

The Northern Ireland Economy: Underperformance and Future Challenges

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Objective

- Looking at the performance of the Northern Ireland economy, especially since 1998
 - Why has the economy performed so poorly in recent decades?
 - Given its current economic weakness what future challenges will Northern Ireland face?
 - What are its options?

Outline

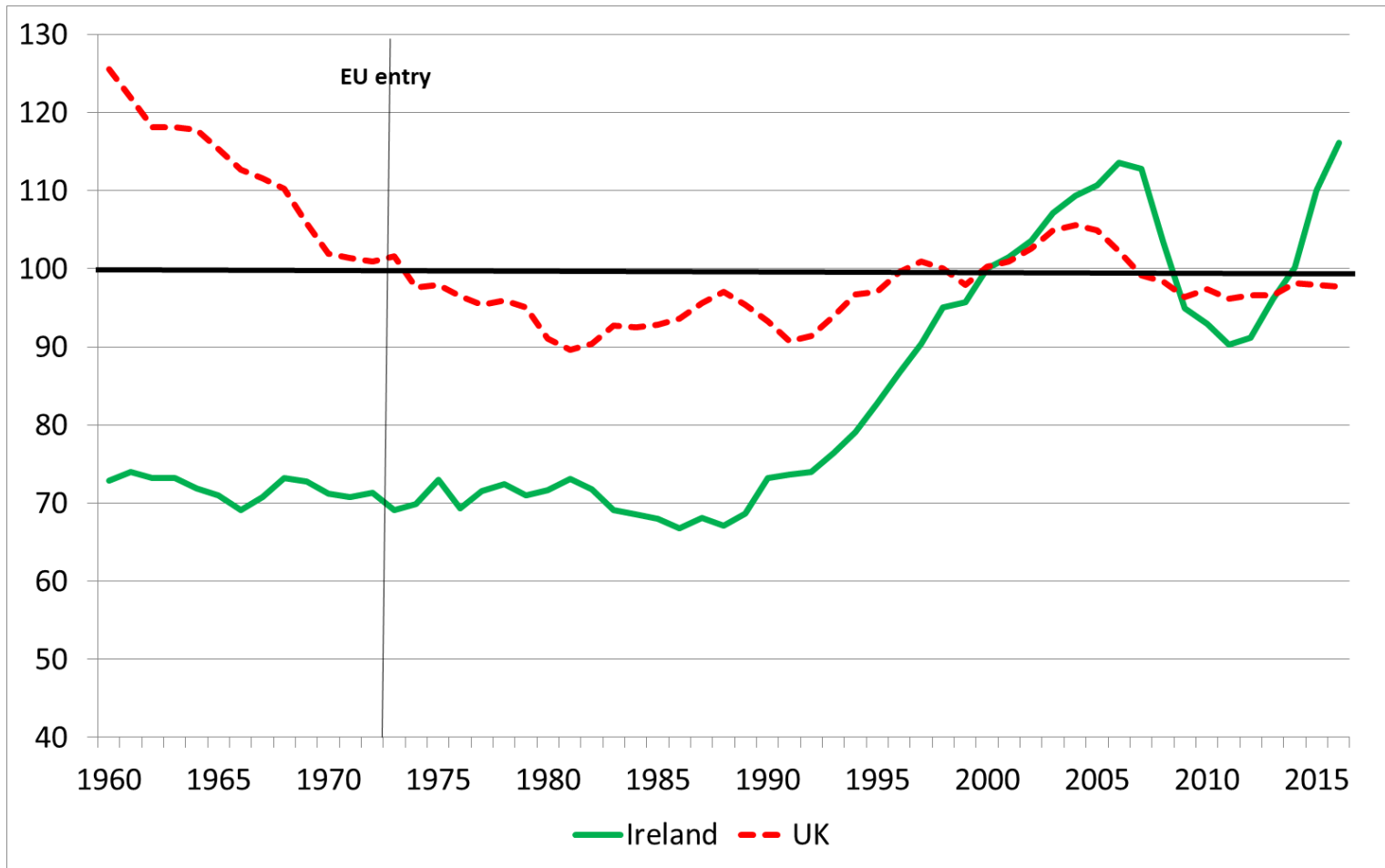
- The convergence process
- Historical evolution
- The economy today
- Options for the future

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

Irish Convergence

GDP/GNI per head, adjusted for PPS, Relative to EU15



Source: Eurostat, EU AMECO, CSO

Regional Convergence within Countries

- Currently regional divergence in EU 13
- Experience in EU 15 large states
 - Relative 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

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

Northern Ireland - Economic History

- Bad first 20 years economically 1920-39
 - Needed a subsidy from central government
- A “good” Second World War & some success up to 1969
 - Subsidy of 7% of GDP in 1960s
- The “Troubles” hit it hard
 - Subsidy rose to 15% of GDP

Real growth per head

	Ireland	UK	Northern Ireland
1926-38	1.4	1.9	0.7
1938-50	1.1	1.4	3.1
1950-60	2.2	3.0	2.0
1960-70	3.9	2.4	3.1
1970-80	2.5	2.0	1.4
1980-90	1.3	2.8	2.2
1990-00	5.5	2.2	3.0
2000-10	0.2	0.9	0.4
2000-18*	1.3	1.1	0.7

