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**Alliance Party Response to DETI Consultation on the Barnett Report –
Independent Review of Economic Policy (September 2009)**

To: economics@detini.gov.uk
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Introduction

The Alliance Party is grateful for the opportunity to respond to this consultation on the Independent Review of Economic Policy. We welcome the review itself and the broad thrust of its conclusions although we are conscious of their limitations.

The Review was primarily a review of economic development policy and the performance of Invest NI as the main operational delivery arm of Northern Ireland's economic policy.

While a significant proportion of economic policy was covered by the report, there are other aspects, particularly of a strategic nature that were not discussed within the report. Furthermore, a number of other Departments have responsibilities that impact upon economic issues.

The central conclusion that the Alliance Party draws from the report is that improving levels of productivity must be the central objective of any Northern Ireland administration.

This report should be considered in conjunction with the Varney II Report - "The Review of the Competitiveness of Northern Ireland", while again acknowledging its limitations.

Structural Problems

We believe that it is critical to address the underlying structural weaknesses in the economy if a long-term and sustainable step-change is to occur.

These include:

- Regional imbalances – only 3 out of 12 UK regions (as defined by EU NUTS and UK Treasury) are net contributors to UK in fiscal terms. UK has one of the most unbalanced economies in developed world.
- Northern Ireland has a very large dependency on fiscal transfers from the UK Treasury, approaching 50% of NI expenditure
- Northern Ireland also has a very large dependency upon the public sector, with it contributing approx. two-thirds of GDP.
- Despite the growth in output and employment over the past 10-15 years, there has been little change in the productivity gap with the rest of the UK. Notably, despite his recommendations in the Varney I and II reports, Sir David Varney does not envisage any meaningful GVA convergence.
- The continued legacy of a divided society has a major impact upon the Northern Ireland economy, including significant pressures of public expenditure through managing segregation, and barriers to labour mobility and investment.
- Comparatively low levels of enterprise/business start-up, funding of innovation/R&D, historic underdevelopment of infrastructure.

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- A highly educated and skilled element of the population is also matched with high levels of educational underachievement and levels of economic activity
- There is a two-speed Northern Ireland, with part of the population plugged into the global economy, with another section effectively excluded. Patterns of deprivation and segregation reinforce the other.

The large size of the public sector may have cushioned Northern Ireland from the worst effects of the current global recession to date, however there is a danger of a slower recovery or even a double-dip recession given that future UK-wide cuts in public spending in order to address the current level of national debt may have a disproportionate effect upon Northern Ireland.

Given the Block Grant financing arrangement for 90% of NI expenditure, there is no real financial incentive for the devolved Executive to increase the level of revenue in Northern Ireland. The size of the Block Grant is determined on the basis of overall levels of public expenditure in the UK and any variations to it. The creation of additional wealth in Northern Ireland will address the level of fiscal subvention from the UK Treasury but would not have an impact on the level of overall resources available.

Limitations of NI Executive Policy

Northern Ireland's economy remains scarred not only by bitter conflict, but also by its position as peripheral to UK regional economic policy.

There is an inescapable reality that delivering a truly competitive NI economy requires far more than minor tampering with economic policy. A fundamental shift, away from social segregation along sectarian lines, away from dependency on the public sector and old-industries, and away from a short-term, piecemeal approach to public service delivery is essential.

The process is hindered by an Executive more inclined towards populist, short-term social policy than realistic, long-term economic policy. It is further hindered by the lack of popular will for a significant change in the fundamentals of a public-sector-dominated economy, as this has made many people in Northern Ireland so comfortable. However, it is also significant that Northern Ireland lacks the fiscal tools, and therefore the ability to react quickly to what investors and local businesses require to develop.

Specific examples of the limitation of Executive policy include:

- Paying little heed to the issue of sectarianism and segregation, through marginalising the existing Shared Future policy, which did note the economic implications of divisions, and failing to agree on any successor policy
- Arising from this, the failure to acknowledge the report commissioned from Deloitte & Touche entitled 'the Cost of the Divide' – (published in August 2007 as a result of a Freedom of Information Act) and the wider challenge of addressing the costs of a divided society.
- The effective side-lining of the Varney II Report - "The Review of the Competitiveness of Northern Ireland" which was dismissed in a one-page Executive response to HM Treasury.

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- The abandonment of efforts to provide a Regional Economic Strategy and instead arguing that the Programme for Government in practice provides this, although work had continued on a fresh RES after the adoption of the current Programme for Government
- A populist approach to public finances, for example freezing the regional rate and deferral of water charges creates opportunity costs for efficient and cost-effective economic interventions.
- Most of the trumpeted economic initiatives under the Executive, such as freezing the regional rate, industrial de-rating, small business rates relief are all aimed at addressing the cost base of doing business rather than levels of revenue and wealth creation through rebalancing the economy. This tendency predates the Executive response to the current economic downturn.
- While the levels of capital investment through the Investment Strategy for Northern Ireland (ISNI) are high, the balance of investment in the economy is not as high relative to the National Development Plan (Republic of Ireland)
- A limited ability to grasp long-term issues (e.g. focus on private not public transport, facilities orientated towards Belfast City Centre at expense of suburbs, fudge on the Review of Public Administration).

