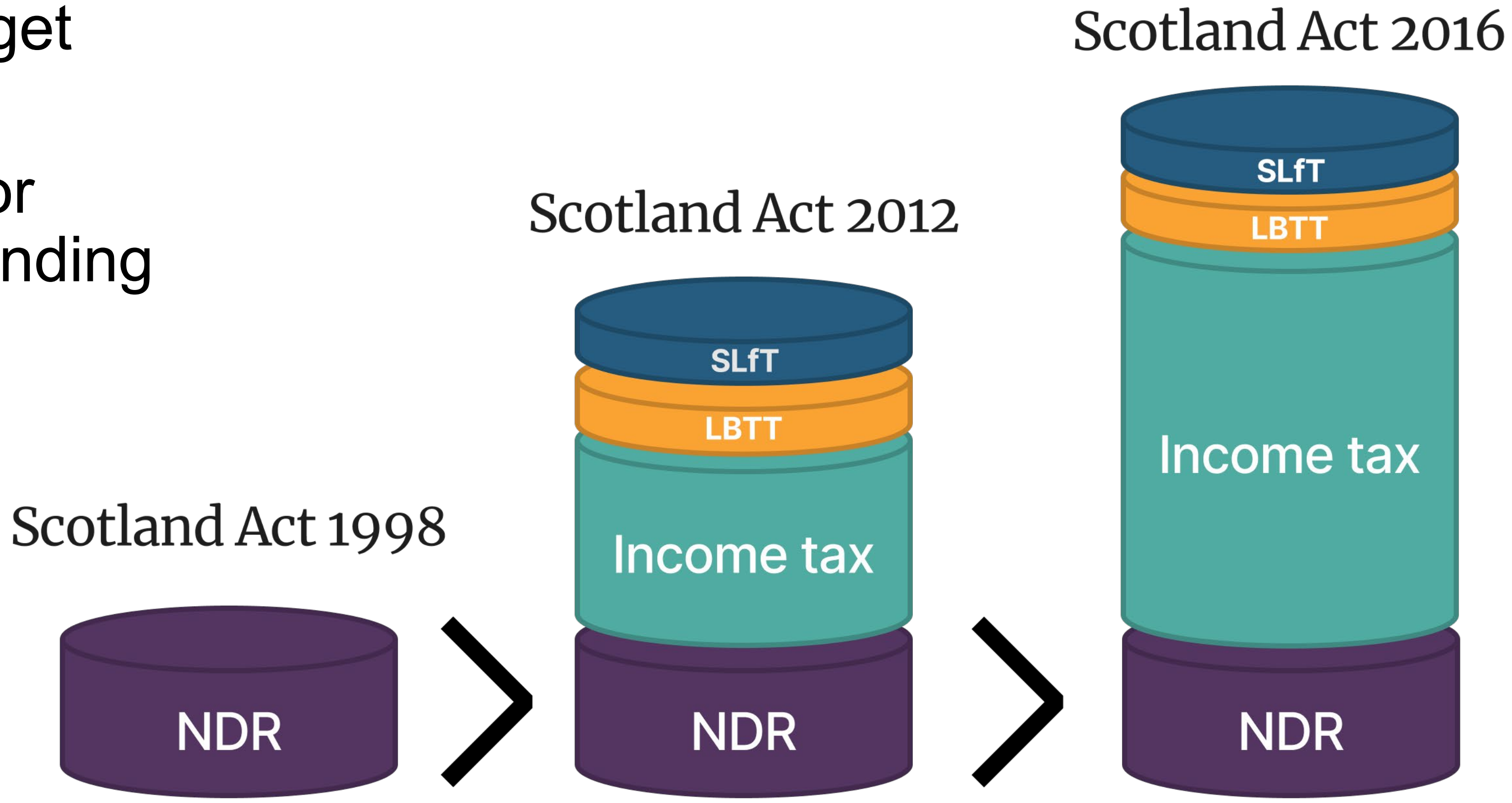
Tourism and economic development

Devolved social security

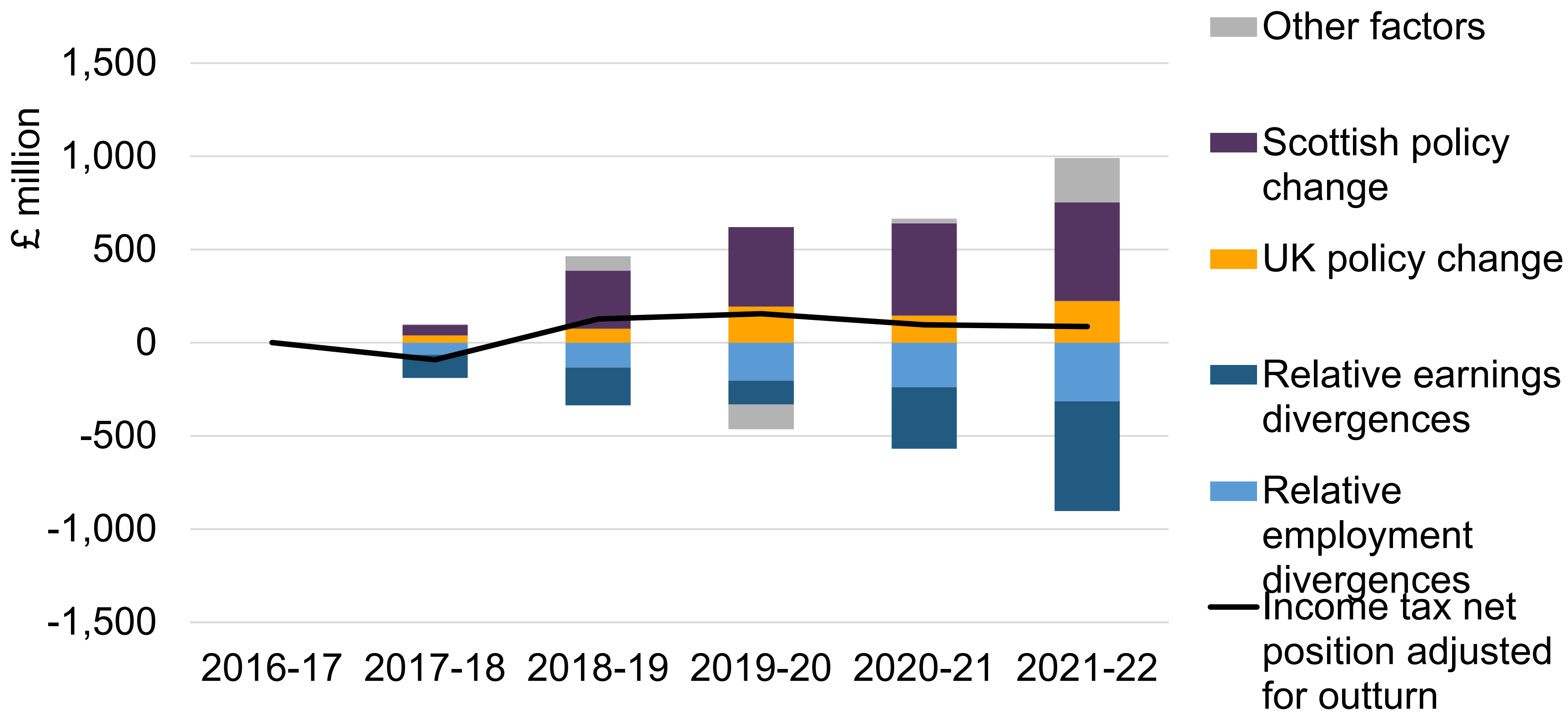
Agriculture, waste, forestry, and environment

Devolution - tax

- Tax has been an important part of the Scottish Budget since 2015-16
- Tax revenues account for around 40 per cent of funding in 2023-24