* GNI* for Ireland

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

Productivity, annual % change

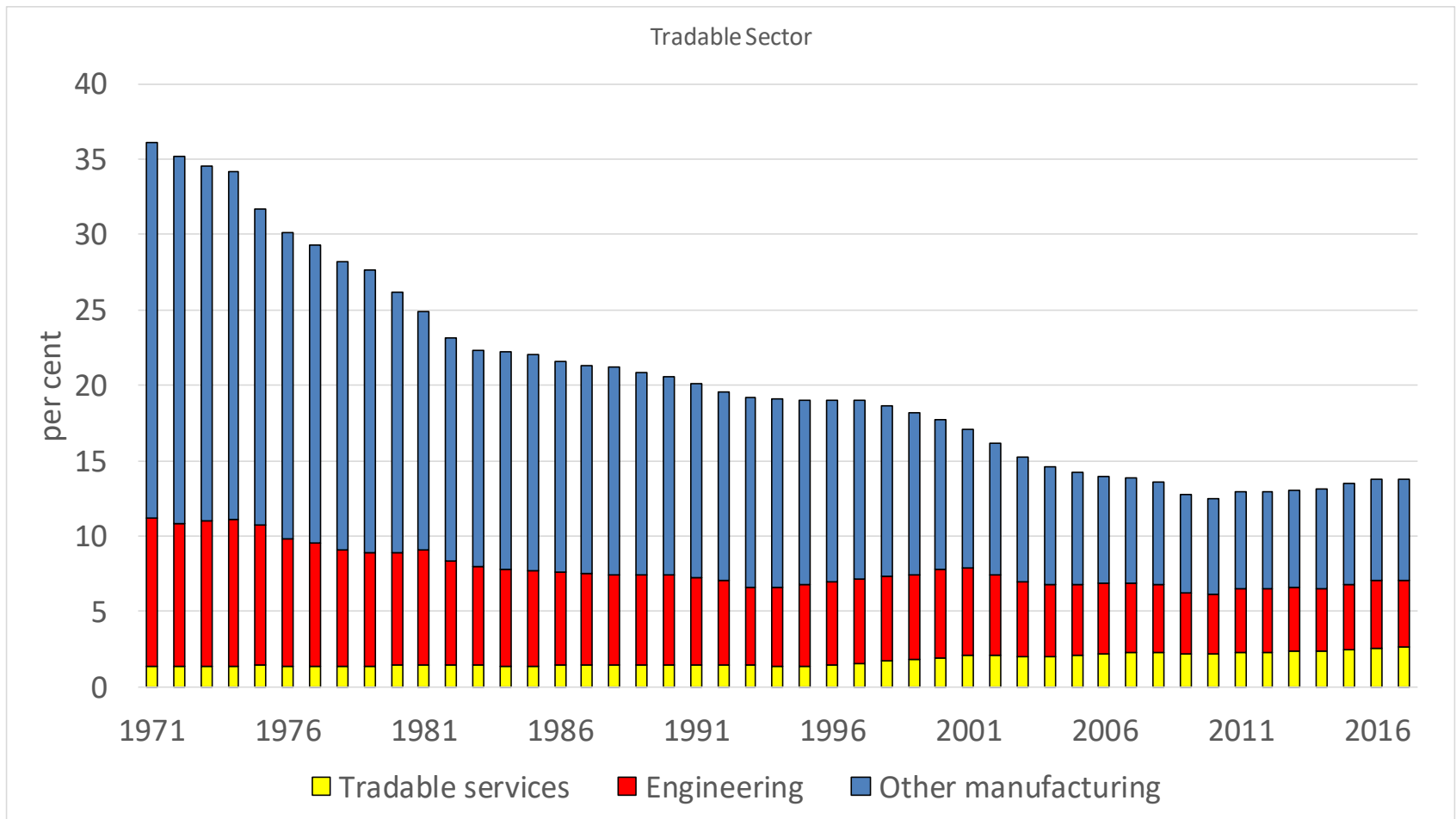
	Ireland	UK	Northern Ireland
1950-60	3.2	3.0	2.8
1960-70	4.3	2.8	3.5
1970-80	2.9	2.0	0.7
1980-90	1.8	2.2	2.3
1990-00	2.5	2.2	1.7
2000-10	1.2	0.9	0.2
2010-17*	1.5	0.7	0.6
1950-00	2.9	2.4	2.2

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

Economy post-1969 “Troubles”

