Northern Ireland
Assembly

COMMITTEE FOR FINANCE AND PERSONNEL

OFFICIAL REPORT
(Hansard)

Industrial Derating

3 November 2010

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:
Ms Jennifer McCann (Chairperson)
Mr David McNarry (Deputy Chairperson)
Dr Stephen Farry
Mr Paul Frew
Mr Paul Girvan
Mr Simon Hamilton
Mr Declan O'Loan
Ms Dawn Purvis

Witnesses:

Ms Veronica Holland	)	Department of Finance and Personnel
Mr Brian McClure	)	

The Chairperson (Ms J McCann):
I welcome Brian McClure, the head or the rating policy division, and Veronica Holland, who is also from the rating policy division. I refer members to the DFP briefing paper. If Brian and Veronica begin with some short opening remarks, we will then ask them questions.

Mr Brian McClure (Department of Finance and Personnel):
Thank you for the opportunity to further update the Committee on industrial derating. If

members are content, I will spend five minutes running through some of the main points and giving an overview of the Minister's position. In addition, I will highlight some of the more pertinent points in the briefing paper.

As members will be aware, industrial derating provides 70% rates relief to the manufacturing industry. This relief has existed since 1929. Around 2003-04, direct rule Ministers decided to start phasing it out. However, before it got too far — it is currently at 30% — direct rule Ministers agreed that the Economic Research Institute should undertake a study into the effectiveness of the policy. The institute duly reported shortly after the return of devolution. It concluded that there were risks in fully phasing out industrial derating. At the time — 2006-07 — it thought that increasing rates to 50% would pose a low risk to jobs and investment. However, the institute highlighted the fact that that assessment was based on fairly limited evidence and that the available information was incomplete. Therefore, the report suggested proceeding cautiously. That was why, at that time, Peter Robinson agreed to hold manufacturing rates at 30% for the current comprehensive spending review (CSR) period, and the Executive endorsed that decision.

Today, we are considering the forthcoming spending review period, and it is important to stress that the Minister is not advocating that the status quo be maintained indefinitely. However, given the current climate and the important contribution made by the manufacturing sector to the Northern Ireland economy, he considers that now is not the time to change the level of support.

The economic rationale behind industrial derating is all about maintaining competitiveness. That was the original rationale in 1929 and it remains the rationale, particularly in the context of economic development being the Executive's top priority. That is why the Minister believes that we should continue with the policy. Were today's economic reality and outlook different, a different proposal may well have been on the table, so it is worth considering the context.

The Minister also feels that it is important for the Executive to demonstrate their continued support for the manufacturing sector through maintaining derating at 30% liability for the spending review. There is also concern that suddenly and unexpectedly increasing liability could force some firms to consider relocating, reduce employment, cease business altogether or lead to disinvestment. On that point, the Economic Research Institute of Northern Ireland (ERINI) survey found that 25% of firms interviewed said that they would consider transferring production to outside Northern Ireland if rates were fully levied here. That was quite a factor for those firms. It may be claimed that they would say that anyway, but the Economic Research Institute also applied its own view.

The briefing paper sets out further information on the revenue implications of increasing the current level of liability, the level of rates arrears and the potential loss to business from increased rates. The figure that we have shown to illustrate the difference between 30% and 100% liability represents a maximum, because it presupposes that all of the extra money would be collected. Evidence also suggests that increasing liability to 50% would not devastate manufacturing in Northern Ireland. However, based on evidence from the ERINI report and other studies, the view is that a number of manufacturers could not afford to pay the extra if it were imposed suddenly. I suspect that many more may refuse to pay. Given the uncertain economic outlook, the collectable figure cannot be predicted with any certainty. I know that the Committee is particularly interested in that figure, but I do not think that we can provide a reliable one.

The ERINI report also states that, due to the lack of comprehensive data, it is difficult to put a meaningful figure on how many firms could go to the wall over increased rate liability. However, the Minister thinks that there would be a risk of an adverse impact on manufacturing at that time, which is why he believes the level of support should be retained. I again emphasise that it is not suggested that the status quo should continue indefinitely. The level of support would have to be reviewed again before the end of the forthcoming spending review period. Indeed, it would be open to a new Assembly mandate to do that sooner rather than later.

Finally, our briefing paper to members highlights the type of businesses that benefit from industrial derating. They are quite broad in nature but there are some exceptions that the Committee may care to note. At the previous session, someone asked whether some software businesses benefit from industrial derating: they do not, because they involve an insufficient degree of manual labour. Therefore, the policy has some anomalies. Industrial derating is not a policy that the Department would come up with now, but it is a one that has existed for many years.

