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Northern Ireland Economic Overview

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Article 1: Northern Ireland Economy:
Latest Position and Future Prospects

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INTRODUCTION

Since the publication of the last Annual Economic Bulletin, there has been a vigorous debate on the Northern Ireland (NI) economy. The Programme for Government Sub-Group on economic issues acted as a catalyst for the debate and it produced three reports on the challenges facing the economy. Though the reports are wide-ranging in their recommendations, there is a clear consensus on the need to grow the private sector, particularly its export base.

The purpose of this article is to outline the latest position of the economy and its future prospects. There are four sections. Initially, the latest economic data is presented to give an overview of the economy. A broad range of variables is examined including output, the labour market, exports, innovation and the housing market. The second section outlines some historic trends to describe NI's economic performance relative to other parts of the UK. It decomposes the output gap into its constituent parts to highlight the main factors behind the development of the economy over the last decade. The third section reflects on recent forecasts of the main economic variables and reveals the extent of the economic challenges facing the economy in the medium to long term. The final section refers to some of the ongoing economic research of the Department.

NI ECONOMY - LATEST POSITION

The most recent data on the NI economy illustrates that, between 2004 and 2005, Gross Value Added (GVA) grew by 3.8% (nominal terms). The growth placed NI in seventh position in terms of the twelve UK regions and just below the overall UK rate (3.9%). With regard to GVA per head of the population - the most commonly recognised measure of regional prosperity - NI remained at

roughly 80% of the UK level and only marginally above the North East (79%) and Wales (78%).

The GVA data can also be used to produce measures of productivity which, in turn, highlight regional economic performance. Figure 1 presents two measures of productivity - GVA per filled job and per hour worked. Average labour productivity, as measured by GVA per filled job, fails to take account of any regional variations in part-time / full-time workers. GVA per hour worked is therefore a more accurate measure of labour productivity and, as Figure 1 illustrates, NI remains at broadly 80% of the UK. On this measure, NI displays the lowest labour productivity of all UK regions.

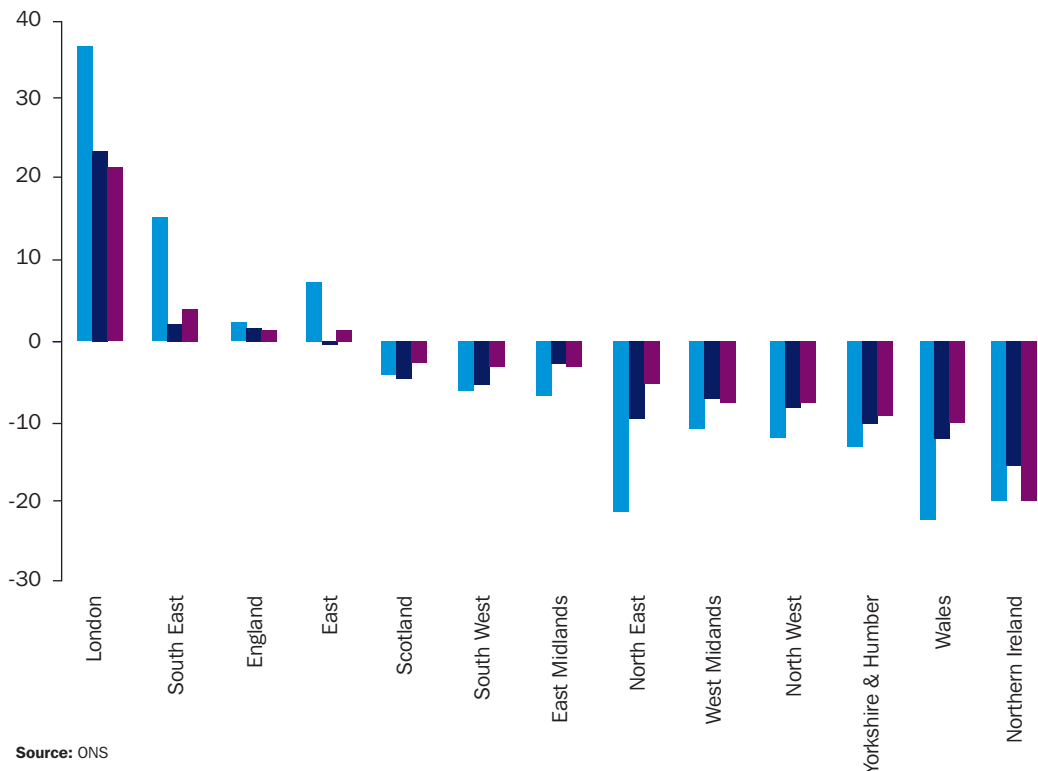
In terms of the sectoral composition of GVA, the construction sector was the fastest growing (8.2%), accounting for 7.7% of GVA in 2004. Private services was the largest and second fastest growing component of the economy during 2004, contributing over £10.6 billion (45.0%) and growing at a rate of 7.4% over the year. Although the public sector remained large in relative terms (accounting for 28.4% of output), it grew at a lower rate than the private sector (6.3% over the year). The manufacturing sector has experienced significant changes, particularly in terms of employment, but it grew by 2.8% and accounted for a significant proportion of regional output in 2004 (16.1%).

