



Department of
**Enterprise, Trade
and Investment**

www.detini.gov.uk

Quarterly Economic Review

Economic Research
January 2006

Stimulating
innovation
enterprise and
competitiveness

Contents

1

Core Economic Brief

Global Review and
Outlook

Page 3

UK Review and Outlook

Page 5

Republic of Ireland
Review and Outlook

Page 7

NI Review and Outlook

Page 9

2

Special Topics

Infrastructure

Page 14

Core Economic Brief

1

GLOBAL REVIEW AND OUTLOOK

Global economic growth was 3.4% during 2005 and is expected to increase slightly to 3.6% in 2006. World growth is being mainly driven by the rapidly developing economies of China and India.

GDP growth in the US was robust in 2005 at 3.6% and is expected to moderate slightly in 2006. The US current account deficit was 6.5% of GDP in 2005 and is expected to rise to 6.7% in 2006. The OECD has concerns about how long the US can maintain the existing deficit without it having a negative effect on the economy.

Euro area growth lagged behind many of the other G7 nations in 2005 at 1.5%. Growth is expected to pick up slightly to 2.2% during 2006 due to increasing demand for Eurozone exports.

There remain significant variations in the performance of EU member states. While the Spanish economy continued to expand at a robust pace, growth in France, Germany and Italy remains disappointing. Economic expansion within EU accession

economies remains considerably above the EU average.

Real GDP Growth (%)

Table 1

	2005	2006 ¹	2007 ¹
World	3.4	3.6	3.4
US	3.6	3.5	3.3
Euro area	1.5	2.2	1.6
Germany	1.1	1.9	0.6
France	1.5	2.2	1.8
Ireland	4.5	5.0	4.5
UK	1.7	2.1	2.8
NI*	3.2	2.4	2.9
Japan	2.3	2.0	1.8
China	9.3	8.6	8.8

¹ Forecast

Sources: OEF World Economic Prospects: Winter 2005/06
* OEF/RF UK Regional Economic Prospects: Autumn 2005

China's economic growth is projected to slow slightly from 9.3% in 2005 to 8.6% in 2006 and 8.8% in 2007. China continues to run a large current account surplus, which is forecast to grow to 8.3% in 2007. This is mainly due to rapid growth of exports and the liberalization of international trade in clothing and textiles.

In late December, China released updated GDP statistics which increased the estimated size of the economy. China is now the sixth largest global economy, having overtaken Italy. The service sector accounted for most of the growth with its share of the economy increasing from 31.9% to 40.7%.

GDP growth in Japan was 2.3% in 2005 and is forecast at 2.0% in 2006 and 1.8% in 2007. Japan's headline deflation has

been diminishing, and inflation is expected to return by 2007.

World trade grew by over 10% in 2004 and is expected to moderate at 7% in 2005 and 2006. A risk for future trade growth is the increasing tendency for countries to protect their native industries from competition originating from developing and newly developed countries, mainly in Asia.

World crude oil prices in September were \$60.47bbl, up by 3% from the previous month. Oil supplies continue to be tight due to lack of capacity in the refineries and prices are likely to reflect this in the future .

[Overall, the global expansion is set to pick up slightly in 2006.](#) Future risks to growth include the US budget deficit.

UK REVIEW AND OUTLOOK

Growth of the UK economy slowed sharply in 2005, with the OEF, World Economic Prospects (Winter 2005/06) estimating GDP growth of 1.7%, below the strong growth of 3.2% in 2004. However, GDP is expected to pick up in 2006 with growth forecast to be around 2.1% as a result of expected oil price decreases.

Latest ONS figures indicate that inflation, as measured by the Consumer Price Index (CPI), was 2.0% over the year to December 2005, down from 2.1% in November and equal to the Monetary Policy Committee's target.

The Bank of England maintained interest rates at 4.5% for the fifth month in a row in January 2006. UK annual house price inflation was 2.5% in November 2005, up

