The Northern Ireland Economy

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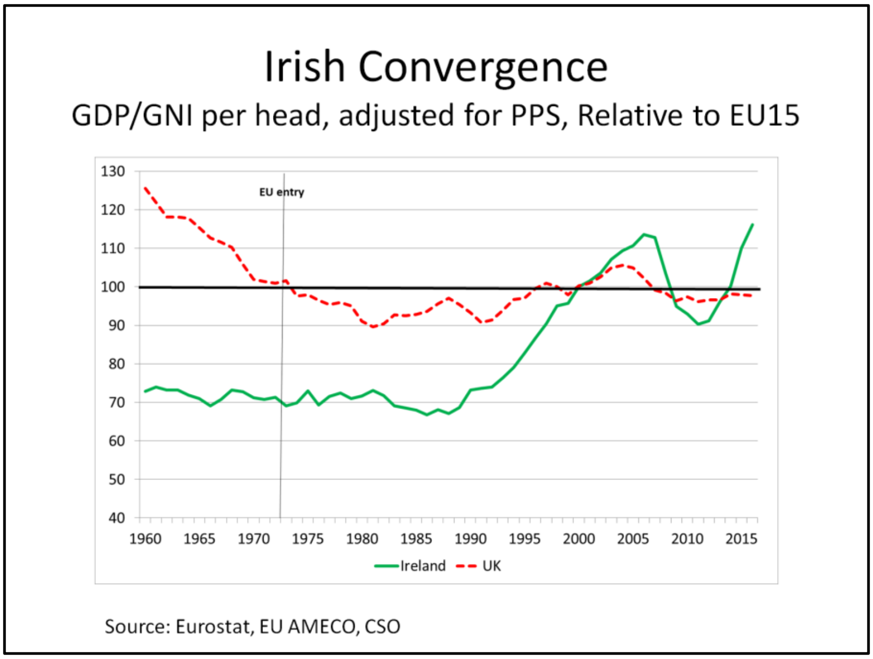
Outline

- The convergence process
  - National
  - Regional
- Historical evolution
- The economy today
- Options for the future

Considering how countries and regions catch up. Competitiveness is a major factor in driving convergence. It is different for national than for regional economies because the cost base tends to be rather similar within national economies whereas it is often very different between different countries. Need to look at examples of convergence – what works and does not work.

Convergence in EU

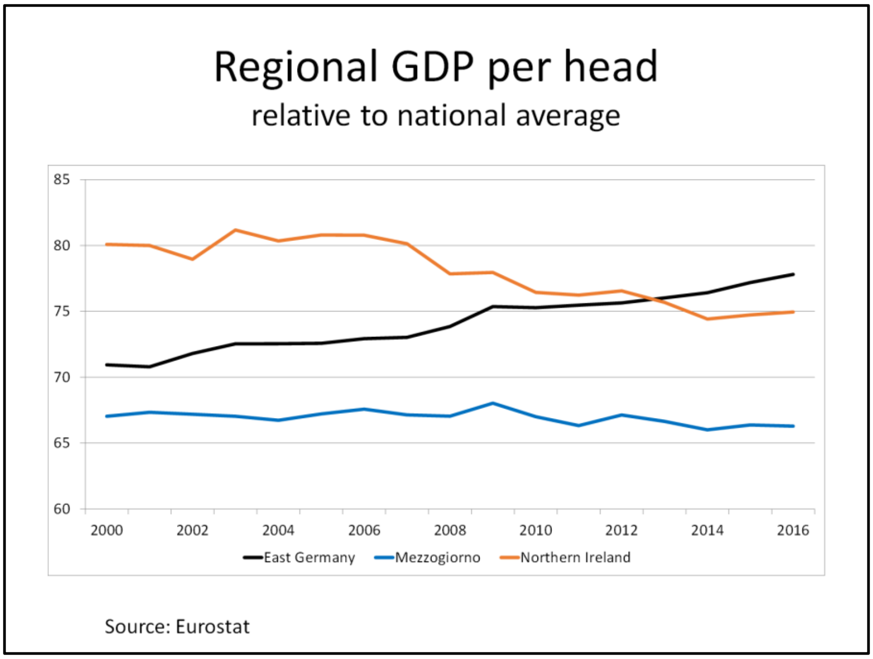
- The EU has been a major success story
  - Standards of living of poorer countries have quite rapidly caught up with richer countries
  - True for the EU 15, and true today for the EU28
- National convergence because
  - EU Single Market, learning from the leaders AND differences in national cost base the key
- Regional convergence within countries
  - Less satisfactory
  - Regional convergence: are there adequate differences in regional cost base to drive it?
  - Need to make it more attractive to locate away from booming major cities