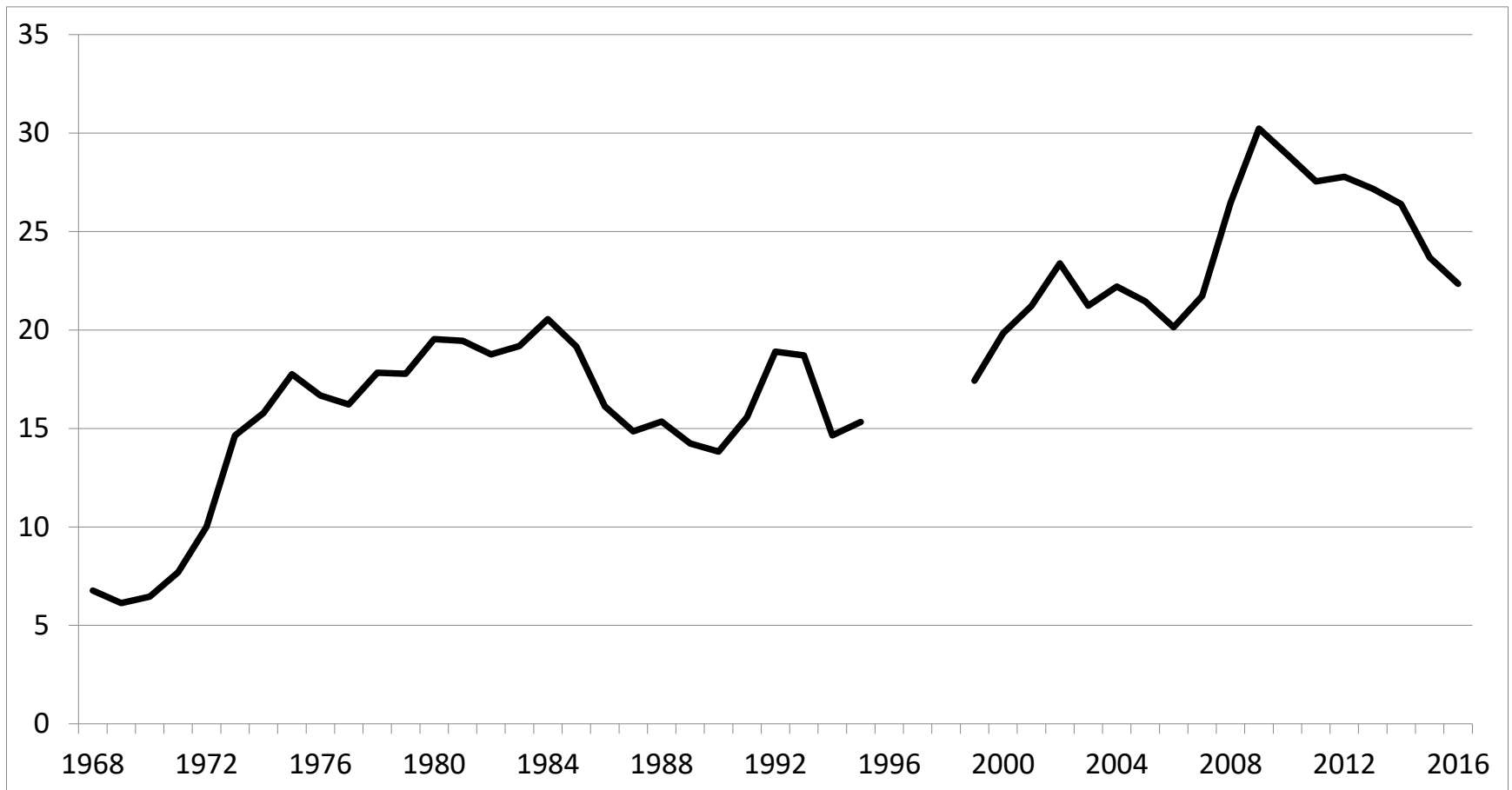
- 1970s:
- Collapse in regional economy
 - Ending of foreign investment
 - Closure of many existing businesses
 - Collapse in tradable sector
- Very large increase in regional transfers
- Used to fund big expansion in public sector
- 1980s – big regional subsidy to private sector

Tradable sector employment share



Northern Ireland Subvention

% of GDP



Source: NI Department of Finance, ONS, Eurostat

Economy since 1998 agreement

- 1998 Agreement:
 - Effectively ended terrorism
 - Fitful return to self-government with forced coalition of both sides
- An economic “peace dividend” was expected
- Instead, worst UK regional performance
- Regional transfers higher, not lower

Decomposition of regional growth

UK, 2000-2017

$$\underbrace{\frac{GDP}{Pop}}_{\text{GDP per capita}} = \underbrace{\frac{GDP}{Emp}}_{\text{Productivity}} \cdot \underbrace{\frac{Emp}{LForce}}_{\text{Employment Rate}} \cdot \underbrace{\frac{LForce}{Pop1564}}_{\text{Participation Rate}} \cdot \underbrace{\frac{Pop1564}{Pop}}_{\text{Dependency Ratio (inverse)}}$$

