On Fiscal Devolution and Economic Dividends: A Response to the 2021 Dónal Nevin Lecture

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Overview

1. The economic predicament of NI is longstanding/involving three sets of processes. We should view fiscal devolution as a complement to policies aimed at improving the supply-side, not a substitute for them;
2. The Institutional Geography literature tells us that "Economic Dividends" don't automatically flow from fiscal federalism/devolution. The very creation of fiscal commission/fiscal council fits this. (Design matters);
3. In selecting taxes to devolve we can think about the pros and cons of devolving each tax discretely, but as a piece of economics this approach may conceal (Sequencing matters);
4. The concentration/diffusion of costs and benefits as well as the overall balance should concern us in thinking about fiscal devolution (Equity matters).

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Structure

- Northern Ireland’s economic predicament
- Of “Economic Dividends” and Institutional Geography
- Lessons for Northern Ireland Fiscal Devolution

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The NI Economic Predicament 1

- Northern Ireland’s economic predicament in 2021 remains a combination of three sets of processes:

1. **Those it shares with rest of the UK** (i.e. outside of “Inner Core” 10/13 UK regions run a notional fiscal ‘deficit’, mixed long-run econ (McCann, 2016; Crafts, 2018)**;**
2. **Magnified versions of shared problems** (e.g. skills, export structure, innovation, rebalancing/public sector dependence and productivity above all) (Budd, 2016; NI Productivity Forum since 2021)**;**
3. **Problems unique to NI** (e.g. border/divided society/legacy issues (Best, 2018; FitzGerald and Morgenroth, 2019; Teague, 2021).

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The NI Economic Predicament 2

Some observations on the three factors:

1. The three factors have waxed and waned over time;

2. Devolved bodies really can only deal with 2 & 3;

3. Non-economists often exaggerate 3 (& economists sometimes rather superficial regrading it);

Implications:

- Once you understand the triple nature of the problem, any idea of a "silver bullet"/game changer becomes less likely (consistent with Mac Flynn, 2020; O'Rourke (2017); Ó Gráda and O'Rourke, 2021) .
- Likewise, the consensus view that there is very weak evidence that tax devolution promotes growth (Bell, 2016) becomes easier to understand.
- Some observations regarding institutional geography (Rodríguez-Pose and Gill, 2005).

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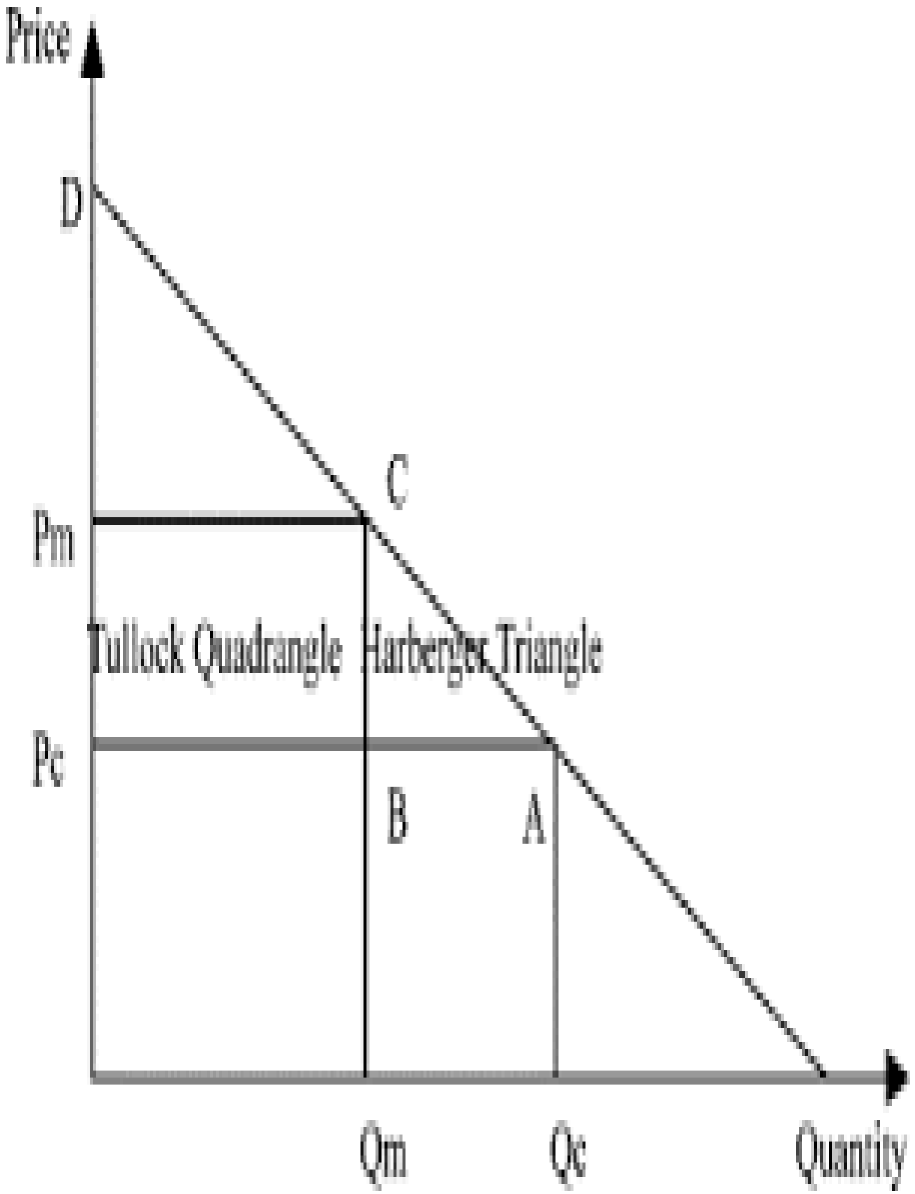