Northern Ireland is the only part of the world that has property tax relief for manufacturing. We could not introduce it now because of EU state-aid rules, but, in its current form, it qualifies as a pre-accession aid.

We are asking for the Committee's view on including the proposal in the Budget paper that will go out to consultation. We do not intend to undertake separate consultation on the matter; it will be consulted on in the round along with the Budget. We intend to review things in light of the consultation response, and, if necessary, we will give further evidence to the Committee. Obviously, the Committee is free to take evidence from other sources, and that evidence will be reviewed in due course. All that we are asking the Committee for today is its view on including in the Budget paper the proposal to hold the industrial rating liability at 30% for the spending review period. That would require subordinate legislation that would have to be debated in the Assembly in the new year, so there will be an opportunity then for the Assembly to consider the issue fully.

Mr McNarry:
I am not moved to increase those rates. Perhaps discussion beyond what Brian said is required to determine where industrial derating sits and should sit in relation to growing the economy, which is very important. I understand what we are being asked, and my initial reaction is that it is OK to include the proposal in the Budget consultation paper. However, I am concerned that that may be a piecemeal approach.

We heard that there may not be a Budget and that, if there is one, we are unsure about what type it will be. Brian McClure alluded to the fact that a review might be necessary, although that would be up to the newly mandated Assembly. I think that we should be stronger on the matter. Indeed, I would prefer the Department to specify its position. I know that Brian did that, but there needs to be an Executive position on industrial derating. Let us include it and, if necessary, consult on it. Nevertheless, regardless of whether there is good reason to include consultation in the Budget process, it seems to me that the approach is piecemeal and based on shifting sand. I would like the relief to be retained and not be subject to conditions.

As I said, it requires Executive endorsement and it should be included in the things that we are going to address, perhaps as part of a strategic objective. How on earth can you tell industrialists and businessmen to base their budgets on — I do not know whether there would be consensus for this — the likelihood that derating will continue when, on the other hand, a review is due and something else might hit it? In my opinion, you cannot ask businesses to work around piecemeal proposals that have no objective unless, as I asked, the Department's attitude to growing the economy becomes firmer and it can say that the proposals are part of that pursuit. That seems to fit in with keeping businesses afloat. You cannot fault a business for basing its budget on the current rates regime.

Businesses are inclined to take costs as they are. Not many of them have the luxury of writing off costs as they might be, and it could have a detrimental effect. If we are serious about growing our economy, that is part of a package that would fit into what we can do. I do not know whether we would lose that if we were to reduce corporation tax or create enterprise zones. We still have not taken any decisions on those, and, until we do, we should retain derating.

Mr McClure:
The Minister's clear position is that he wants to retain industrial derating at 30% liability — 70% relief — for the entire spending review period. He will seek the Executive's endorsement of that, but, before he does so, he wants the views that the Committee expresses today on the issue put forward to the Executive. Like Mr McNarry, our Minister is very keen on certainty for business and that there are no sudden shocks for business. That is what this policy is about.

Mr McNarry:
I do not have a problem with that. This is not a criticism of the Minister, who, over recent times, seems to be performing very well. Perhaps he should come to the Committee, but he is the Minister, and, if he has a strong opinion, he should take that opinion forward. He does need my support or the support of anyone else on that. I hope that he is not hedging his bets, because, if the Committee were to say no, what on earth would the Minister do? He would not have the Committee's support to take to the Executive, so, without any disrespect to Brian, I would rather the Minister were here to tell us what he is doing or what he wants to do.

Dr Farry:

In the past, I have been sceptical of derating because it is a blunt instrument, and I have viewed it as not the most efficient way of supporting business. In some respects, I saw it as ossifying the current structure in the economy rather than encouraging change. Those criticisms still stand, but, that said, I recognise that, in the current specific economic climate, removing it would be disproportionately destabilising to business, which is already under considerable pressure. For that reason, I am prepared to be a bit more pragmatic. Brian, given the changes in the EU state-aid rules that we expect to come into effect by 2013, will we be able to continue to have that policy for the next four years anyway?

Mr McClure:

There is no absolute certainty on that, but our reading of the situation is that, because it is a pre-accession measure, there are no signs that any of the changes that are coming up on state-aid rules would affect it. That is not to say that the European Union could not suddenly do something unexpected, but it is our reading that, with respect to the changes to state-aid rules, we are reasonably safe. We will have to continue to monitor that, and, if there is any likelihood that the position will change, we will advise the Committee immediately.

Dr Farry:

I have one big reservation about the proposals. It is a slightly different emphasis to David's point, and I accept what he said about business needing a degree of certainty. I appreciate that the opportunity to set a lower rate of corporation tax over the next four years is an "if", and we can discuss how big an "if" that is. If it were to come to pass, based on the Azores ruling, we would have to fund it. There is logic in saying that the lost revenue from industrial derating is an obvious candidate for reallocating towards corporation tax measures.