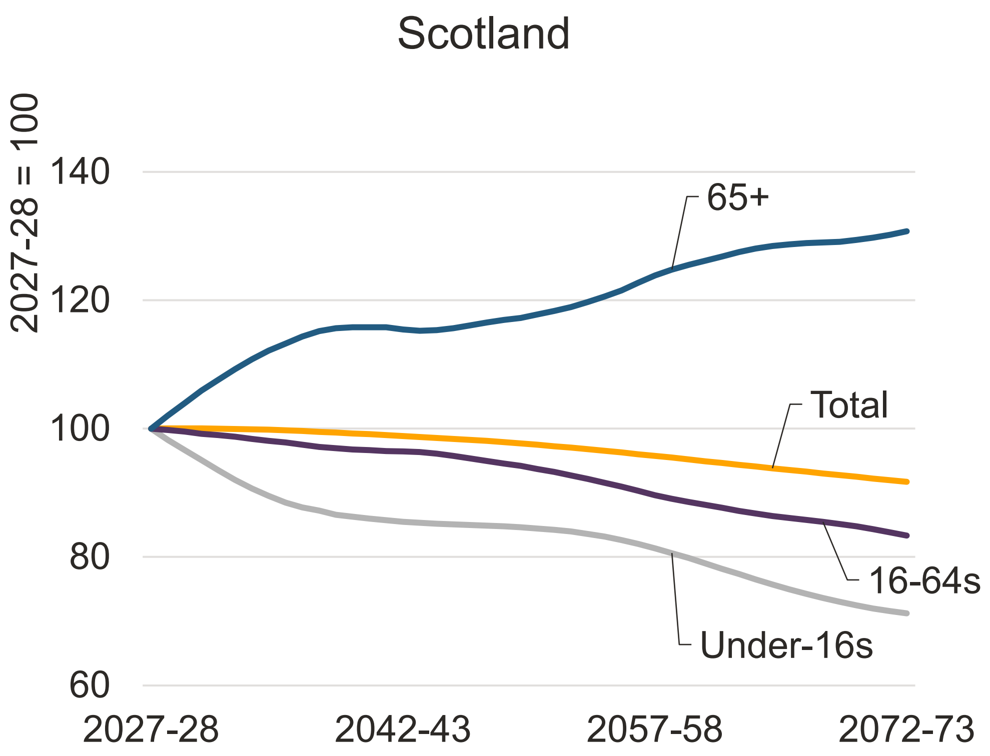
Contribution of income tax

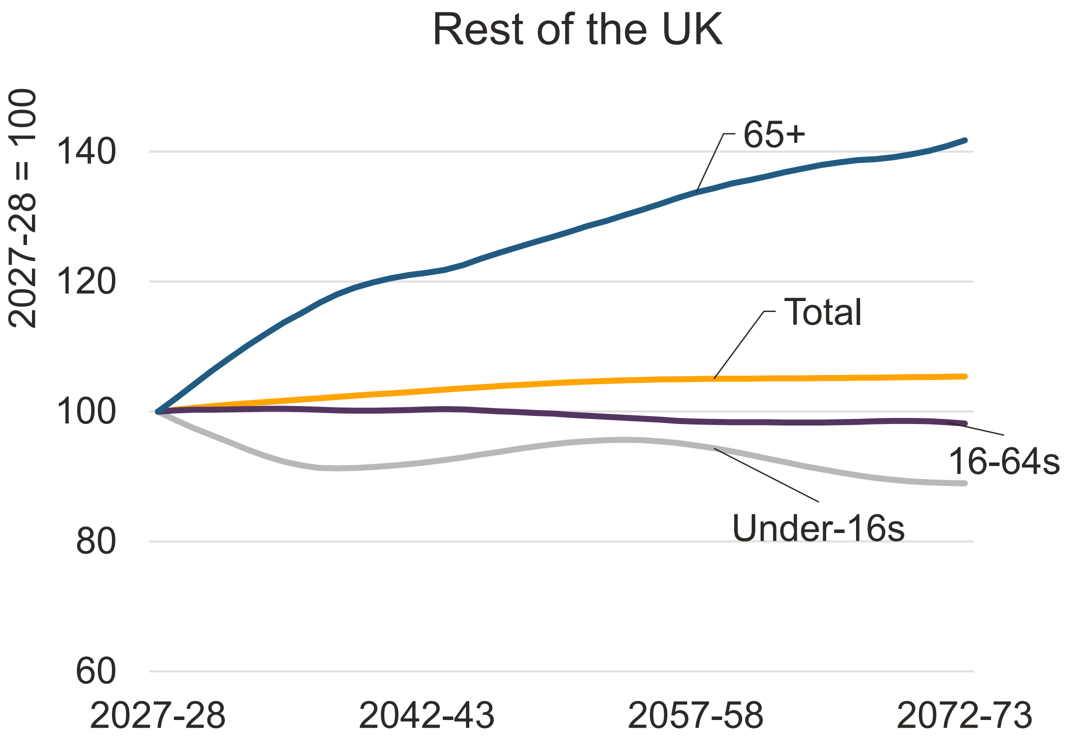


- Net contribution from income tax devolution was £85 million in 2021-22.
- Slower earnings and employment growth in Scotland has offset contribution from higher tax rates and changes to the higher rate threshold.