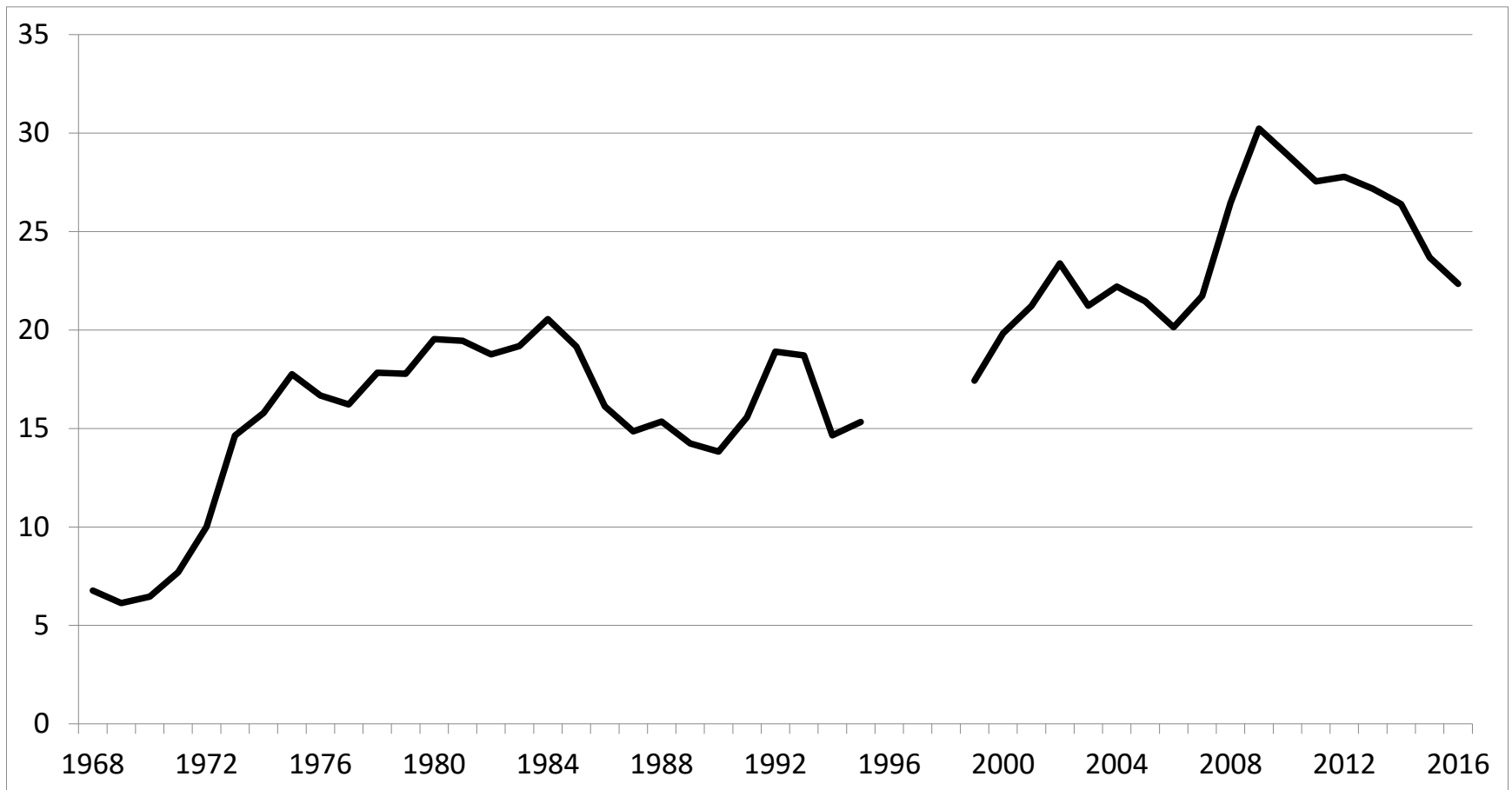
Growth, annual average, percentage points

	GDP per head	Productivity	Employment Rate	Participation rate	Dependency
Ireland	1.0	0.9	-0.2	0.4	-0.2
UK	1.0	0.9	0.1	0.2	-0.1
North East	1.3	0.7	0.2	0.5	-0.1
North West	1.4	1.2	0.1	0.3	-0.1
Yorkshire	0.8	0.7	0.1	0.1	-0.1
East Midlands	0.8	1.0	0.1	0.0	-0.3
West Midlands	0.9	1.0	0.0	0.1	-0.2
East England	0.8	0.9	0.0	0.1	-0.2
London	1.5	1.0	0.1	0.2	0.1
South East	0.9	1.0	0.0	0.1	-0.2
South West	0.7	0.8	0.0	0.1	-0.2
Wales	1.0	0.7	0.1	0.4	-0.2
Scotland	1.4	1.1	0.2	0.2	-0.2
Northern Ireland	0.7	0.2	0.1	0.4	0.0

Source: Eurostat

Northern Ireland Subvention

% of GDP



Source: NI Department of Finance, ONS, Eurostat

Average regional net fiscal balance, less national balance, 2000-2016, % of regional GDP

North East	14.6
North West	8.2
Yorkshire & Humber	6.3
East Midlands	2.3
West Midlands	6.4
East of England	-5.6
London	-8.1
South East	-8.8
South West	0.6
Wales	17.9
Scotland	2.9
Northern Ireland	19.9
England	-1.4

Public expenditure per head, % of UK

	2004-16
North East	107
North West	104
Yorkshire	97
East Midlands	91
West Midlands	97
East	88
London	114
South East	86
South West	92
Scotland	115
Wales	111
Northern Ireland	123
UK	100

Expenditure per head 2016

PPS adjusted € thousand

	Northern Ireland	UK	Scotland	Ireland
Household Consumption	15.2	19.8	18.4	16.5
Government consumption	6.7	5.9	6.9	4.6
Personal and public consumption	21.9	25.7	25.3	21.1
Investment	24.5	31.7	29.3	42.0
GDP/GNI	24.5	31.7	29.3	33.3

On consumption basis, Northern Ireland slightly better off than Ireland

Ireland better off than UK and UK regions based on GDP/GNI

Standard of living in Northern Ireland heavily supported by public expenditure

Difference due to:

1. Normal economies invest 20% of GDP, UK invested 17% and Northern Ireland 14%
2. Higher savings in Ireland

Factors explaining poor Northern Ireland economic performance

- Legacy effects of the “Troubles”
- Low investment in physical capital
- Low human capital
 - Poor educational system
 - Emigration of graduates
- Poor governance
 - Wasted public expenditure
 - Dependency culture
 - “Cash for ash”