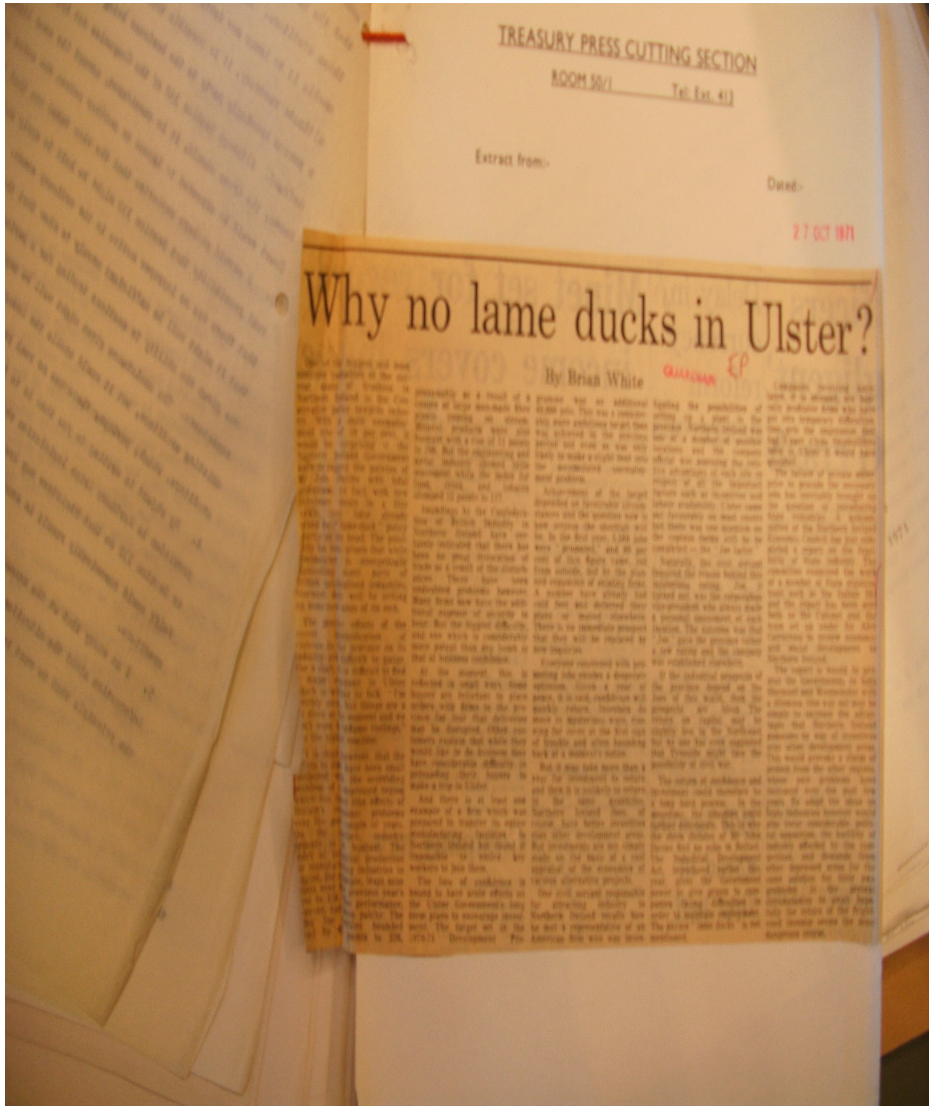

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The Past as Present: Some Historical Observations 1

- **Practice and theory in UK devolution** (Brownlow, 2017; Eiser, 2020).

- **Fiscal Federalism** (assignment of tax and spend to different tiers) anticipated in the real world/two ‘generations’ (Oates, 1972; 1999; 2005; Vo, 2010; Eiser, 2020).

- **GOI 1920** had 76 articles and 9 schedules no less than 14 articles are about finance (Torrance, 2020, p.52). GOI influential on 1990s legislation (Torrance, 2020).

- **Contemporaries** well aware of limits of tax devolution/HMT control (Lawrence, 1965; Gibson, 1996; Jordan, 2020).

The Past as Present: Some Historical Observations 2

“Because of capital mobility, and the likelihood of competitive bidding between jurisdictions, efficient resource allocation suggests this [responsibility for tax on profits] should fall to central government, as under the 1920 [Government of Ireland] Act” (Gibson, 1996, p.20).

- **From revenue to expenditure-led** (Lawrence, 1965; Rowthorn, 1981, Johnson, 1985, Wilson, 1989).

- **Soft Budget Constraints/Rent-Seeking: cause or consequence?** (Hewitt, 1990; Brownlow, 2007; 2016; Teague, 2021).

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On Institutional Geography 1

- Decentralization (aka asymmetric federalism/devolution) often associated with benefits regarding accountability, representativeness and policy innovation (Oates, 1972; Eiser, 2020).

- When combined with mobility, tax devolution seen as efficiency-enhancing (Tiebout, 1956; Hamlin, 1991; Eiser, 2020).