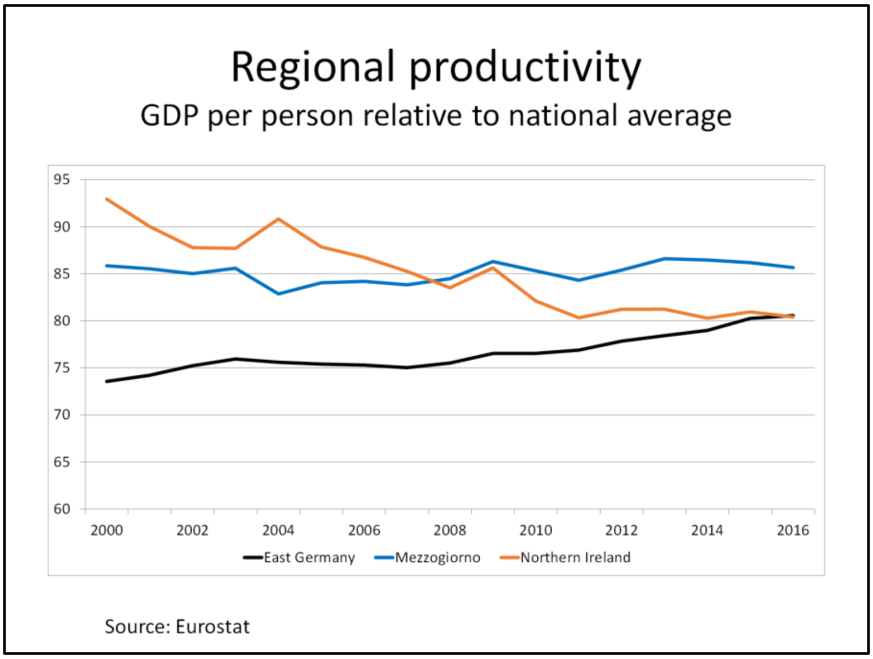
The convergence and outperformance of Ireland is a model. The interesting question is: why did Ireland fail to make progress for so long. As O'Gráda, 2002 suggests, the major Irish policy failures were the decision to opt out of free trade after the Second World War and the failure to invest in education, including third level. The first issue was addressed by EU membership in 1973 and the investment in education ramped up from Free Education in 1968, but only really reached its climax over the last decade. Competitiveness relative to the EU15 played an important role. The result was the Celtic Tiger period. With appropriate policies it could have happened a generation earlier

Regional Convergence within Countries

- Currently regional divergence in EU 13
- Experience in EU 15 large states
  - Success story is Germany (Eastern Germany)
  - Failure is Italy (Mezzogiorno)
  - Northern Ireland is similar to Italian experience
- Key factors in success:
  - Regions must be attractive for investors, not through subsidies, but because they are competitive and attract skilled employees



Northern Ireland output per head has fallen relative to the UK average since the Belfast Agreement – suggests bad economic policies by the Northern Executive. By contrast, East Germany has made steady progress, though it still has a long way to go. The Mezzogiorno languishes. What has distinguished the Mezzogiorno and the North is that they enjoy a standard of living much closer to the national average as a result of major transfers. Their cost levels are, as a result, closer to the national average and there is less incentive to invest.



The poor performance on productivity in the North should be seen against a very poor performance for the UK as a whole in raising productivity. East Germany is raising productivity steadily. This underpins a real convergence in living standards without relying on increasing transfers.

Lessons from elsewhere in EU

- Once there is convergence in living standards: less incentive for progress in output and productivity.
  - German success story involved “tough love” – had to increase productivity
  - Mezzogiorno, having achieved a good standard of living in 1970 by transfers, no further need to increase productivity
- Being more competitive than the national average matters for convergence from below
  - Attracting and holding skilled labour matters

Real growth per head

	Ireland	UK	Northern Ireland
1926-38	1.4	1.6	0.7
1938-50	1.1	1.3	4.0
1950-60	2.2	2.9	2.6
1960-70	3.9	2.4	3.7
1970-80	2.5	2.0	0.8
1980-90	1.3	2.8	2.7
1990-00	5.5	2.2	2.4
2000-10	0.2	0.9	-0.2
2010-16	3.3	1.3	0.2

Sources: Kennedy et al, 1988, CSO, Bank of England, NISRA, Eurostat, ONS
For Ireland 2010-14, not 2014-16

The North had a good run from the Second World War till 1969. However, the Troubles caused a pretty catastrophic collapse in output in the early 1970s. As discussed later, the subsidy from London was ramped up in the 1970s to offset the effect of the Troubles, accounting for all of the limited growth in that decade. Since the Belfast Agreement growth in the North has been very low – even worse than in the UK. Much of it has been accounted for by a further ramping up of the transfer from London.