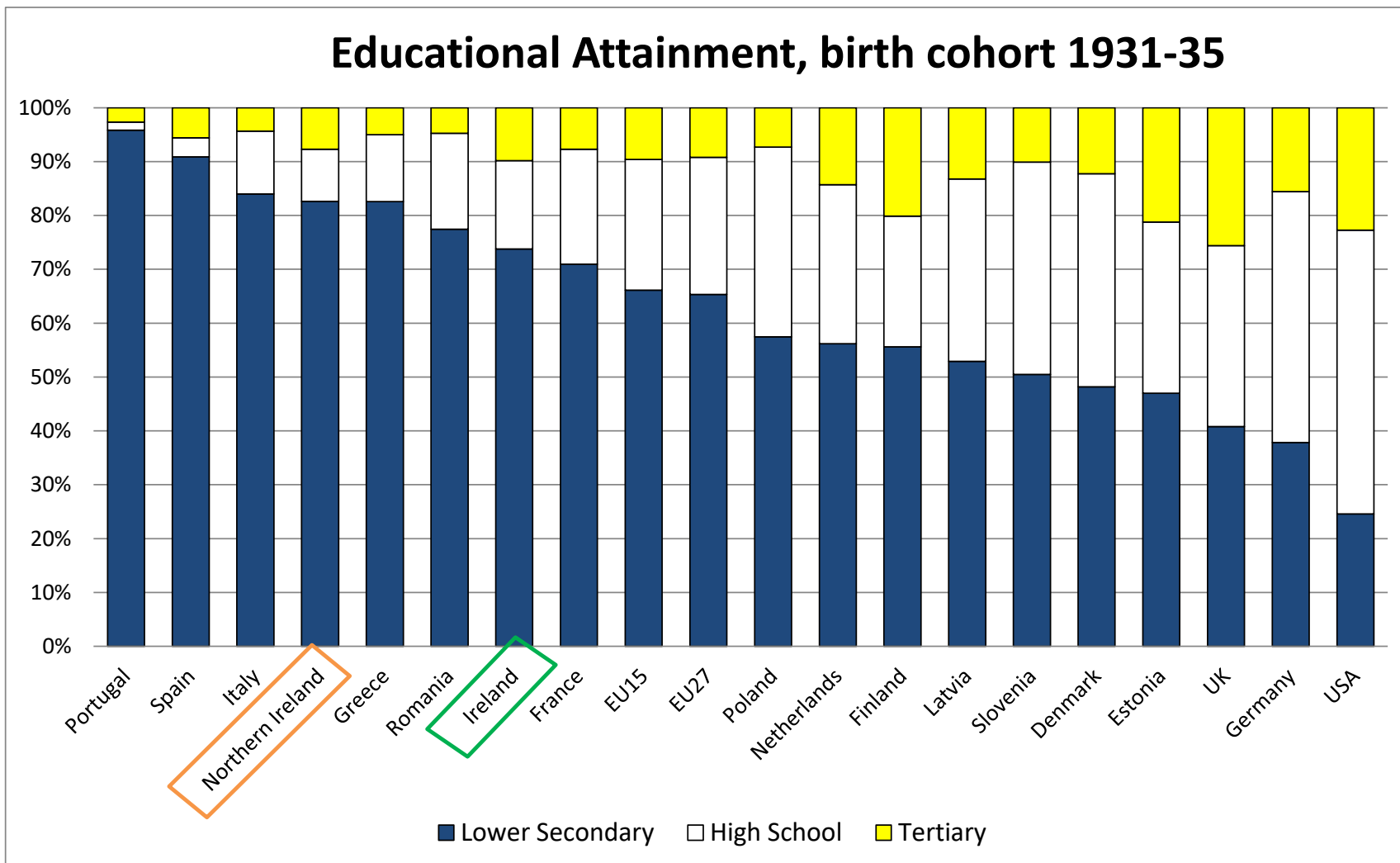
Human Capital and Growth

- Human capital affects economy through 3 key channels
 - Productivity – higher earnings
 - Labour force participation – mainly women
 - Reduced probability of unemployment
- Measurement:
 - Micro-economic studies – individual benefits
 - Macro-economic studies – model based