- Any 'economic dividends' are however contingent on institutional design, which lies behind policies. Hence its important to get these right when designing tax devolution (Rodríguez-Pose and Gill, 2005; Eiser, 2020).

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On Institutional Geography 2

- Rodríguez-Pose and Gill (2005) (and others) note that well designed decentralization can have economic dividends

A) More effective tailoring of preferences to local circumstances;

B) Enhanced accountability;

C) Enhanced scope for innovation/ “laboratory federalism”.

- But there are costs if badly designed:

A) Lack of hard budget constraints/ race to the bottom;

B) Spatial inequities;

C) Institutional burdens/diseconomies of scale.

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Birnie and Brownlow (2017) 1

- Very much based around the idea that improving competitiveness/productivity is important for NI and that tax variation powers should be seen as complements.

- Considers Holtham type principles and impact/feasibility.

- In an ordinal sense APD and Income Tax performed better in terms of (high feasibility/high impact).

- Concentration and Sequencing issues noted.

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Birnie and Brownlow (2017) 2

- Refinements: Brownlow and Birnie (2018) Mac Flynn (2020) Eisner (2020).

- Key point is that concentration of benefits/costs may not be symmetrical and that the levels of certainty concerning costs and benefits will also not be symmetrical (eg CT) (explains Bell?).