Productivity

	Ireland	UK	Northern Ireland
1950-60	3.3	2.8	3.3
1960-70	4.3	2.8	-0.2
1970-80	2.9	2.0	0.2
1980-90	1.8	2.2	2.8
1990-00	2.6	2.2	1.9
2000-10	1.3	0.9	-0.4
2010-16	3.0	0.7	0.0
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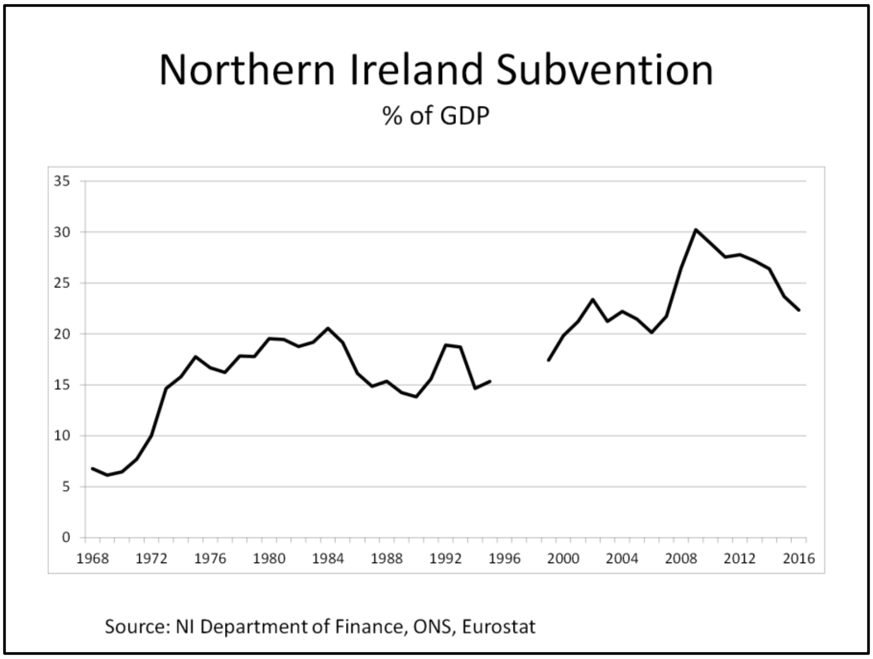


The transfer from London rose from 7% before the Troubles to over 17% in the 1970s. It fell back to 15% in the 1990s before the Belfast Agreement. Since the agreement it has increased to 20% to 25% of regional GDP.

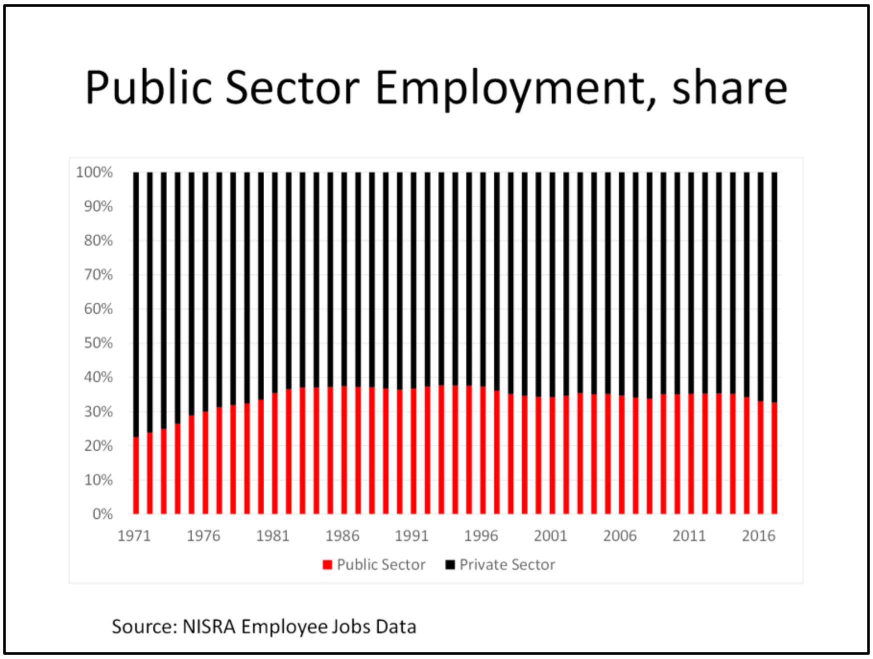
A paper by Thumann and Daly suggests that the transfer is much smaller. However, they assume away a substantial part of the welfare bill – that the UK would pay it for ever; that the North, whether in the UK or Ireland, would not pay towards debt interest, defence, development aid etc.; and that the Republic would continue to support the NI very high levels of public expenditure with a much worse provision of public goods in the South.