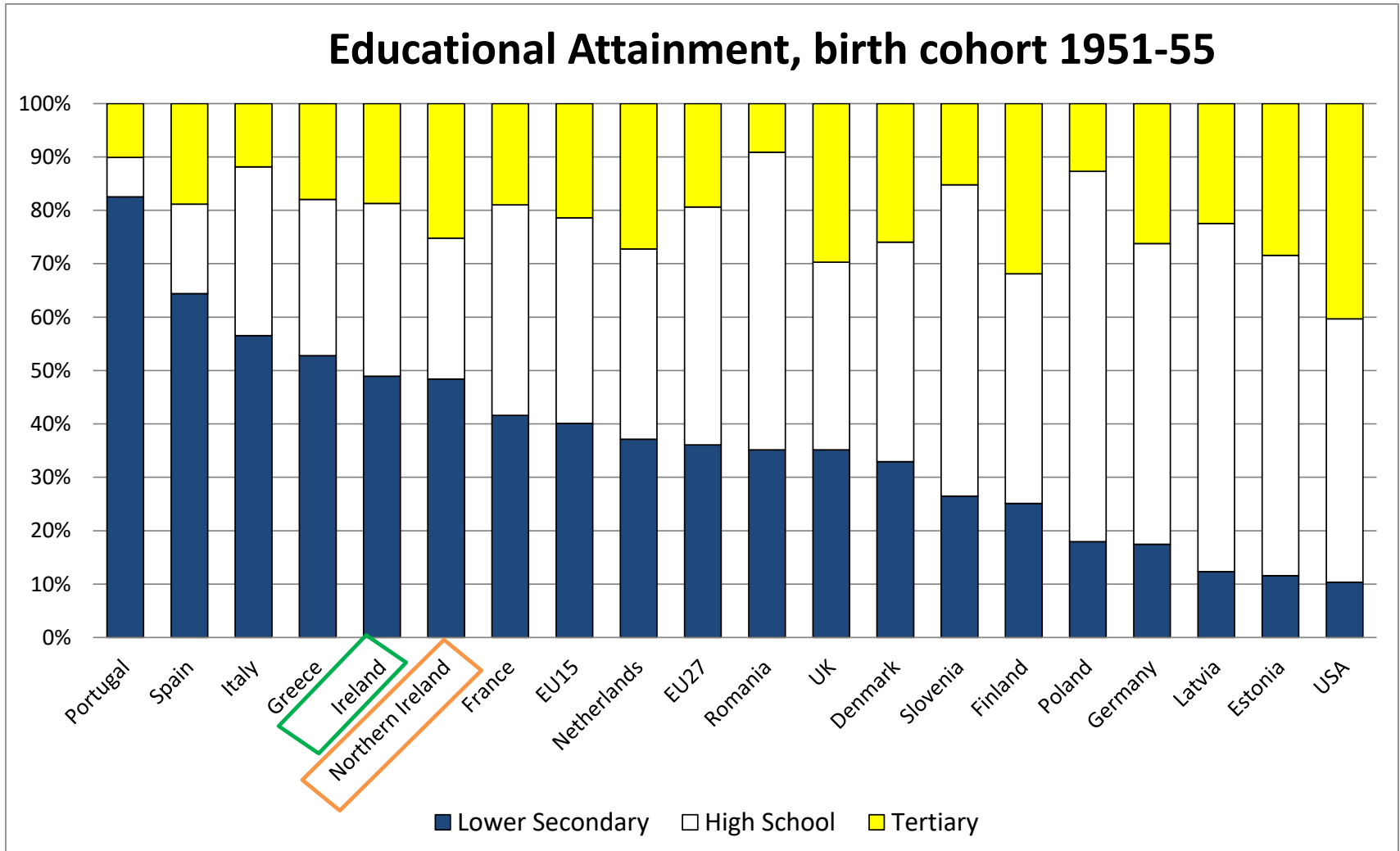
Two Education Systems on Island

- One primary system in Ireland from 1830s, initially multidenominational. However, it soon became denominational.
- Still similar education systems in 1920; fee paying secondary throughout
- UK Education Act, 1944, Northern Ireland Education Act, 1947: Free secondary education in Northern Ireland on English model
 - Northern Ireland: selection @ 11 and 30:70 split. Now 40:60
- Ireland: Investment in Education, 1965. 1967: Free secondary education
 - Ireland: no selection into schools, but streaming within some schools
- **Hannan and Boyle, 1987, and Smyth, 2016: Streaming not good for less talented pupils. Result: reduction in streaming since 1980s**
- **Borooah and Knox, 2015, shows that the selection of 40% of children into grammar schools very seriously disadvantages the remaining 60%**
 - “Taken collectively, Northern Ireland’s post-primary secondary schools fail to meet the minimum acceptable standard for post-primary schools in England”
 - Only 20% of protestant boys from a deprived background reached the requisite standard whereas 33% of Catholic boys from the same background did so.

