Northern Ireland Assembly

Research and Information Service Briefing Paper

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Public Finance Scrutiny Unit

Executive Budget 2016-17: Northern Ireland Economic Context

Paper 1 of 4

As part of a four-part series, this Briefing Paper seeks to inform the Assembly's scrutiny of the Executive Budget 2016-17. It outlines key aspects of the Northern Ireland economic context, which merit consideration when assessing the Executive's priorities and related allocations in its Budget 2016-17.

Introduction

This Paper seeks to support Assembly scrutiny of the Executive Budget 2016-17. Looking at key economic measures, it seeks to highlight key aspects of the Northern Ireland (NI) economy, which should inform plenary and committee consideration of the Executive's priorities and allocations for its Budget 2016-17.

With the above in mind, the Paper presents the following:

- Section 1 - NI's recent performance in terms of economic growth;
- Section 2 - NI's relatively poor productivity in relation to other United Kingdom (UK) regions;
- Section 3 - NI's labour market in terms of economic inactivity and low pay; and,
- Section 4 - concluding remarks about NI's recent economic performance.

Throughout the Paper, potential scrutiny points are highlighted.

1 Economic Growth

In 2011 the Executive announced its commitment to the NI economy, stating:

> *The Executive has taken the important step of making the economy the top priority in this Programme for Government.*

And:

> *The aim of the rebuilding and rebalancing of the Northern Ireland economy, in the aftermath of a sustained global economic downturn, will remain the principal goal of the Executive's collective efforts.*[1]

To inform Assembly members' consideration of the Executive's above-stated intent, the following sub-section summarises NI's economic growth performance since 2011, looking at two key economic measures, i.e. Gross Domestic Product and Gross Value Added.

1.1 Economic Growth: Gross Domestic Product

Gross Domestic Product (GDP) measures the total value of new goods and services produced in a country in a given time period. The Office for Budgetary Responsibility

[1] NI Executive (2011) *Programme for Government : building a better future*: http://www.northernireland.gov.uk/pfg-2011-2015-final-report.pdf

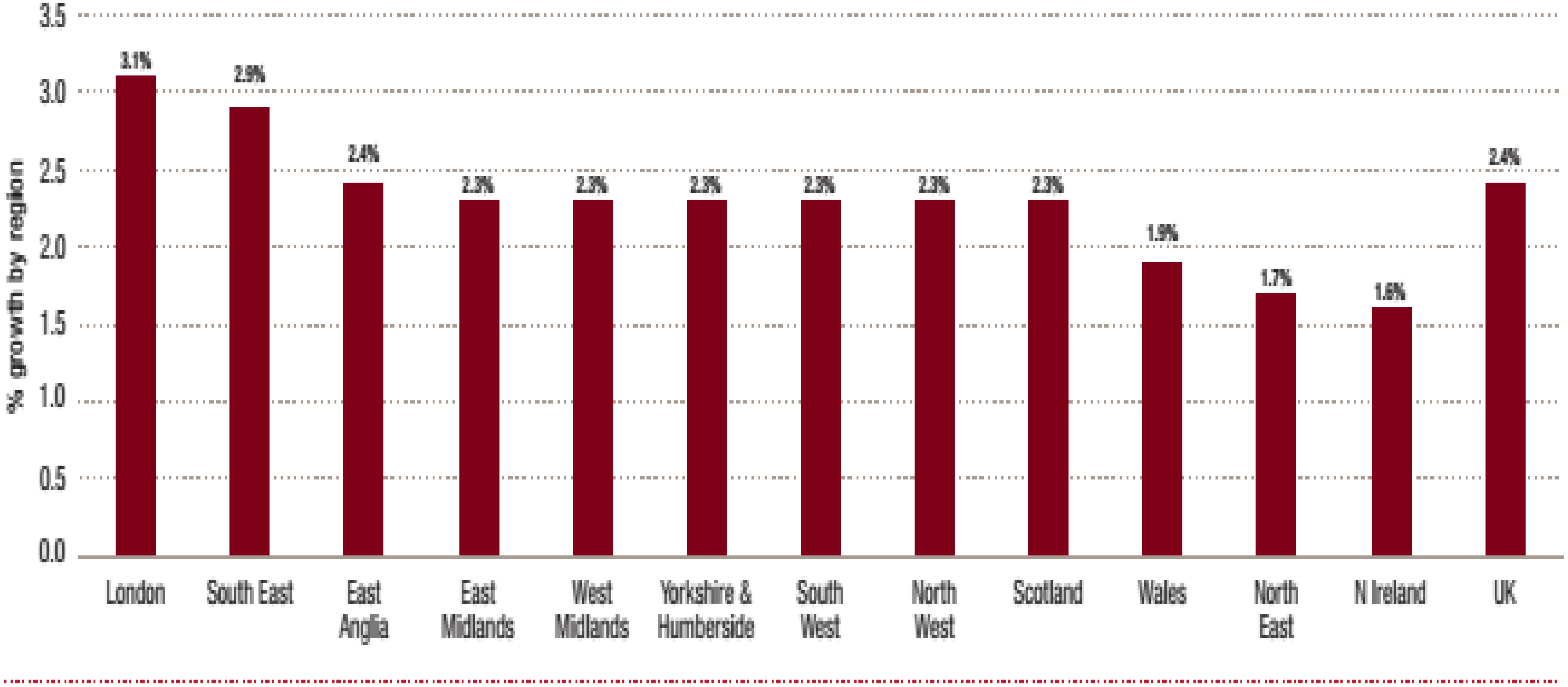
(OBR) has estimated United Kingdom (UK) GDP growth at 2.4% for 2015.[2] Put simply, the value of all goods and services produced in the UK during 2015 rose by 2.4%.