In certain respects, the NI labour market continues to be a key strength of the economy. For the period Nov - Jan 2007, there were 770,000 persons in employment, an increase of 1.2% over the year and the highest level on record. Private services is the largest sector in terms of employee jobs, with 44.7% of the total and growing at a rate of 2%. The public sector still accounts for a significant proportion of employee jobs (31%) but the annual

Regional Economic Prosperity and Productivity

Figure 1

■ GVA per head
■ GVA per filled job
■ GVA per hour worked



Source: ONS

growth was more moderate (1%). Manufacturing is the only sector to have experienced a decline in employment (1.3%) but it still makes up 12.2% of the total. The impact of an improving labour market is reflected in the unemployment data - currently at an historic low (4.3%). However, economic inactivity remains persistently high at 26.9%, the highest rate of any UK region and significantly above the UK average (21.1%).

Notwithstanding the overall growth in employment, the region has the second lowest employment rate (69.9%) - marginally ahead of London - and

remains well below the UK average (74.4%). Furthermore, with regional output only keeping pace with the UK average, it is clear that labour productivity remains a key economic priority going forward. This issue is explored further in the remaining sections of the article.

Average gross weekly wages in NI, were the second lowest of all the UK regions in 2006 (NI - £324.7 with only the North East lower at £322.0). The rate of growth over the year was also the lowest of all UK regions at 1.9% (UK = 4.3%). Of the various factors influencing wages in NI, one important

issue is that too many people in the workforce have no qualifications - 14% compared to 9% of UK employees. The differential is also reflected more broadly, with 22% of NI's working age population having no qualifications compared to 14% for the UK.

Widening the export base and increasing the current level of export intensity is also critical to the development of the economy. With regard to tradable services exports, growth was impressive at 18.8% over the year, with the computer industry the largest contributor. However, the absolute level (£156.4m in 2005) still remained at only 0.6% of output. In terms of manufacturing exports, the growth (0.6%) is slowing and is much lower than the service sector but the level remains considerably higher - £4.6bn in 2005/06 representing almost one fifth of output.

Export performance is also linked to R&D and innovation. Firms competing within the global economy are acutely aware of the need to refresh products and introduce new management and trading processes. Figure 2 uses the latest Community Innovation Survey (2005) to illustrate that the incidence of product innovation is predominantly greater within manufacturing which, as shown above, has higher levels of exports. It should also be noted that, within services, the computer industry has a high proportion of firms active in product innovation (45.6%) and it helps explain why this sub-sector has been a strong contributor to service exports.

It is also encouraging to note that Business Expenditure on R&D (BERD) continues to be driven by Small and Medium sized Enterprises (SMEs). The contribution of SMEs to total BERD has increased each year since 2001 and currently stands at 51%. This compares favourably to the UK

average where the SME contribution is only 18.6%. Over the period 2001-05, SME expenditure on R&D in NI increased by 72.9% (UK=18.7%).

One feature of the economy attracting an increasing amount of interest is the housing market. The average price of a house in NI was £208,438 during Q1 2007, with annual growth (44.8%) well in excess of the UK (12.4%). In terms of single incomes, this represents over 12 times the average wage in 2006 and reveals the extent of the affordable housing issue in NI. House prices were 95.9% of the UK average in Q1 2007 and interest payments as a proportion of income are beginning to increase, although they have yet to reach the levels of the early 1990s. The ratio of house prices to income for mortgage borrowers was at its highest recorded level in NI during 2006 (4.1), and was above the UK figure (4.0) for the first time. Article 23 outlines the demand and supply side factors behind the growth in NI house prices.

Before progressing to the long-term historical performance of the NI economy, it is worth commenting on two contextual factors that impact on its relative economic performance:

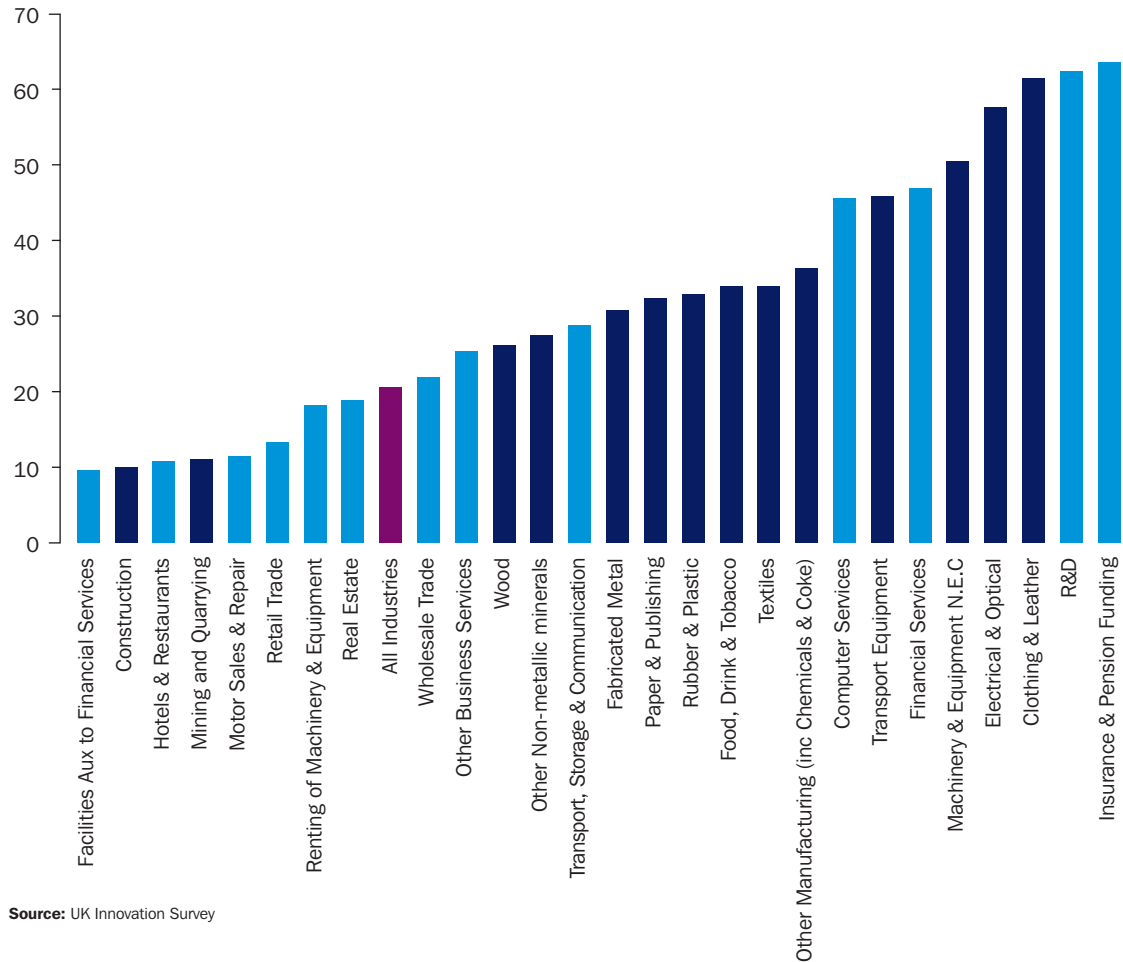
- **Economic Structure:** Relative to the UK, NI has a larger share of employees in the public sector, construction, manufacturing and agriculture. Conversely, NI is still under represented in business and financial services, which encompass many of the high value added service activities. Relative to the UK, business and financial services contribute 8.3% less to total employment in NI. This fact underlies one of the recommendations from the Programme for Government Sub-Group on the economy, namely the pro-active targeting of financial and business service companies with the view to locating in NI.

NI Product Innovation by Sector (2002-04)

Figure 2

■ Services

■ Manufacturing (and other production)



Source: UK Innovation Survey

This is due to the positive role these sectors play in terms of boosting productivity and wages.

- **Firm size:** NI is still more of a small firm economy than the UK, with only 19% of employment in NI by large firms (250+ employees) compared to 41% in the UK. The lack of large businesses in NI impacts on the