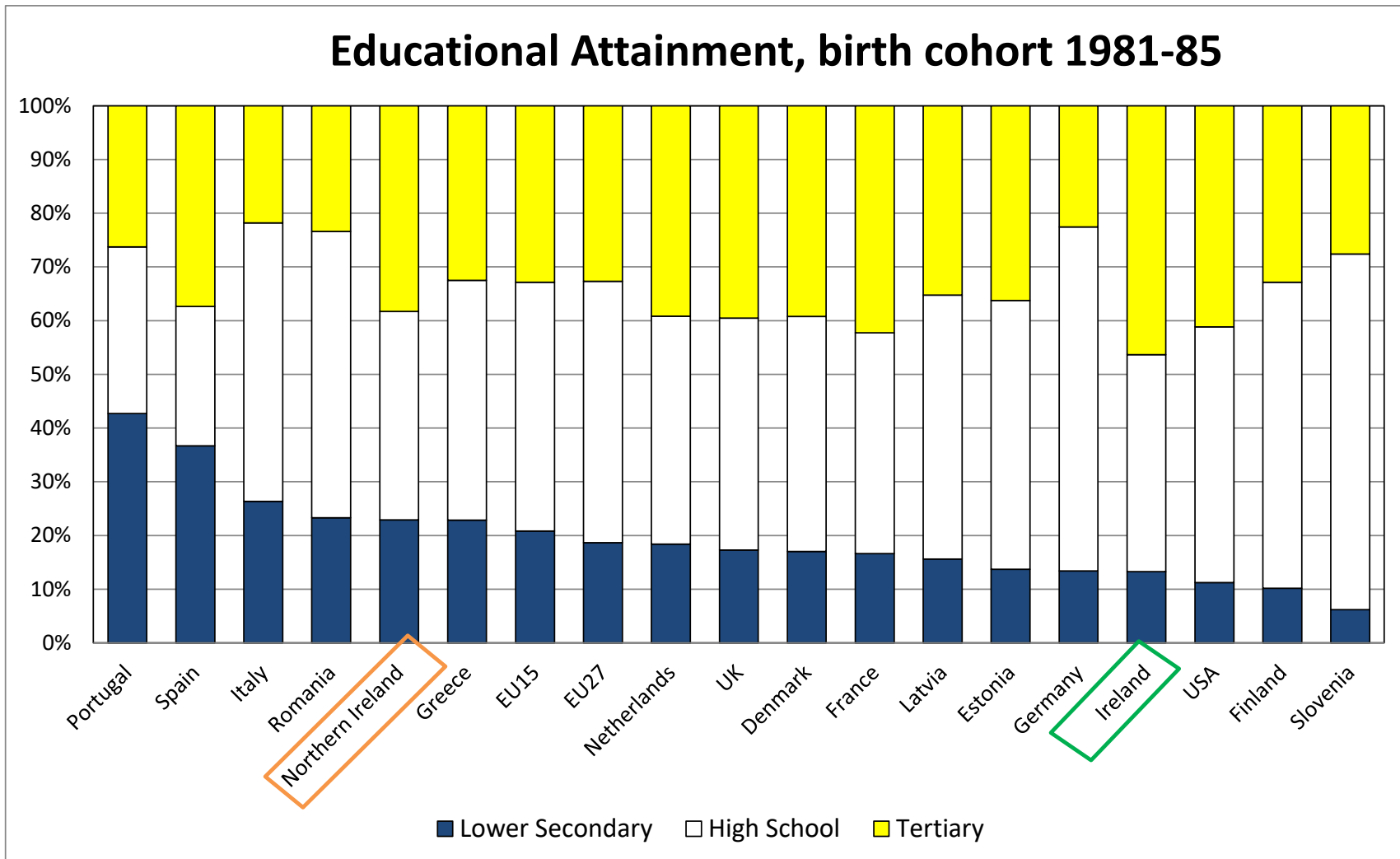
Education – cohort of 1931-5



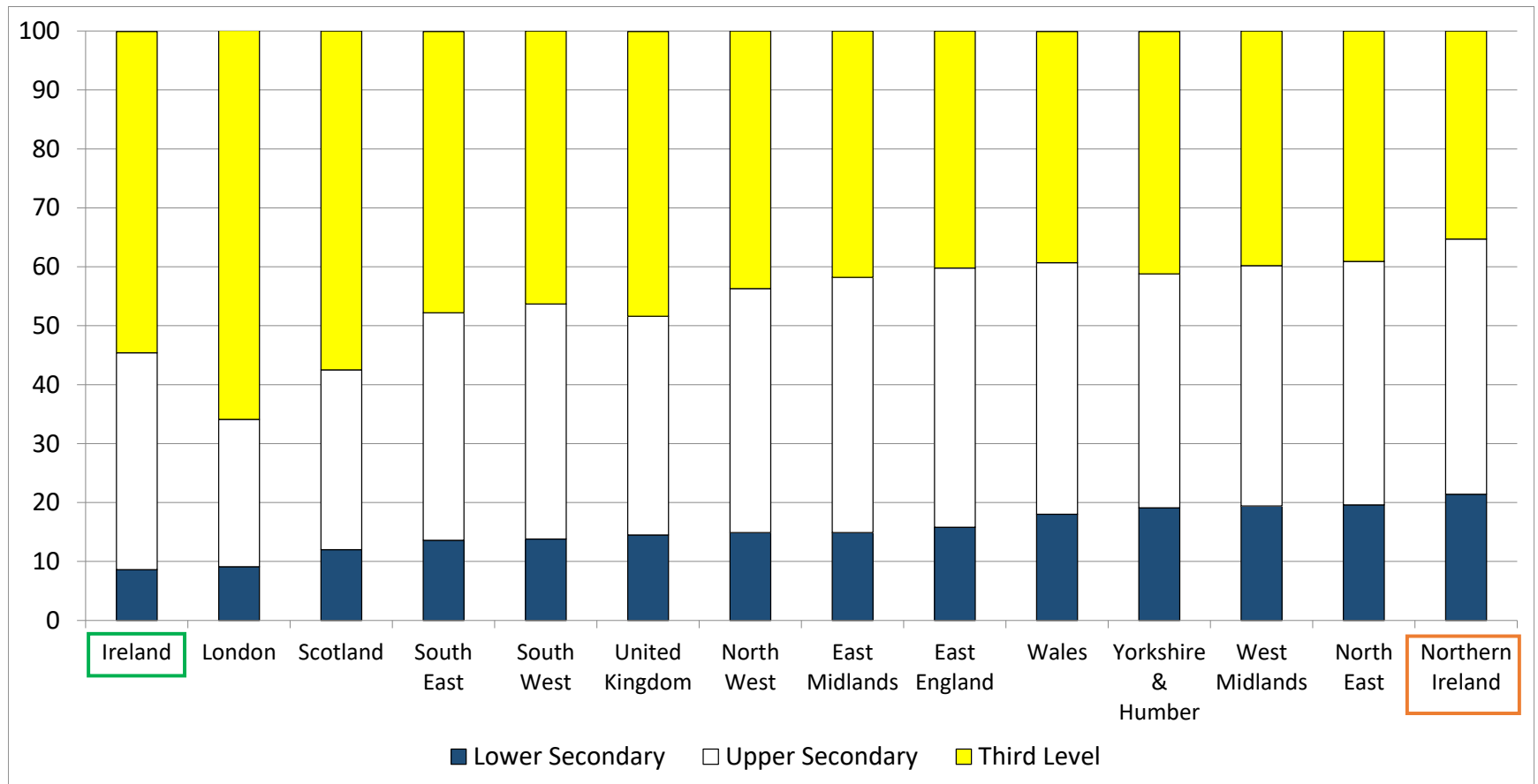
Education – cohort of 1951-5



Education – cohort of 1981-5



Educational Attainment, aged 30-34, 2017



Human Capital & Growth: Northern Ireland

- Borooah, 2015
 - Upgrading education: returns to the individual
 - Productivity effect – growth +0.25% a year
- Fitzgerald, 2019
 - If Scottish level of education would add 1% a year to growth
- Siedschlag and Koecklin, 2019
 - Very significant impact of education on Foreign Direct Investment

Growth and Human Capital

	Average growth rate 1999-2016	Share of Population 30-34 with third level education
United Kingdom	1.7	48.3
North East	1.4	39.1
North West	1.8	43.7
Yorkshire and Humber	1.3	41.1
East Midlands	1.6	41.8
West Midlands	1.4	39.8
East of England	1.5	40.2
London	2.6	66.0
South East	1.7	47.7
South West	1.6	46.3
Wales	1.5	39.2
Scotland	1.9	57.5
Northern Ireland	1.3	35.3

Emigration

- Many children leave Northern Ireland to attend third level in England and Scotland
- Two-thirds never come back.
- Also outmigration of graduates

Northern Ireland first year students

By location of third level institution, as % of 18 year olds

	Northern Ireland	GB	Total
2008	36	15	51
2009	37	15	52
2010	35	16	51
2011	35	19	54
2012	35	15	50
2013	39	16	55
2014	38	17	55
2015	33	19	52
2016	37	19	56
2017	36	19	55

Share of population in England and Wales Aged 15-64, 2011, %

Born in	Age	Lower Secondary	Upper Secondary	Third Level
Ireland	15-24	6.1	4.7	11.6
	25-49	5.9	4.1	8.7
	50-64	14.6	17.2	6.5
	65+	35.7	19.2	44.0
	15-64	10.0	7.3	8.4
Northern Ireland	15-64	8.7	10.5	23.5

Future Challenges for Northern Ireland

- Brexit
 - Serious impact on economy
 - Opposed by majority of population of Northern Ireland
 - Also negative impact on political and social life
- Changes within UK pose challenges for Northern Ireland
 - For example, Scottish independence could further isolate Northern Ireland
 - Rise of English nationalism with an English government for the UK

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 – would have been disruption to trade because of non-tariff barriers
 - Damage to SMEs
- If significant border in Irish sea – major disruption to Northern retail and distribution sector
 - Increase in consumer prices, loss of competition and choice, loss of jobs etc.
- The Final “Deal” worst of the mooted “Deals”

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 –if subvention rapidly reduced

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 likely so limited resources for transformation through investment in physical and human capital
 - Major cuts in some areas of expenditure needed to redirect funds to physical and human capital investment