Regional GDP

In terms of NI GDP growth, PricewaterhouseCoopers (PWC) forecasts that the NI economy will grow by 1.6% in 2015, the lowest growth of the 12 UK regions, as shown below in Figure 1:

[2] OBR (2015) *Economic and fiscal outlook November 2015*:http://cdn.budgetresponsibility.independent.gov.uk/EFO_November__2015.pdf

Figure 1: PWC GDP growth forecast for 2015[3]



Source: PwC analysis

[3] Figure 1 is reproduced by RaISe from PWC (2015) UK Economic Outlook: November 2015: http://www.pwc.co.uk/assets/pdf/uk-economic-outlook-full-report-november-2015.pdf

1.2 Economic Growth: Gross Value Added

Another measure of economic growth is Gross Value Added (GVA). The Office for National Statistics (ONS) provides the following definition of GVA:

Gross Value Added (GVA) is a measure of the increase in the value of the economy due to the production of goods and services. It is measured at current basic prices, which include the effect of inflation, excluding taxes (less subsidies) on products (for example, Value Added Tax). GVA plus taxes (less subsidies) on products is equivalent to Gross Domestic Product (GDP).[4]

As with GDP, NI's GVA growth pattern is below the UK average. The following table shows the Ulster University Economic Policy Centre (UUEPC) GVA growth forecast for NI and the UK from 2015-2020:

Table 1: NI and UK Economic Growth Forecast[5]

GVA % p.a	2015	2016	2017	2018	2019	2020
NI	1.9%	1.5%	1.5%	1.5%	1.7%	1.8%
UK	2.6%	2.6%	2.2%	1.8%	1.9%	2.0%

The UUEPC explain the slowdown in NI economic growth during 2016 to 2018 as follows:

Looking beyond 2015, the UUEPC forecasts a reduction in economic growth. Lower levels of government spending, an end to falling prices and rising interest rates (albeit modest) will all have a negative impact.[6]

The UUEPC makes a connection between lower government spending and the slow-down in the NI growth pattern in 2016-2018. This can be partially explained by NI's high reliance on government spending relative to other parts of the UK. This reliance is in part due to the high level of public sector employment in NI. The public sector accounts for 26% of total employment in NI.[7]

Regional GVA

The Office of National Statistics (ONS) provides regional estimates of GVA per head of population. This measure provides a useful way of comparing the economic growth of regions of different sizes. Figure 2 below shows the annual growth in GVA per head for each UK region in 2012, 2013 and 2014.