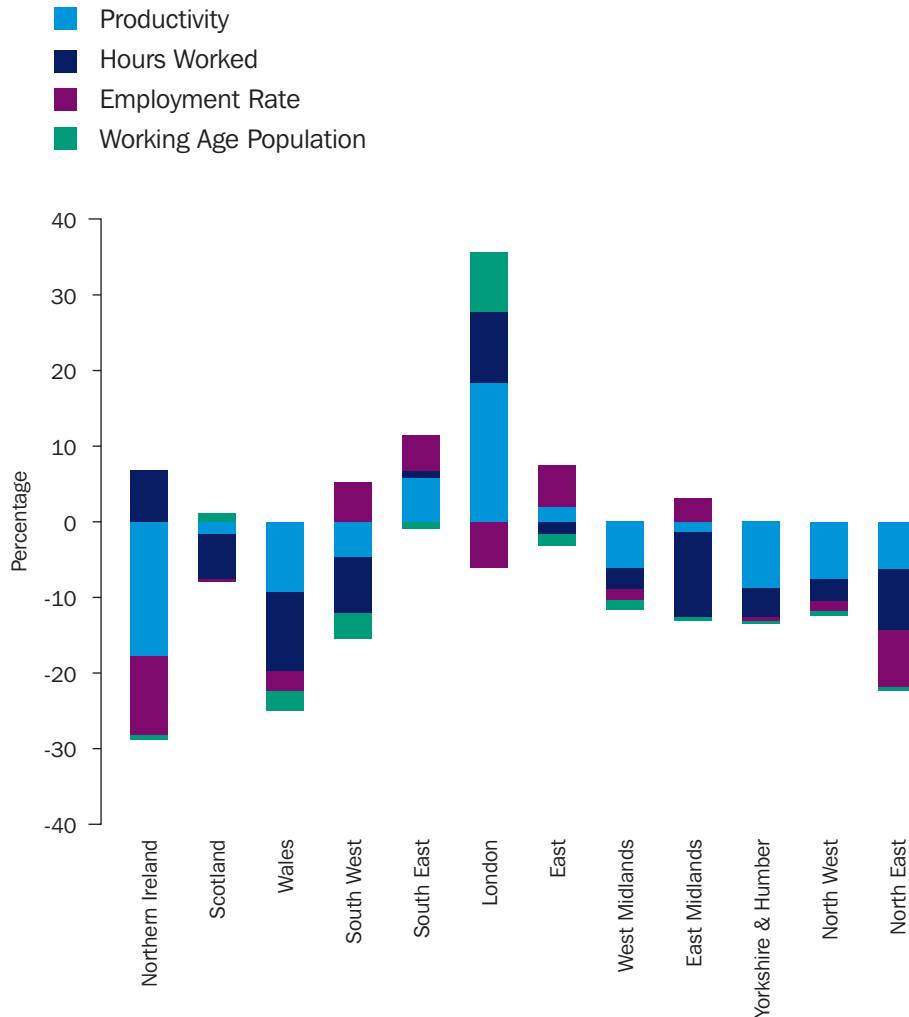
ability to carry out significant levels of R&D and export sales. Article 9 considers the issue of firm size in more detail.

LONG-TERM HISTORICAL PERFORMANCE

The previous section highlighted the significant gap in NI's recent economic prosperity relative to the UK. GVA per capita in NI was 80% of the UK in

Decomposition of GVA per capita (2004)

Figure 3



Source: ERINI, ONS

2005 and has remained around this level over the past decade. This section outlines the main factors behind the prosperity gap and how they have changed since 1996.

Figure 3 presents a decomposition of GVA per capita into its main components relative to the UK:

- Labour productivity - output produced per hour worked
- Hours worked - actual hours worked per person in employment
- Employment rate - persons in employment as a proportion of the working age population
- Working age population - persons aged 16-59/64 as proportion of the total population

Relative to the UK average, NI performs poorly in all components except hours worked. The analysis also reveals that the NI position is not atypical, as other regions such as the North East and Wales have similarly high negative prosperity gaps with the UK. However, a key point confirmed by Figure 3 is the extent to which the UK economy is driven by the performance of the Greater South East¹. For example, 42% of total UK output was generated by the three regions comprising the Greater South East. It is for this reason that the section on 'Economic Forecasts' compares NI's performance relative to the UK and the UK excluding the Greater South East.

(i) Employment Rate

NI's employment rate is the second largest negative component of the GVA per capita gap with the UK. Although the employment rate in NI has increased since 1996, this is similarly the case for the UK. NI's employment rate therefore fell from 90.0% of the UK in 1996 to 89.6% in 2004.

NI has had the fastest regional growth in employment outside of London over the decade to 2006. Job growth has been driven by the services sector, in particular private services which have added almost 100,000 jobs to the economy since 1996. The major private services growth sectors have been business services (+36k), retail trade (+31k) and hotels & restaurants (+15k). While public services have also contributed to employment growth, this has been more in health and education rather than in public administration.

As the employment rate is calculated as a proportion of the working age population rather than the labour force, the denominator also includes the economically inactive. The persistently high levels of economic inactivity in

NI have therefore lead to a significant proportion of the working age population remaining outside of employment. Over the decade to 2006 an extra 15,000 people of working age became economically inactive in NI. Encouragingly, the largest increase has been in students (+19k), which potentially benefits NI through a greater supply of skilled labour in the future. Also, there has been a reduction in persons looking after family / home (-7k), reflecting the success of attracting mothers back into the labour market through part time working. However, the largest component of economic inactivity in NI is sick / disabled, accounting for 32.3% of the inactive and this has increased by 3,000 since 1996 (UK overall = -70,000).