Alternatives?: Homeless or Adoption

- 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?
 - What would be the costs for rest of the island and what would be the wider economic consequences for both jurisdictions?

Subvention under Unification

	UK		Ireland		
	£	€	£	€	% GNI*
Revenue	16668		16668		
Adjusted for corporation tax	341		341		
Adjusted revenue	17009		17009		
Regional expenditure	20562		20562		
Depreciation	2,069		2,069		
Other accounting adjustments	624		624		
Other expenditure - national					
Defence	1,033		215		
Debt Interest	1,139		0		
EU Transactions	-392		-392		
Residual	369		369		
Other expenditure - international					
EU Contribution	259		418		
Foreign Office/DFA	44		51		
International Development	211		167		
Residue	97		97		
Total Expenditure	26015		24181		
Deficit	9347	11406	7513	9168	5.2
Deficit adjusted for corp. tax	9006	10990	7172	8751	5.0
Deficit including interest			8311	10141	5.8

Adoption by Ireland?

- Could maintain living standards in Northern Ireland but lock in dependence
- Fiscal adjustment in 2016, even with no UK debt, would have been at least 5% of GNI*
- For Ireland (RoI) paying for the subvention would be similar to fiscal adjustment of the financial crisis, resulting in 10% reduction in living standards (RoI)
- This would leave Northern Ireland over 10% better off than Ireland (RoI) through an exceptional permanent subvention from Ireland (RoI)

Adoption by Ireland?

- This paper has concentrated on issue of regional transfers. There would be other very important economic consequences:
 - A very hard border in Irish sea would see major loss to Northern Ireland economy, much greater than initial impact of ending of soft border on island.
 - Equalisation of welfare and public sector wages would be very costly
 - Research shows that until educational attainment of labour force in Northern Ireland greatly increased, there would be no prospect of convergence in productivity, including through FDI

Conclusions

- Educational Reform: a win-win
 - Failure to invest effectively in education crucial in Northern Ireland's poor economic performance in the UK
 - Selective nature of educational system does serious damage to economy and society
 - Challenge of how to evolve to a more inclusive system
 - Will take a long time even if start to reform today
 - Attracting back Northern Ireland graduates – could produce effects much earlier
- North faces major economic problems which will be greatly aggravated by Brexit
- 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 – the implications of English nationalism
 - If successful development is accomplished this would leave open choices in the very long term