[4] ONS (2015) *Regional Gross Value Added (Income Approach) 1997 to 2014*: http://www.ons.gov.uk/ons/dcp171778_426841.pdf

[5] Ulster University Economic Policy Centre (2015) *Presentation to the NI Economic conference 2015* by Professor Neil Gibson.

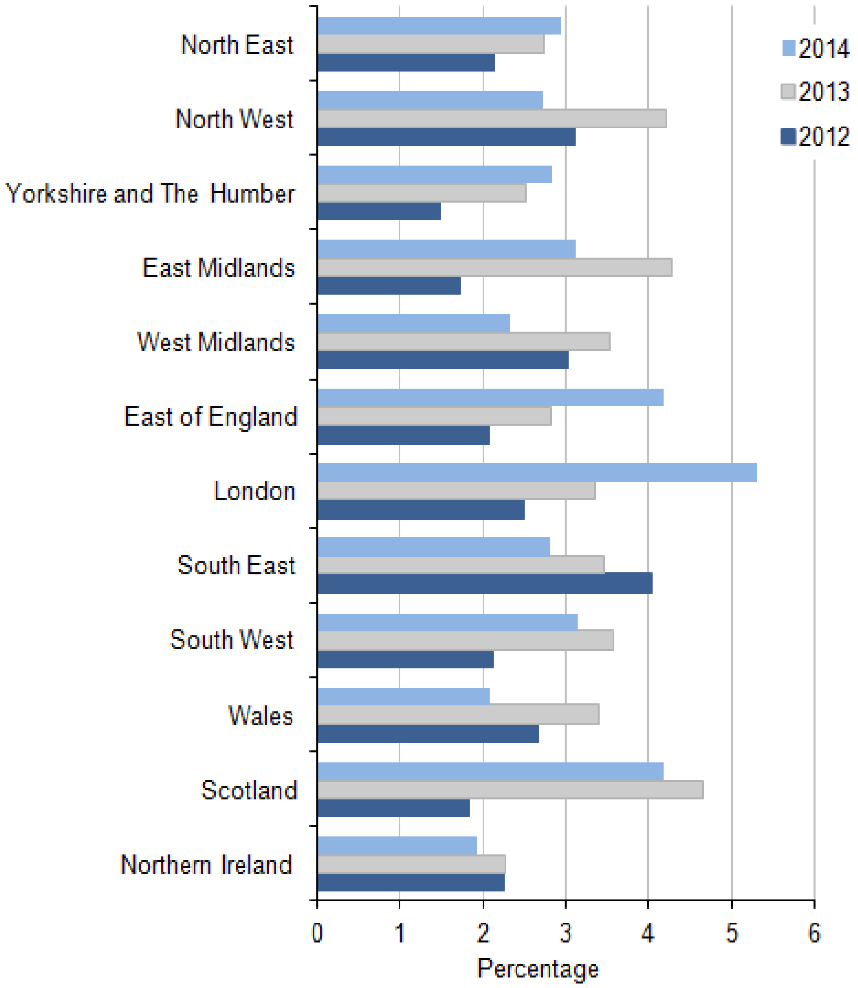
[6] UUEPC (2015) Outlook Spring 2015): http://www.ulster.ac.uk/__data/assets/pdf_file/0003/65982/epc-outlook-spring15.pdf

[7] Deloitte (2015) The State of the State :

It shows that NI is one of the weakest regions in terms of GVA growth per head. For example, in 2014 NI experienced the lowest annual growth of all regions at 1.9%. This compares with other regions as follows:

- NI had the lowest percentage increase of all the devolved regions;
- NI had less than half the percentage growth of Scotland, London and the East of England in 2014; and,
- NI and Wales are the only regions to experience a reduction in growth from their 2012 position.