The Past Approach to Inward Investment

Alliance has concerns over the limits of the current approach to attract Foreign Direct Investment into Northern Ireland. While Northern Ireland has done relatively well in terms of the volume of inward investment, this investment depends largely on selective financial assistance rather than the underlying competitiveness of Northern Ireland economy. Indeed, levels of State Aid offered per job have been comparatively high by wider international standards. The nature of investments has had a significant impact on employment levels, but some have been short-term in duration. Yet, they have generally not had an impact on productivity levels, and the productivity gap with the rest of the UK. Access to selective financial assistance may be limited in the near future due to changes in EU State Aid Rules. The opportunity has not been taken to address the underlying structural problems of the Northern Ireland economy.

Implications for Selective Financial Assistance from the Report

Alliance welcomes the more realistic approach to selective financial assistance within the Barnett Report.

We are particularly struck by the reality that, due to changes in the external environment of EU State Aid rules, the current approach to FDI will shortly become unsustainable, potentially as early as January 2011, but no later than 2013. This will be a major shock to economic policy, and indicates the urgency of a shift to a different model of economic development. This shift may include a greater focus from INI on small businesses.

Location of Investments

Alliance is also concerned at pressure from some quarters to overly manage and direct the internal location of investment. Locating new investments in disadvantaged communities does not necessarily bring new sources of employment for such communities given the problems over skills and employability. It is better to address these problems and issues regarding labour mobility, and have greater flexibility with respect to the location of investment decisions.

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We note that the report stresses that “Competitiveness varies between places in a region, with cities often offering higher growth and productivity. It is therefore important to allow companies the scope to locate where they can operate most profitably.”

It is natural that there will be geographic imbalances in levels of economic activity. This in part reflects the inevitable clustering of sectors in particular locations. Indeed, this should be encouraged.

Focus on Productivity

Alliance warmly welcomes the increased emphasis upon productivity as the key outcome. We recognise the inevitability and perhaps even the desirability of moving away from the grants based approach. Instead, an approach based on the underlying competitive aspects of the local economy such as the skills of the workforce should be central focus in the future.

Greater attention should also be given to the development of indigenous economic activity, and focusing efforts on the export of goods and services.

While we agree with the importance of measuring productivity changes primarily on a relative rather than an absolute basis, we are concerned that a singular focus on relative productivity changes runs the risk of false positives, for example a deeper recession in the rest of the UK could leading to convergence at same time as worse overall absolute performance in productivity levels within Northern Ireland. It should be borne in mind that Northern Ireland did not go into recession in the early 1990s with the rest of the United Kingdom, but nevertheless the structural problems in the local economy persisted.

In terms of measuring the relative productivity levels in Northern Ireland, we are concerned at benchmarking this against the UK average minus the Greater South East of England. While we recognise the distorting nature of the level of economic activity concentrated in that region, the use of a comparator that removes this distortion does not sufficiently challenge the overall imbalance of the UK economy and the dependency of 9/12 regions on a fiscal subvention and the public sector. The current measurement effectively leads to Northern Ireland comparing itself in terms of how effectively it competes for the scraps from the table.

Furthermore, Alliance believes that Northern Ireland should also be formally compared to EU NUTS regions to give a much wider perspective to productivity changes.

Economic Responsibility

Alliance is concerned at the fragmented approach to the economy in Northern Ireland. While the Department for Enterprise, Trade and Investment has a clear lead role in operational economic matters alongside energy, other Departments have major contributions to make. These include:

- DFP for the Budget and overall economic strategy;
- OFMDFM through its economic policy unit;

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- DARD with respect to agriculture, a significant aspect of the local economy and also a considerable recipient of financial support, the efficiency or otherwise of which has not been scrutinised;
- DEL for skills and training, and further and higher education, plus the labour market;
- DE for primary and secondary education;
- DoE for planning
- DRD for infrastructure and strategic planning; and
- DSD for urban regeneration.

Alliance supports the rationalisation of the institutions of government in Northern Ireland in general. The potential financial savings from the reorganisation of government departments are considerable. Even greater potential benefits from any rationalisation are available through providing a more efficient and economy-facing government.

The DETI-DEL merger may make sense in a limited sense but the problem of fragmentation of economic policy and delivery is much wider. However, there should be also consideration on other opportunities for example the splits in planning between DRD and DoE, and also the problems around the roads versus planning interface between those two Departments. This problem of fragmentation further extends to strategic economic matters.

Efficiency of Invest NI

Alliance appreciates the detailed analysis of the performance of Invest NI overall and the individual programmes. The organisation comes across as being top-heavy on administration, and also at the high end in terms of the costs of jobs created and supported. Alliance accepts that deadweight/additionality analysis varies between programmes. However, there is a need for a wider appreciation of the opportunity costs involved in the ongoing financial investment through Invest NI rather than investing in other aspects of the competitiveness of the Northern Ireland economy.