(ii) Working Age Population

NI's working age population accounted for only a small proportion of the negative gap in GVA per capita, increasing from 97.8% of the UK in 1996 to 99.3% in 2004. This measure relates to the dependency rate - the proportion of people outside of working age not contributing to output. A greater working age population reduces the dependency rate and increases the potential supply of labour. The working age population in NI has steadily increased since 1996, with high numbers of students feeding through into the 16-59/64 age group. A positive job creation record in NI has, therefore, been necessary to meet the additional supply of labour from a growing working age population. However, the number of people aged 0-15 in NI has been in steady decline since 1971 and has decreased year on year since 1993. This reflects the ageing population which has become a feature of developed economies.

Further growth in the working age population is therefore likely to come from migration, in particular

from eastern European countries within the EU and candidate countries for EU membership. Over the period 1995/96 - 2003/04, NI experienced net out-migration of 7,140 and this was mainly due to 18/19 year olds leaving for other UK regions / ROI to study. However, in the year following EU enlargement in 2004, there was a large net increase in migration of 6,671, in particular of persons aged 25-44. Migration and its interaction with the labour market is examined in more detail in Article 14.

(iii) Actual Hours Worked

Hours worked is the only component of GVA per capita where NI performs better than the UK average. In 2004, the average employed person in NI worked 6.8% longer than the UK average, with London the only other UK region having significantly longer working patterns. While the London figure is unsurprising given the impact of the business and financial services sectors in the City, it is not as obvious why NI exhibits such long working hours. Recent research by Regional Forecasts² suggests that this is due to the agriculture sector, where the average hours worked per week is 52.7 in NI compared to 38.1 in the UK. Despite the relatively small size of the sector, this has the effect of increasing NI's hours worked to its current level. Hours worked across all other sectors are similar between NI and the UK average.

(iv) Labour Productivity

NI's labour productivity, as measured by GVA per hour worked, was 82.2% of the UK average in 2004 and was the lowest of all UK regions. Productivity has been falling in NI since 1996 when it was 89.5% of the UK and is the largest negative component impacting on GVA per capita. On this measure, the higher hours worked in NI clearly has a negative impact on the figures for labour

productivity, however a key issue is the extent to which low productivity is consistent across all sectors.

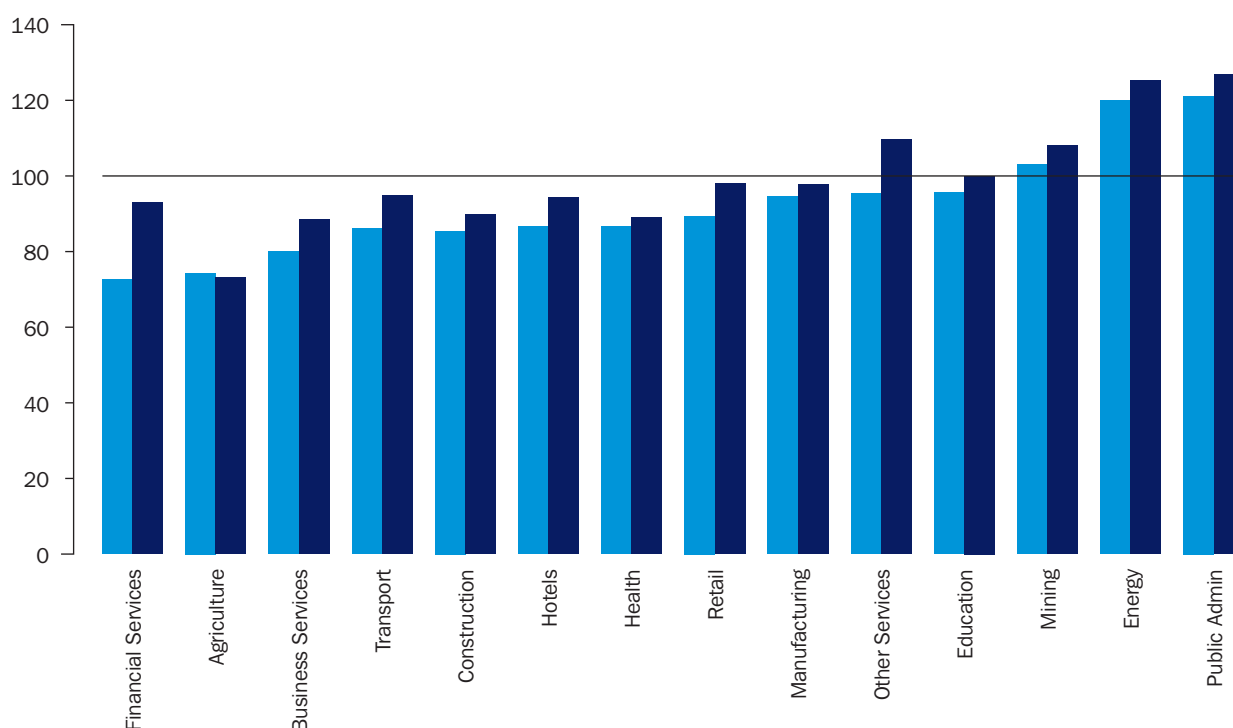
Figure 4 outlines sub-sectoral productivity in NI relative to the UK average (and the UK excluding the Greater South East). As can be seen, public administration, energy and mining are more productive in NI than the UK average. Education, other services and manufacturing are slightly less productive. However, from an economic development perspective, a number of sectors significantly under-perform in NI, particularly financial and business services. This feature remains when the Greater South East is removed, although the differential is much reduced, especially for financial services.