Figure 2: UK Regional GVA per head since 2012[8]



[8] Figure 1 is reproduced by RaISe from ONS (2015) *Regional Gross Value Added (Income Approach) 1997 to 2014*: http://www.ons.gov.uk/ons/dcp171778_426841.pdf

1.3 How does the Executive Budget 2016-17 support economic growth?

The Executive Budget 2015-16 stated:

> *Investment in infrastructure is a key driver of economic growth. The Executive invests directly in large scale projects such as roads, public transport, hospitals, schools and water infrastructure, which are all areas within public sector ownership.*[9]

Investment in building roads, e.g., can boost employment in the construction industry, creating a multiplier effect, e.g., higher wages leading to increased consumer confidence and spending.

Issue for consideration:

1. What is the Executive's anticipated impact on NI economic growth, given its 2016-17 budgetary priorities and allocations seeking to support infrastructure investment?

2 Productivity

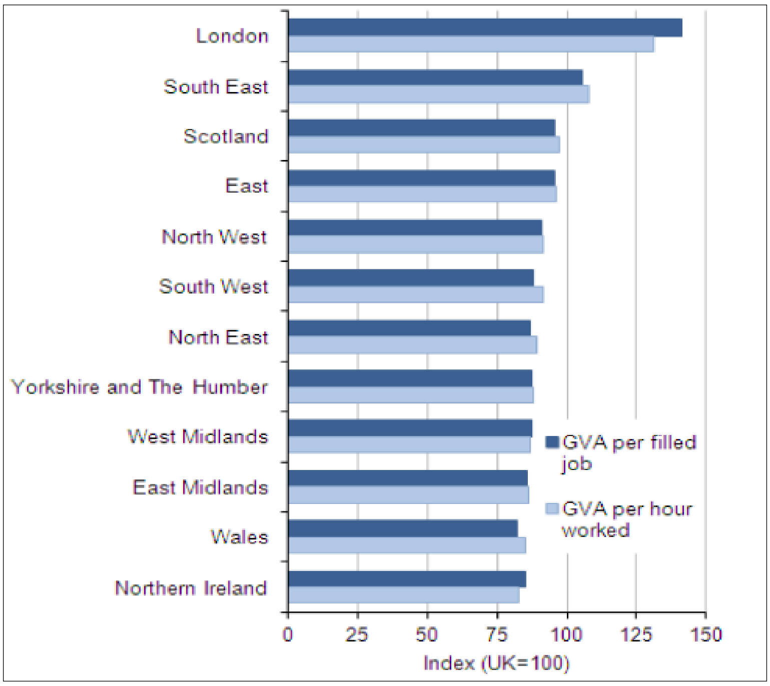
A UK House of Commons briefing paper recently expounded the importance of high productivity.[10] It stated:

> *Productivity generally refers to how efficiently inputs (labour and capital) are used to produce outputs (goods and services). Productivity is important as it is directly linked to living standards – a country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.*[11]

In terms of productivity, NI has underachieved relative to the UK average. Figure 3 below shows that in 2012, NI was estimated as the least productive region when measured by GVA per hour worked; 17.2% below the UK average:[12]

[9] NI Executive (2015) Budget 2015-16: http://www.northernireland.gov.uk/budget-2015-16.pdf
[10] Productivity is a measure of the efficiency of production. It is the ratio of output produced to the inputs required in the production process.
[11] House of Common's Library Briefing Paper, 3 July 2015, *Productivity in the UK* http://researchbriefings.files.parliament.uk/documents/SN06492/SN06492.pdf
[12] Office for National Statistics (2014) *Regional Economic Indicators*: http://www.ons.gov.uk/ons/dcp171776_369754.pdf

Figure 3: GVA per hour worked and GVA per filled job, 2012[13]



The most recently available data[14] shows that in 2013 GVA per employee in NI was the third lowest of the twelve UK regions. In terms of GVA per hour worked, NI has the lowest productivity in the UK at 82.2% of the UK average.[15]

2.1 How does Budget 2016-17 support NI's productivity?

If improving NI's productivity is a budgetary priority for the Executive, then the Budget 2016-17 allocations should reflect that through an appropriate level of investment in infrastructure, skills and science.