- Hence risk-reward story requires a range of economic analysis (More context specific e.g. Brownlow, 2020, NIPF, various).

- Once we consider how taxes interact with each other/distributional implications then discrete studies become more difficult.

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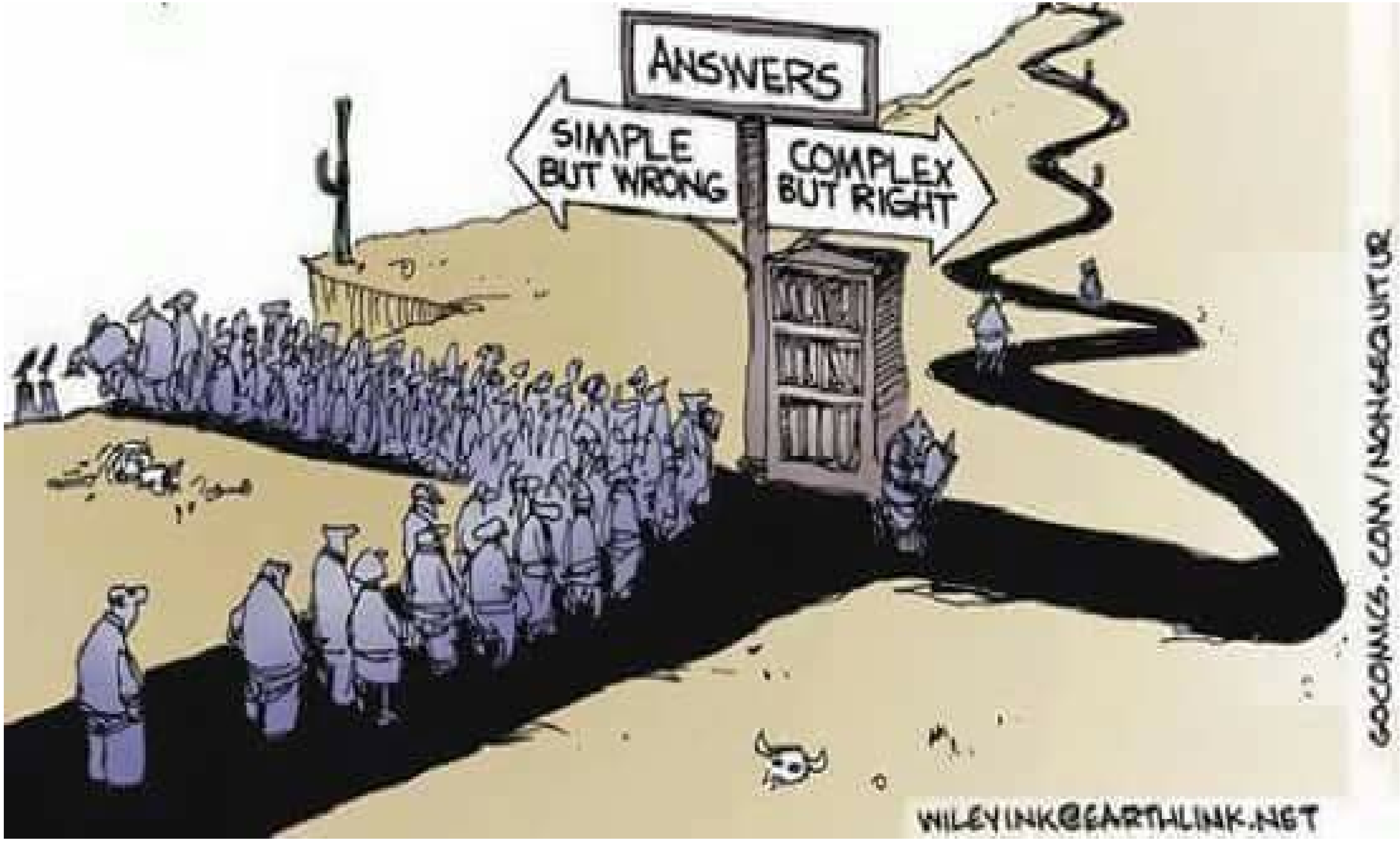

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