Aside from under-representation, relatively low productivity in business and financial services is a concern for NI. As the previous section highlighted, the Programme for Government Sub-Group pinpointed these sub-sectors as typically representing high value-added activity in the economy. Much of NI's fall in overall productivity has been due to declining productivity in private services and, in particular, business services. Private services productivity has been declining relative to all regions, not just the Greater South East. The main factor behind falling productivity in business services is the rapid employment growth of the sector. Although GVA has grown, it has been at a much slower rate than employment, resulting in overall productivity reductions per employee. It is also important to remember that, while the sub-sector contains high value-added employment, there is also a significant element of lower paying jobs.

NI Sub Sector Productivity (2004)

Figure 4

- NI relative to UK average
- NI relative to UK (excluding Greater South East)



Note: RFL use GVA per employee therefore data will not correspond with data used elsewhere in this article

Source: Regional Forecasts Ltd

Many of the other sectors where NI has experienced strong employment growth - hotels & restaurants, retail trade, construction - are also low productivity sectors, contributing to low and falling relative labour productivity for NI as a whole. The combination of low productivity and longer hours worked in agriculture also has a negative impact on NI's labour productivity. The relatively poor economic structure is particularly significant for productivity. For example, Regional Forecasts estimate that, even if each sector in NI had the same productivity as the UK, around 40% of the productivity gap would remain due to higher

employment concentration in low productivity sectors. NI's sub-sectoral productivity patterns will be a key research issue for DETI during 2007/08.

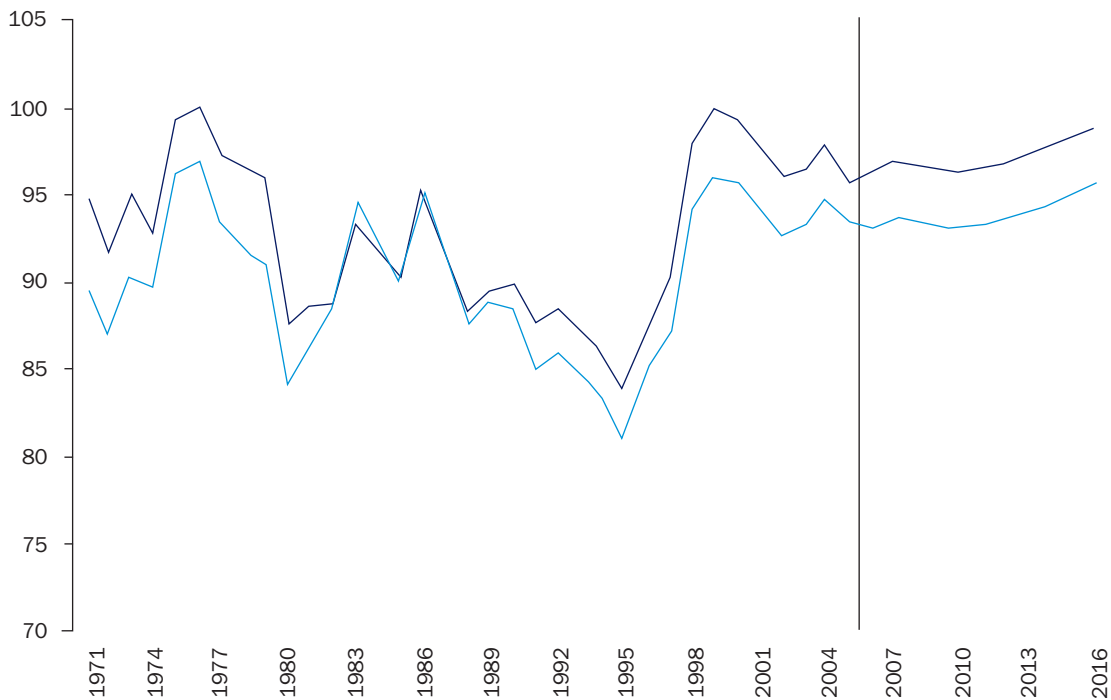
ECONOMIC FORECASTS

In recent years, the NI Policy Simulation model has been developed for the Economic Development Forum and for a number of Government Departments including DETI. The model allows us to assess the likely future trends in the NI economy over the next decade. This section builds on the earlier analysis and presents medium term forecasts for the two main factors behind

Manufacturing Productivity Forecasts

Figure 5

- NI relative to UK average (=100)
- NI relative to UK excluding Greater South East (=100)



Note: Vertical line represents the beginning of the forecast period

Source: Regional Forecasts Ltd

NI's GVA per capita gap with the UK - productivity (manufacturing and private services) and the employment rate. Also, for reasons outlined in the previous section, forecasts are presented relative to the UK average and for the UK excluding the Greater South East (GSE). It is also worth stressing that the forecasts naturally preclude factors such as additional resources stemming from the Comprehensive Spending Review (CSR)/ economic package and substantive changes to Government policy.