That may not account for it in its entirety, but using an element of it jumps out as an obvious way of doing things. In essence, we would be moving resources from a less efficient means of support to business to what was described to the Committee as a more efficient way to support it. If we lock ourselves into one method of supporting business over four years, I fear that we could restrict our ability to deliver on other options that may come our way in the future.

I have no problem with linking this issue into the wider budgetary consultation, but I would be happier with an approach that sees the Executive give a more general commitment of support to business of at least the value of industrial derating. In practice, in year 2 or 3, that may involve industrial derating plus corporation tax, purely industrial derating, or entirely corporation tax, with the potential to throw in more resources if corporation tax is costing less than £200 million. That would allow a bit more flexibility at the same time as providing surety to business.

Mr McClure:

The legislation allows that to be unlocked. Were we to want, as I think is the suggestion, to cross-fund corporation tax in some way, we would just introduce a new set of regulations in a subsequent period. However, reducing industrial derating to 50% would raise £16 million. During an earlier session, the CBI talked about a range of £100 million to £300 million of a deficit to fund corporation tax, so it would go only a small way towards that.

Dr Farry:

Sure, but a whole range of sources will have to be drawn on to fund corporation tax.

Mr McClure:

It would, absolutely; yes.

Dr Farry:

It would be unfair if, for example, health and education took all the hits while inefficient economic measures escape.

Mr McClure:

A decision of the Assembly on industrial derating would not lock it in for ever and a day. The Assembly could introduce new legislation; if the context changes because of corporation tax flexibility, the policy would change too. I take the member's point. We must be careful with our words around policy announcements or whatever may well come out of this process. It may be that the Assembly will state that it wishes to provide a certain level of support, whether from this source or others. That is the ongoing position.

Dr Farry:

Thank you.

Ms Purvis:

In my opinion, the paper probably raises more questions than it answers. It refers to job losses in the manufacturing sector and the contraction in the manufacturing base, but there is no analysis of the reasons for that contraction, for example the departure of foreign-owned companies such as Visteon and Baker Hughes, taking their jobs with them. Again, there is no information about the potential risk to the manufacturing base. There are no specifics about companies going under, and the paper is based on an ERINI survey that was conducted, I think, in 2007.

Mr McClure:

That is correct.

Ms Purvis:

I take issue with some of the suggestions that the Department has used from that survey, including:

> "The Minister considers that suddenly increasing liability from 30% could force firms to consider relocating elsewhere".

How would the Department know that? There is no evidence of that. It seems to me to be an assumption made by the Minister based on a survey conducted in 2007.

The paper continues:

> "Of those surveyed by ERINI 25% said they would consider the transfer of part or all of production to outside Northern Ireland".

In real terms, how many firms is that? Are they still manufacturing in Northern Ireland or have they gone since 2007?

The basis of the paper is in question. I am concerned that, since the ERINI report, there has been a significant decline in the economy. The Minister is of the view that, even if the real risk to industry and jobs is not particularly high, every single job loss would be blamed on the imposition of the Assembly. I am not sure whether he has the same concern about every single public sector job loss. The paper does not answer any of our questions from the last session.

When the Committee agreed that industrial derating should be extended for the last CSR, surely businesses had a four-year run-in to get over the shock. How would it be a shock if businesses had years to prepare for derating to be increased to 50% liability? When the issue was agreed last time, it was not agreed for ever and a day.

ERINI's paper also stated that a major threat to the sector was its competitive position deteriorating. I have difficulty with a blanket benefit to business because ERINI's paper refers to a lack of innovation and interest and to a risking cost base. Obviously, if industrial derating is kept as it is, it will help to keep the cost base down, but there is no link with innovation and investment. I have a difficulty with that because businesses can take that, put it in their back pocket and say that that is all right. It is about keeping costs down but it is not tied into job creation, R&D or helping with exports.

What consideration has been given to looking at the income from 100% liability and using the other 70% — 30% comes in currently — in other ways to help the base to become more competitive by investing in innovation, research and development, and increasing exports? You said at the last meeting that we cannot change the legislation. We wanted businesses to invest the 70% that they do not pay or do something with it to create jobs. There is nothing to say that we cannot increase that to 100% and use the other 70%. Has any consideration —

Mr McClure:
Recycling it in manufacturing?

Ms Purvis:
Yes.