Demographics

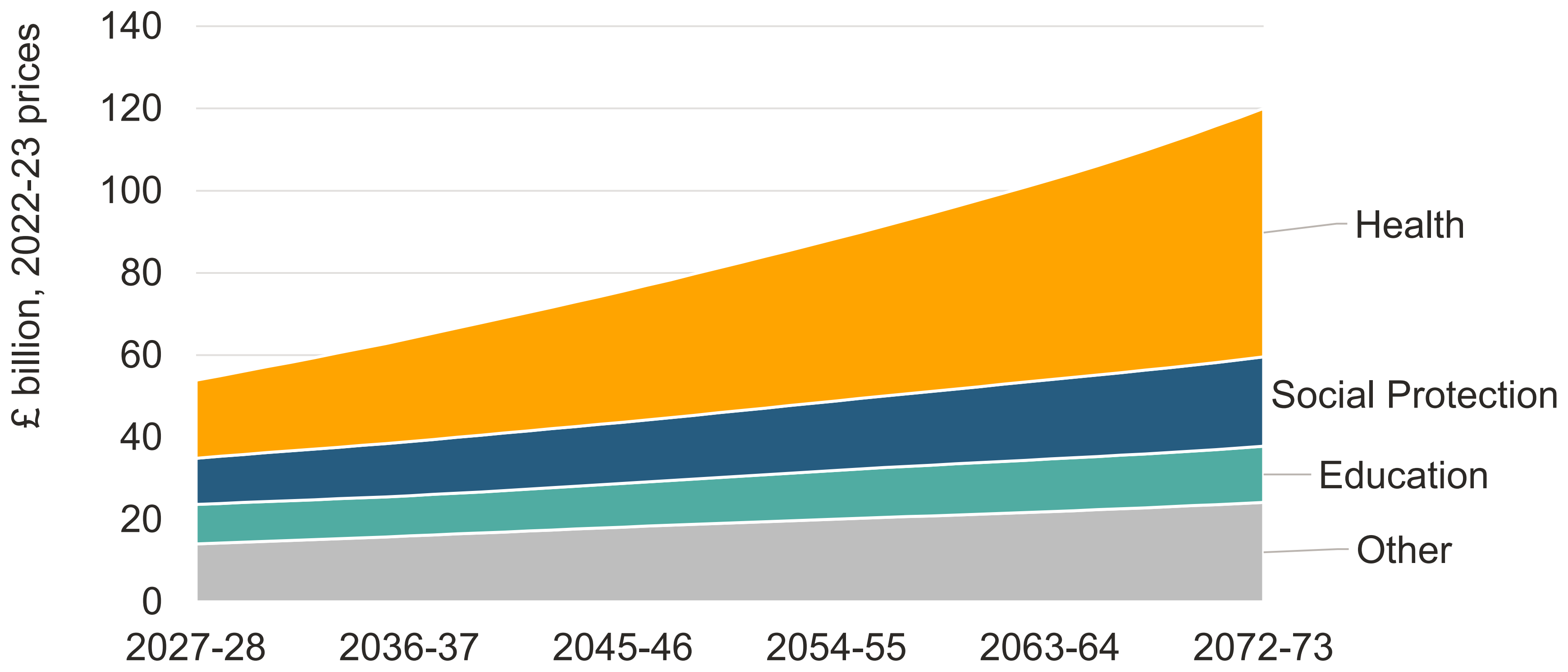
Scottish Fiscal Commission





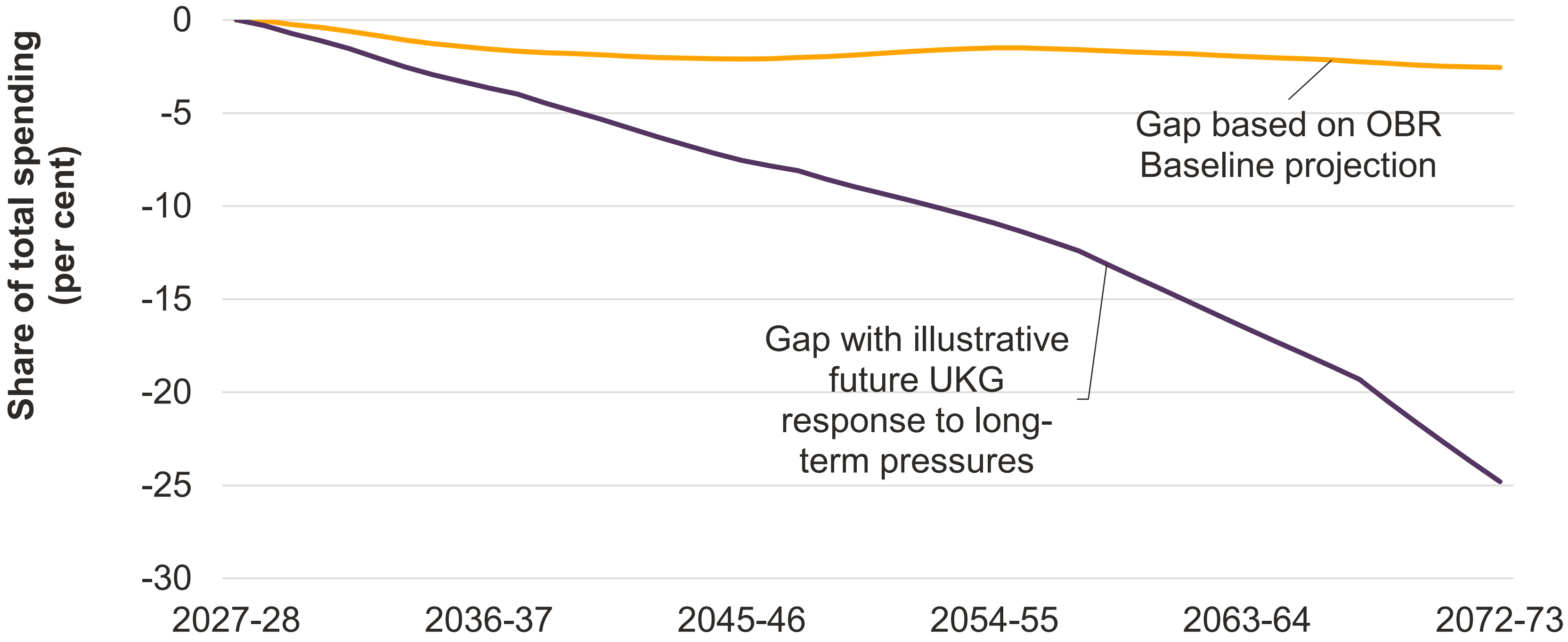
The overall Scottish population falls by 7 per cent in the next 50 years, while the population for the rest of the UK grows by 10 per cent.

Spending projections



- Health is the largest component of spending, increasing from around a third of total devolved spending at present to about half in 50 years' time.

Scottish Annual Budget Gap



- Average budget gap for the Scottish Government estimated to be 1.7 per cent over the next 50 years based on current tax and spending plans.
- If future UK Governments were to respond to UK fiscal pressures, as the OBR suggest, we estimate an average budget gap of 10.1 percent each year.

Conclusions

Scottish Fiscal Commission

- Positive contribution from tax to the Scottish Budget, but also brings challenges as growth in the tax base important for funding position.

- Sustainability of Scottish devolved finances very strongly linked to UK sustainability.
  - Net Block Grant projected to grow more quickly than other areas of funding over 50 years

- Scale of challenge such that tax changes alone will not be enough.