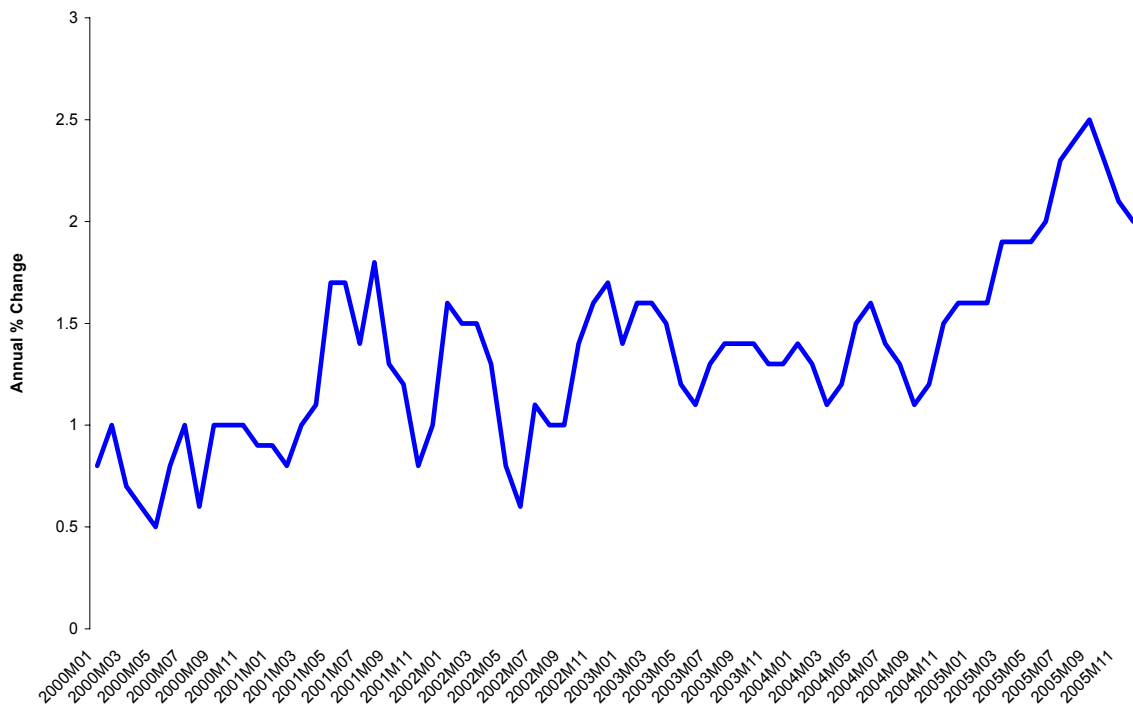
from 1.8% in October 2005 with the average house price in the UK now £186,431.

Retail sales have continued to pick up in recent months, with the volume of retail sales increasing by 1.0% between September and November 2005, the largest increase since August 2004.

In the three months to November 2005 manufacturing output decreased by 0.8%. There were significant decreases in output across a range of manufacturing sub – sectors. The most significant falls were in textiles, leather and clothing (-3.0%), the food, drink and tobacco sector (-1.5%) and the paper, printing and publishing sector (-1.2%). There were no significant increases.

CPI – Annual Percentage Change

Figure 1



Source: ONS Consumer Prices Index

Latest ONS figures show that UK GDP grew by 0.4% in the third quarter of 2005 compared to 0.5% growth in Q2. Growth in this latest quarter was largely driven by a 0.7% expansion in the service sector. The construction sector also grew at 0.5% and manufacturing expanded by 0.3%. Over the year to Q3 2005 UK GDP increased by 1.7%.

Business investment in the UK rose only slightly in the third quarter of 2005, with a quarterly increase of 0.3% and an annual increase of 1.9%. Compared with Q3 2004, manufacturing investment rose by 4.6% and services increased by 1.5%. Construction investment also increased by 3.6%. The CBI industrial trends survey (December 2005) continues to highlight the difficulties facing the manufacturing industry, with strong competition in domestic markets, compounded by the

sharp slowdown of the past year and weak export orders.

The UK labour market remains one of the economy's main strengths, with total employment increasing by 221,000 over the year to stand at 28,764,000 – a rise of 0.8%. However the number of people in employment has fallen by 22,000 over the quarter. The working age economic activity rate stood at 78.6%, unchanged from the previous quarter and the same period a year ago.

Unemployment stood at 1,528,000 in September – November 2005; this represents an increase of 8.6% (or 121,000 people) over the year. The rise was the biggest for 12 years and lifts the unemployment rate to 5.0%. The proportion of unemployed who have been out of work for 12 months or more has increased over the year and currently stands at 20.4%.