According to the Treasury, key drivers of productivity are:

> *..a dynamic, open enterprising economy supported by long-term public and private investment in infrastructure, skills and science.*[16]

In 2011, the Treasury explained NI's poor productivity, stating:

> *Low productivity is largely due to under-representation of high productivity sectors in Northern Ireland, including finance and business services.*

[13] Office for National Statistics (2014) *Regional Economic Indicators:* http://www.ons.gov.uk/ons/dcp171776_369754.pdf
[14] ONS (2014) *Labour Productivity, Q3 2014*: http://www.ons.gov.uk/ons/dcp171778_389391.pdf
[15] ONS (2014) *Labour Productivity, Q3 2014*: http://www.ons.gov.uk/ons/dcp171778_389391.pdf
[16] HM Treasury (2015) *Fixing the Foundations: Crating a more prosperous nation*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/443898/Productivity_Plan_web.pdf

Northern Ireland tends to be over represented compared to the UK average in low productivity sectors such as agriculture and food processing.[17]

The Treasury largely attributed NI's poor productivity performance i.e. the lack of high productivity employment and an over reliance on low productivity jobs in agriculture and the services sector, to the structure of its labour market.

Given that the new NI rate of corporation tax is not to be applied to the financial sector, one task for the Executive will be to ensure that in future the NI labour market includes other high productivity employment opportunities, e.g. in IT and pharmaceuticals.

3 Labour Market

In relation to the NI labour market the Executive's Programme for Government 2011-15 states:

We need to rebuild the Northern Ireland labour market following the impact of the global economic downturn while also continuing to rebalance the economy to increase living standards.[18]

In 2010, the NI Economic Reform Group described the effect of the recession on the NI labour market relative to other UK regions as follows:

Despite having proportionately the smallest private sector, it has suffered the largest percentage loss of jobs of any region during the current recession. Its unemployment rate has risen to the third highest of any region, and a higher percentage of […] working-age population are inactive than in any other region.[19]

3.1 Economic Inactivity

The "Economically Inactive" is defined as:

People who are not in work, but who do not satisfy all the criteria for ILO20 unemployment such as those in retirement and those who are not actively seeking work.[21]

[17] HM Treasury (2011) *Rebalancing the Northern Ireland Economy*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81554/rebalancing_the_northern_ireland_economy_consultation.pdf

[18] NI Executive (2011) *Programme for Government : building a better future*: http://www.northernireland.gov.uk/pfg-2011-2015-final-report.pdf

[19] Northern Ireland Economic Reform Group (2010) *The Case for a Reduced Rate of Corporation Tax in Northern Ireland*: http://www.ergni.org/reports/report_corporation_tax_may_2010.pdf

[20] The International Labour Organisation.

[21] Office for National Statistics, February 2002, Barham, C, Economic inactivity and the labour market, http://www.ons.gov.uk/ons/rel/lms/labour-market-trends--discontinued-/volume-110--no--2/economic-inactivity-and-the-labour-market.pdf

Economic inactivity has been a historic problem for NI's economy. As stated by the Minister for Employment and Learning in December 2013:

> *This level of economic inactivity has been a persistent feature of our economy over the past thirty years, within the range of 26% and 32%, irrespective of the changes within the economic cycle.*[22]

In NI, figures for the third quarter of 2015 show that 27.7% of the working age population (16-64) are classed as Economically Inactive.[23] NI remains above the UK average Economically Inactive rate of 22%. Moreover, NI remains highest of all twelve UK regions.[24]

It should be noted that not all forms of economic inactivity have negative consequences. For example, students pursuing qualifications may result in long-term benefits to both themselves and the NI economy, assuming they join the NI labour force on graduation. The Department of Employment and Learning's (DEL) current *NI Economic Inactivity Strategy* notes that:

> *Northern Ireland, for example, has a higher proportion of students contributing to our inactive total than any other region of the UK.*[25]

In addition, the Executive's Programme for Government 2011-2015 included a commitment for DEL and Department of Enterprise, Trade and Investment (DETI) to develop and implement a strategy to reduce economic inactivity through skills, training, incentives and job creation. That strategy was launched by the DEL and the DETI in April 2015. However, the estimated funding of approximately £60m for the ten-year programme is not currently available.