New Opportunities

The Barnett Report is relatively silent on the identification of future areas for development. Alliance accepts dangers in governments trying to target certain sectors for development ahead of others at the expense of the market. The dangers of this in terms of a direct intervention industrial policy are much greater than in terms of sectoral identification for particular development. It is important that such areas of development are related to underlying competitive strengths and potential opportunities within the economy. The development of the Green Economy is one such opportunity. Alliance also believes that Northern Ireland has potential strengths in health care. Within the global economy, Northern Ireland may provide an attractive location for global services given its position between the United States and the Far East, plus its educated English-speaking population.

Green Economy

Like in other economies, Northern Ireland's future competitiveness will be related to how it adapts to the realities of the challenge of climate change. These challenges have been well set out in the Stern Reports. The market can drive innovation, along side the removal of distorting subsidies and the application of the 'polluter pays

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principle’. However, adaption requires investment and other actions from government to facilitate change. Yet, change should provide new job opportunities and fresh sources of economic activity.

There are a number of obvious aspects to any Green New Deal:

- Energy efficiency in homes and businesses
- Investment public transport and other changes to our infrastructure
- Better fuel efficiency in private transport
- Further development of renewable energy
- Improving the energy Network – smarter grid

There may now be an opportunity for Invest NI to have a greater focus on the green economy, and to take advantage of an opportunity to promote Northern Ireland as a ‘green island’.

Indeed, the switch to alternative energy is something that should be undertaken even outside the context of climate change. Energy costs are perhaps the area where Northern Ireland currently has its greatest competitive disadvantage.

The Barentt Report stresses: ‘Promoting greater energy efficiency/conservation in the private sector should be accorded a higher priority in the 2009 Strategic Energy Framework (reflecting, where appropriate, the current and ongoing work of the Green New Deal for NI)’

There is a challenge to merge economic and environmental thinking. While changes may involve increased costs in the short-term, government must provide leadership on the longer term economic vision.

All-Island Economy

Notwithstanding the current deep difficulties within the economic and fiscal situation in the Republic of Ireland, there is a clear relationship between the future economic development of both parts of the island. Alliance is disappointed that this aspect was neglected within the Barnett Report. There is a need to ensure that neither jurisdiction is placed at a competitive disadvantage in respect to foreign direct investment.

Alliance Party Recommendations and Conclusions

We would first repeat our three main policy themes as put forward in our response to the Northern Ireland Executive’s draft Programme for Government in January, as these are each relevant to the task of increasing competitiveness in Northern Ireland:

- tackling sectarianism/segregation;
- re-balancing the economy; and
- delivering sustainable public services.

Sectarianism and segregation continue to define NI society, even after a decade of ‘peace’. Issues include:

- acknowledging that there is a clear relationship between economic development and the creation of a shared future in that a shared future is necessary for economic development and economic development will assist with the creation of a shared future.

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- addressing the higher cost of public services for same level of delivery (and therefore over-complex public-sector structures), including the duplication of the provision of goods, facilities and services by the public sector, and, to an extent, the private sector either implicitly or explicitly to perceived separate sections of the community;
- tackling low labour mobility; and
- understanding the nature of the ‘brain drain’ of best qualified talent seeking to escape the scourge of a bitterly divided society (NI school leavers have among the best qualifications in the UK, but its workforce has among the worst).

Re-balancing the economy means more than a simple move from public-sector to private-sector (the benefits of which are well documented and need not be repeated here). It also means:

- moving from low-wage/low-tech to high-wage/high-tech (requiring painful political decisions on moving away from old industries such as manufacturing and farming) to make the whole of NI competitive in key industries – it is not sustainable for Northern Ireland to compete on the basis of low costs especially in a very competitive global economy;
- shift from focus on ‘qualifications’ to focus on actual skills (this is fundamental to the success of the ‘Nordic Model’, where recruitment is primarily based on demonstrable skills, and where relevant vocational skills are therefore more highly regarded) delivering more competition for jobs; and
- acknowledgement at all levels of the link between sound economic policy and sound environmental policy;
- arising from the previous point, appreciating that Northern Ireland has an opportunity to become a world leader in the green economy. There is an obvious marketing opportunity in the notion of the ‘green island’.
- Northern Ireland should also be compared to EU NUTS regions to give a wider perspective on productivity changes.
- exploring whether there are areas of existing excellence which should be nourished, in particular in science, technology and healthcare; and
- giving greater priority should be given to helping indigenous NI companies access foreign markets or partnerships, in particular in the United States, than seeking further inward investment.

Delivering sustainable public services means a shift from short-term to longer-term thinking, including:

- radicalising means of service delivery and financing of infrastructure to make public services themselves more competitive (including, potentially, greater use of PFI, congestion charging and road tolling);
- a particular focus on the efficiency of Invest NI or any successor body; and
- recognition of ‘Greater Belfast’ as the hub for the NI economy (not just the City Council area), and therefore able to compete with other ‘world cities’.