As shown in Figure 5, manufacturing productivity has shown strong convergence with the UK and

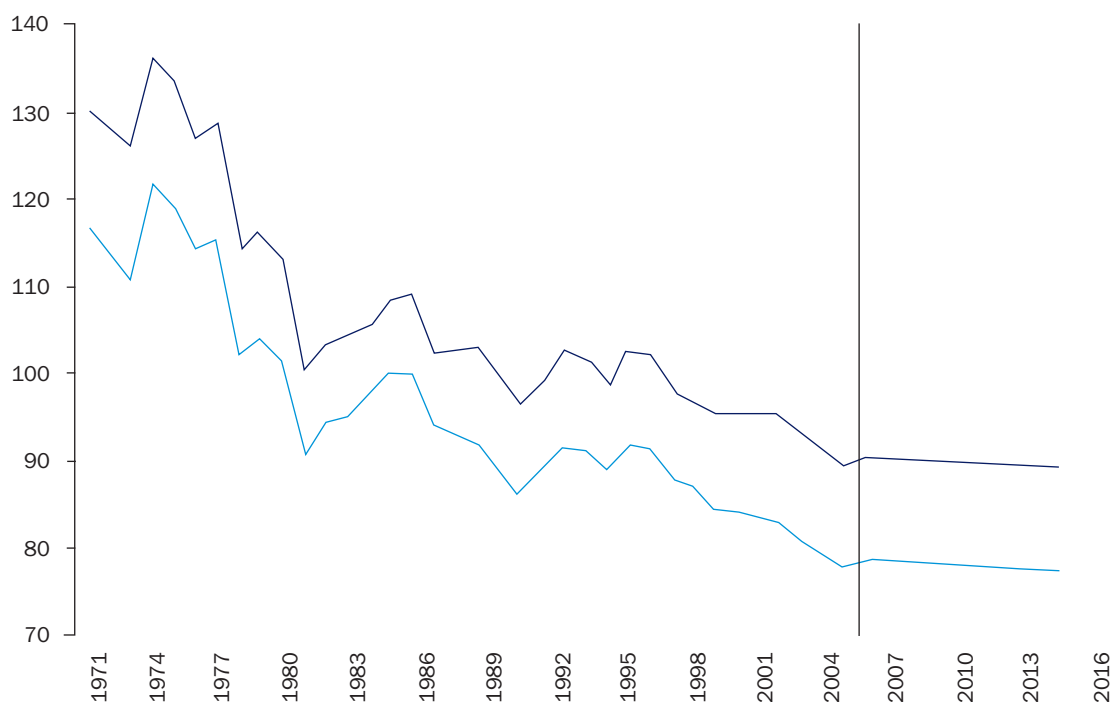
the sector has clearly benefited from Government assistance in recent years. Forecasts indicate that NI will continue to converge with the UK average although at a reduced rate. Removing the GSE also improves NI's relative manufacturing productivity, although the change is relatively marginal due to the small proportion of the manufacturing industry in the GSE regions.

Private services productivity in NI (Figure 6) has been in steady decline relative to the UK average since the 1970s. As the section on 'Long Term Historical Performance' highlighted, the rapid employment growth in business services is a key

Private Services Productivity Forecasts

Figure 6

- NI relative to UK average (=100)
- NI relative to UK excluding Greater South East (=100)



Note: GVA Data Pre-1980's will be less reliable than recent data

Source: Regional Forecasts Ltd

factor behind the downward trend since the mid 1990s. The analysis also illustrates that the decline is forecast to continue, although at a reduced rate. As would be expected, excluding the GSE regions results in a marked improvement in NI's relative performance given the scale of private services activity, particularly in London and the South East. However, the forecasts suggest that NI will remain well below the rest of the UK throughout the forecast period.