Mr McClure:
That is a very good point. We looked at that back in 2006 when we were engaged with Northern Ireland Manufacturing and other business organisations. In fact, we reached the stage of naming the proposal; it was called the STAR (skills, training and research) scheme. It looked at whether a proportion of the savings from the rates scheme could be recycled back into manufacturing. The industry was quite keen. There were complications about the skills levy at that time, and it never developed as a policy. At the time, the direct rule Minister decided not to take that forward

because it was complicated. We looked at the proposal, and, if the Committee wanted, we could look at it again. However, it could not be introduced quickly because it would require primary legislation, consultation and research. We could re-engage with business organisations on that issue.

The ERINI study back in 2007 struggled to identify possible closures or the impact on individual businesses. We do not have any newer research. We asked the Minister whether he wanted us to commission a further study, but he felt not because of two reasons. One reason was because of the general cross-party support for retaining industrial derating at 70%, which many voices at that time were looking to be a long-term fix. Secondly, he feels that any change in policy is inconsistent with rebalancing the economy in Northern Ireland, and he felt that that was not the appropriate thing to do. For that reason, we did not reopen the issue with new research.

I am not an economist, and we have to look at the evidence that is presented by economists. ERINI carried out a substantial piece of work, but even it failed to identify that at an individual level. I accept fully that we are not armed with all of the facts, but I am not sure that we ever will be, and you may well get a different view from a different set of economists. I am sorry that that is an unsatisfactory answer, but I am trying to explain how we got to this position.

Ms Purvis:

It is very important that we grow our manufacturing base in Northern Ireland. There is no question about that, but when does stimulus to help growth become dependency on the state? I am concerned that a continual blanket handout becomes dependency rather than stimulating growth in that sector through jobs and exports.

Mr McClure:

I do not disagree with you.

Mr O'Loan:

I am interested in your answer to Dawn about the possibility of a scheme that would return to manufacturing in a more targeted way some of the extra revenue that potentially would be raised. I thought that we had been told previously that that would not be permitted under the rules, so I am interested that you were exploring that, and I am keen that you open that exploration again and get that evidence in front of us at some stage. I guess that everyone would like to move away from that discount, and, by that, I mean that we would like to feel that we had the confidence that the manufacturing sector could stand the stand the ordinary rates charge in the same way as other businesses.

I take David's point that we do not want to spring surprises on any section of business so that, if there were a change, it would have to be phased in properly, due notice would have to be given, and so on. The difficulty is that the evidence is not clear. The costs of the discount are clear enough; I understand that, for every 10%, a figure of around £8 million is involved. How much benefit is going to manufacturing out of that? For all the analysis in your paper, which is based on the ERINI evidence, we do not have real clarity. By and large, I conclude that, if there is to be change, it is up to the Minister to lead it. He is not currently minded to do that.

Other businesses pay rates at 100%. Is there evidence that pressure on manufacturing is greater than that on other businesses in these difficult times for everyone?

Mr McClure:

Probably not. As you know, the big sector that is suffering in Northern Ireland is construction. The service sector is not doing terribly well either. Over the past quarter, output from the manufacturing sector has grown a little, but, again, it depends what sub-sector you are talking about. This morning, I heard the CBI talking about some sectors that are doing quite well, including ICT, food processing, and so on. Sectors that have been successful in exporting to countries that have not suffered so much from the economic downturn are doing well, but that does not apply across the board. We cannot retarget this measure. We are stuck with it, warts and all. The Committee will know that, if we were to modify it in any way, it would become the nature of a new scheme, which, therefore, would not be allowable under state-aid rules.

Mr O'Loan:

Last week, a member raised the question of arrears, which I thought was a good question. I note that your paper states that there were arrears on around 19% of properties that are subject to industrial derating. You say that there are arrears on 7% properties that are classified as other derating. I do not know what that is, and it may be a small category. You say that there are arrears on around 15% of properties for all other non-domestic properties. Do you regard that as very strong evidence that those in the manufacturing sector have significantly more difficulty in paying their rates bills than others?

Mr McClure:

I certainly did not take that from the evidence. Veronica, do you have any comments on that point?

Ms Holland:

Without the level of support that is provided to the sector, the figures would be slightly different. For example, I imagine that the arrears figures would be higher. For the other derating category, there should be a footnote in the paper to cover sport and recreation and transport.

The Chairperson:

No other members have indicated that they want to ask a question, so thank you very much for attending. Do you need to wait while we discuss this?

Mr McClure:

If possible, yes, because I would like to be able to report back to the Minister.

The Chairperson:

If the Committee agrees, I suggest that we agree in principle that the proposal to retain the scheme be included in the draft Budget consultation. The Committee will then be able to consider its final position in light of that consultation. Furthermore, you mentioned the STAR scheme, to which a couple of members also referred. We could recommend that further exploration be carried out into that scheme and that that should also be included in the draft Budget consultation. Are members happy that we do that?

Members indicated assent.

Mr McClure:

Thank you very much.