Also of note is that under the Fresh Start political agreement, responsibility for this strategy will shift to the new Department of Communities.

3.2 Low Pay

NI wages are amongst the lowest in the UK. However, key points from the latest NI *Annual Survey of Hours and Earnings* include the following optimistic outlook:

> *In April 2015 median gross weekly earnings for full-time employees were £485, up 5.4% from £460 in 2014. This represents the largest annual*

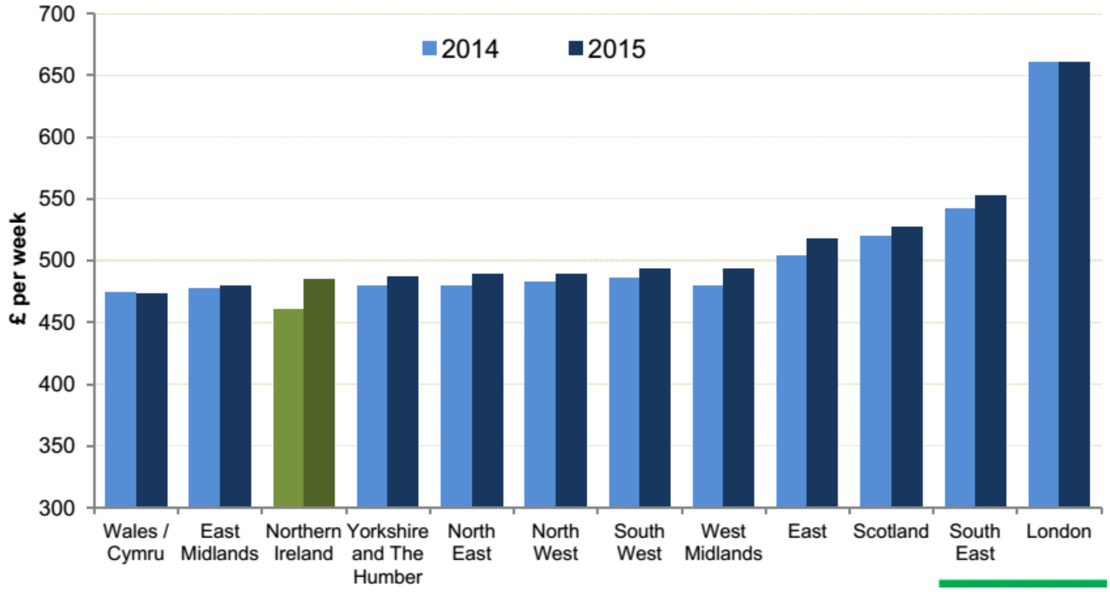
[22] Minister for Employment and Learning, 3 December 2013, Oral Statement to the NI Assembly, http://www.delni.gov.uk/del-oral-statement-economic-inactivity-strategic-framework
[23] NISRA (2015) *Northern Ireland Labour Market Report November 2015:* https://www.detini.gov.uk/sites/default/files/publications/deti/labour-market-report-november-2015.PDF
[24] NISRA (2015) *Northern Ireland Labour Market Report November 2015:* https://www.detini.gov.uk/sites/default/files/publications/deti/labour-market-report-november-2015.PDF
[25] DEL, Enabling Success: Driving social change through economic participation: a strategic framework to tackle economic inactivity, http://www.delni.gov.uk/economic-inactivity-strategic-framework.pdf

percentage increase in earnings since 2004 and the first increase in inflation adjusted earnings since 2009.[26]

Nonetheless, the NI average of £485 still falls short of the UK average of £528.[27] It should be noted that the UK average figure is distorted by the high levels of pay in the London area.