UK Public Expenditure

% of UK average

	Public expenditure per head	Disposable Income per head
England, NE	104	85
Scotland	116	97
Wales	109	88
Northern Ireland	121	82

Source: https://www.gov.uk/government/statistics/public-expenditure-statistical-analyses-2018
Comparing the North and the NE of England, the North is a
little less well off, but dramatically better off in terms of public expenditure.
These data show expenditure but don’t include revenue. Scotland has chosen
higher taxes to fund higher expenditure



The very large transfers from London saw a major increase in the share of public sector jobs in the 1970s to a third of all employees, compensating for a dramatic fall in jobs in the tradable sector. The high transfers have sustained this very large public sector ever since.

Comparison of living standards

Relative to Ireland, 2012

	UK	Scotland	Northern Ireland	Ireland
Personal consumption	1.34	1.26	1.20	1.00
Government consumption	1.18	1.27	1.43	1.00
Investment	0.62	0.60	0.31	1.00
GNI	1.06	0.99	0.84	1.00

Source: CSO, ONS, NISRA, EU AMECO

- Between 2012 and 2016 living standards have risen in Ireland by over 6% per person
- Between 2012 and 2016 living standards have risen in the UK by over 6% per person
- On the basis of GNI (adjusting for data problems) national income per head is today substantially higher than in the UK.
- However, consumption per head is likely still below the UK and the North
- But investment is much higher in Ireland than in the UK
- In turn, investment in the UK is much higher than in the North

Brexit effects on North

- Structure of economy means output will be worse affected by Brexit than UK average
  - Agriculture bigger, mechanical engineering etc.
  - Integrated supply chain with Ireland (Intertrade Ireland report)
- If border with Ireland – major disruption to trade because of non-tariff barriers
  - Damage to retail and distribution sector
- If border in Irish sea – huge disruption to Northern retail and distribution sector
  - Increase in consumer prices, loss of competition and choice, loss of jobs etc.
- Customs Union likely to make a very big difference, greatly reducing problems

Marital Discord or Good Home

- The North remains part of UK

EITHER

- English nationalism and UK economic problems may result in a major cut in subvention from London
- Tough love in the North – because subvention rapidly reduced, for example after the next UK election

OR

- Subvention continues or gradually reduced
- Develop a sustainable Northern Ireland economy
  - Need a dramatic change in policy by a Northern Ireland Executive
  - Slow winding down of subvention
  - Major cuts in some areas of expenditure to redirect funds to physical and human capital investment

Alternatives?

- Tough love – independence?
  - End of subvention - massive cuts in public services
  - Very big rise in unemployment and loss of income
  - Decades needed to catch up
  - Unsustainable: huge emigration and possibly unrest
- Adoption by Ireland?
  - Could maintain living standards in North but lock in dependence
  - For Ireland subvention would be similar to fiscal adjustment of the financial crisis. The result would be a 15% permanent reduction in living standards (ESRI Hermes model)
  - This would leave the North 20% better off than Ireland through the exceptional permanent subvention from Ireland

Conclusions

- North faces major economic problems which will be greatly aggravated by Brexit
  - Costs minimised if UK in customs union
- Long-term risks
  - After 20 years of failure by the Northern Executive, dramatic policy shift needed to make Northern Ireland economy sustainable
    - Need to double investment to sustain real growth
    - Prepare for major danger – English nationalism
    - Successful development could leave open other choices in the very long term