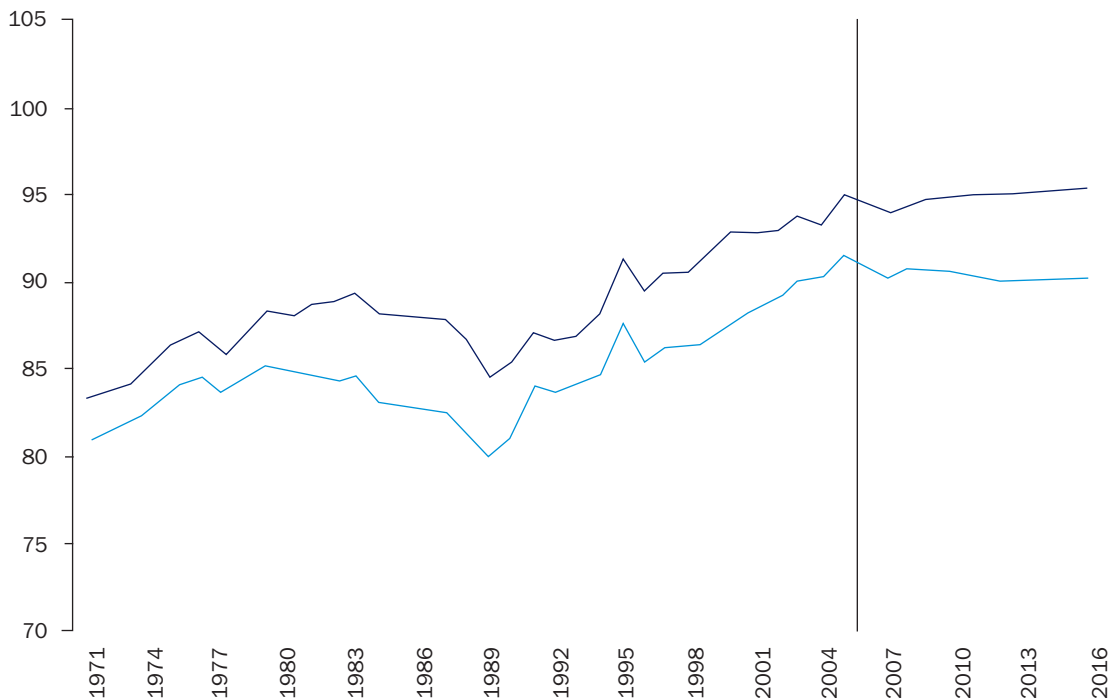
Figure 7 indicates that NI's employment rate has been converging with the UK average although, as previous sections have highlighted,

a considerable gap remains. With increased migration pushing up the working age population and an anticipated slowdown in job creation, the forecasts suggest that the convergence with the UK average will come to an end. However, the effect of removing GSE from the UK figures suggests that NI's relative performance will be one of mild convergence. This is due to the strong predicted performance of the GSE, with its continued strength in financial and business services and one-off factors such as the Olympics driving employment growth.

Employment Rate Forecasts

Figure 7

- NI relative to UK average (=100)
- NI relative to UK excluding Greater South East (=100)



Source: Regional Forecasts Ltd

CONCLUSIONS

This article has sought to give a brief overview of the NI economy in terms of its recent position, longer term historical performance and future prospects. The analysis generally supports the findings of the Programme for Government Sub-Group on economic issues and, in particular, the need to develop a high value added, export driven private sector.

Despite recent economic progress, particularly in terms of the labour market, it is clear that significant challenges remain, not least in

terms of improving labour productivity and the employment rate. With regard to the former, it will require sustained improvements in private sector export performance; innovation / R&D; business growth; value added inward investment and the necessary developments to the economic and physical infrastructure that make the region fit for global competition in the 21st century. It is for this reason that, as part of the CSR exercise, DETI has been considering in a substantial realignment of its Public Service Agreements (PSAs) for the period 2008/09 - 2010/11. The two key economic priorities for the Department

are likely to be focussed on improving in labour productivity - especially within private services but also manufacturing - and the employment rate. The intention is that the PSAs will be shared with the Department of Employment and Learning (DEL), given the significant impact increases in skilled labour and reductions in economic inactivity have on productivity and employment respectively.

Economic development policy will continue to be informed by relevant and up-to-date economic research. For example, the Department will be considering the implications of recent research into the areas of Foreign Direct Investment and innovation support for service-based companies. The same holds for the sub-sectoral productivity analysis referred to earlier. Moreover, in terms of generating improvements in the employment rate, Article 8 suggests that a key sector will be tourism. Its contribution to regional output is the lowest of all UK regions and increased investment in the sector will be needed to attract holiday and business visitors. The Department intends, as part of its 2007/08 research agenda, to commission research into managerial skills and its impact on labour productivity (in conjunction with DEL); enterprise growth and how businesses can address the challenges presented by the sustainable development agenda, in particular reducing greenhouse gas emissions.

On the basis of economic research and other work, the challenge for Government is to ensure that policy interventions to develop the economy are well targeted and sufficiently resourced. However, the private sector has much to contribute as well. In the context of an increasingly globalised economy, with external and value added competition a reality, the NI economy needs to build on recent success and swiftly address the key challenges of increasing economic output and getting more people into work.

Notes

¹ East, London and South East regions

² Regional Forecasts (2007) "Productivity - Regional Story"