Figure 4 below highlights NI's relatively low level of pays compared to other regions in the UK:

Figure 4: Full-time employees' median gross weekly earnings across the UK regions 2014-2015[28]



As Figure 4 shows, unlike other UK regions where wages increased from 2013 to 2014, NI experienced a downward pressure on wages. However, from 2014 to 2015 NI weekly earnings increased. Moreover, NI recorded the largest gross weekly earnings increase over the 2014-15 year (5.4%).

3.3 How Does Budget 2016-17 Support the NI Labour Market?

Skills and employability have long been linked to increased productivity, leading to a high value economy reflected in economic and wage growth. A high value economy is likely to require the education and skills essential to attract high wage employment. The DEL Labour Market Bulletin 2013 found that:

[26] ONS (2015) *Northern Ireland Annual Survey of Hours and Earnings:* https://www.detini.gov.uk/sites/default/files/publications/deti/ASHE-Bulletin-2015.pdf

[27] ONS (2015) *Northern Ireland Annual Survey of Hours and Earnings:* https://www.detini.gov.uk/sites/default/files/publications/deti/ASHE-Bulletin-2015.pdf

[28] Chart reproduced by RaISe from ONS (2015) *Northern Ireland Annual Survey of Hours and Earnings*.

> *It has been estimated that increasing the average level of education in the labour force by one year is associated, over time, with a substantial increase in labour productivity of between 11-15%.* [29]

This is particularly relevant in light of the employment opportunities that could arise from Westminster's anticipated commencement of NI's devolved corporation tax power in 2018, and the Assembly actually choosing to exercise this fiscal power, and then the manner in which it does.

Issue for consideration:

2. What is the Executive's anticipated impact on NI economic growth, given its 2016-17 budgetary priorities and allocations seeking to support investment in a highly skilled workforce?

4 Summary of NI's Economic Performance

Despite returning to positive growth since the recent recession, the NI economy continues to experience faltering growth relative to the UK average. In 2012, 2013 and 2014, NI GVA growth per head was amongst the lowest in the UK.

Low labour productivity continues to be an issue for the NI economy. Productivity figures for 2013 show that in terms of GVA per hour worked, NI has the lowest productivity of all the UK regions. This productivity problem is further evidenced by NI experiencing the third lowest GVA per employee in the UK.

Some positive signs in NI's labour market include falling unemployment figures and rising weekly earnings. However, economic inactivity remains impervious to the recent upswing in the economic cycle. Despite the UK and the rest of the world's economies coming out of a recent global recession, economic inactivity in NI has not improved.

To sum up, NI can be viewed as having a low growth, low productivity, and low wage economy, with the additional problem of high levels of economic inactivity that are apparently resistant to positive changes in the economic cycle.

One way of improving NI's performance is to target resources and investment in areas that could lead to increased employment opportunities and in turn increased economic growth through the multiplier effect of higher wages, subsequently leading to higher disposable income leading to increased consumer confidence. However, the scope for this type of investment is restricted due to the one-year term of the Executive Budget 2016-17.

Westminster's anticipated commencement of NI's devolved corporation tax power in 2018 will no doubt add to the attractiveness of NI as destination for foreign direct investment (FDI). However, it should be kept in mind that a low rate of corporation tax

[29] Department for Employment and Learning (2013) *Labour Market Bulletin 24*.

is not the only influencing factor in attracting FDI. A highly skilled workforce is also a significant factor in this regard. And of course, this also rests on the Assembly actually choosing to exercise this fiscal power, and then the manner in which it does. Assembly scrutiny of the Executive's Budget 2016-17 (and future budgets) should consider whether the proposed priorities and allocations appropriately address this issue.

Issue for consideration:

3. How effectively does the Executive Budget 2016-17 priorities and allocations support economic growth and address the NI economy's fundamental weakness in terms of, e.g., low productivity, high economic inactivity and low pay?