Key UK Economic Statistics

Table 2

	Period	Level	Change over 12 months
Total Employment ¹	September – November 2005	28,764,000	0.8%
Unemployment Rate ¹	September – November 2005	5.0%	0.3%
Economic Activity Rate ²	September – November 2005	78.6%	0.0%
Manufacturing Employee Jobs ³	September 2005	3,105,983	- 3.5%
Service Employee Jobs ³	September 2005	21,914,856	1.4%
Total Gross Value Added	2004	£1,005.4bn	4.6%
Manufacturing Output (2002=100)	November 2005	101.0	-1.8%
Average House Prices	November 2005	£186,431	2.5%

¹ All aged 16 and over

² Working Age

³ Seasonally Adjusted

⁴ Change in house prices is calculated from ODPM index (Feb 2002 = 100)

Sources: ONS Labour Market Statistics, ONS Regional GVA, ONS Index of Production, ODPM Monthly House Price Statistics

REPUBLIC OF IRELAND REVIEW AND OUTLOOK

The OEF, *World Economic Prospects* (Winter 2005/2006) estimates that the RoI economy grew by 4.5% in 2005 and is predicting a stronger growth of 5.0% in 2006. The growth observed in 2005 has been largely underpinned by strong domestic demand.

The Consumer Price Index (CPI) recorded inflation of 2.5% in 2005, up from 2.2% in 2004. The ESRI Quarterly Economic Commentary (Autumn 2005) forecasts that inflation is likely to remain subdued in 2006.

The Permanent TSB / ESRI House Price Index reported house price growth of 6.2% over the year to September 2005. House price growth in Ireland has fallen from the

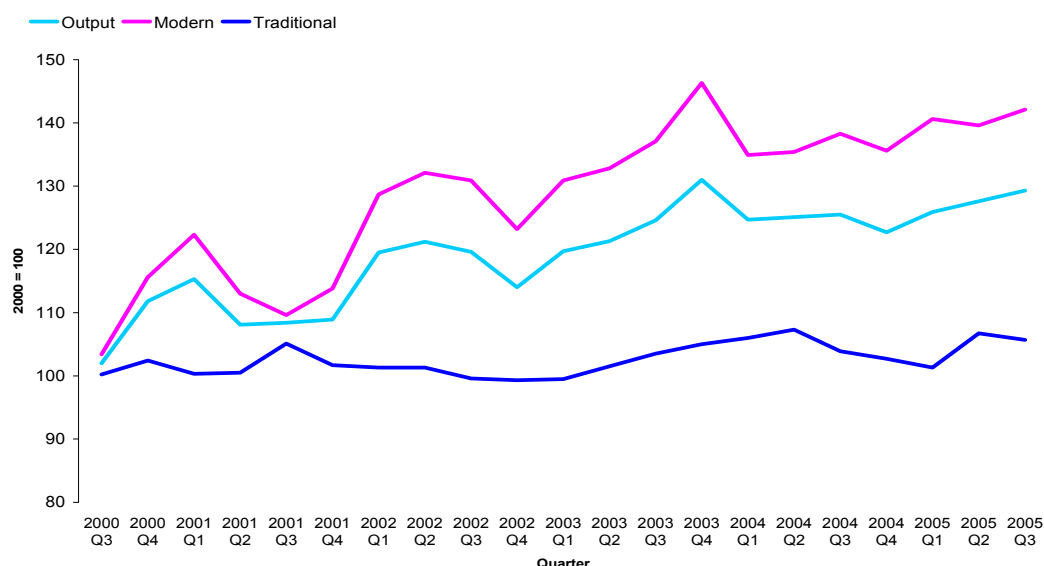
annual growth rate of 12.0% in September 2004, indicating a slowdown in Ireland's house price inflation.

The European Central Bank (ECB) has left Eurozone interest rates unchanged for the second month in a row at 2.25%.

Manufacturing output (seasonally adjusted) increased by 1.3% in Q3 2005 from the previous quarter and 3.0% on the same quarter one year earlier. This was driven by a quarterly increase of 1.8% in output of the 'modern' sectors (chemicals, media, computers & electrical equipment) despite a decrease in output of the traditional industries of -0.9%. Manufacturing productivity (measured as output per hour) was 16.1% higher in November 2005 than one year ago.

Manufacturing Output¹ (2000=100)

Figure 2



¹Seasonally Adjusted

Source: CSO Volume Indices of Production for Manufacturing

Ireland's seasonally adjusted trade balance strengthened over the twelve months to November 2005, with imports increasing by 8.8% and exports increasing by 8.5%. Ireland's trade surplus now stands at €3,237m.

The labour market remains a stronghold of the Irish economy, with total employment increasing by 5.0% to 1,989,800 over the year to June – August 2005. The ESRI forecasts an average increase of 50,000 in total employment in 2006, with the services sector being the main driver of growth.

There were 96,700 persons unemployed in the third quarter of 2005. The unemployment rate decreased by 0.1 percentage points over the year to stand at 4.6 % in June-August 2005, with the ESRI forecasting an unemployment rate of 4.2% in 2006.

Tourism has continued to perform well, with the number of overseas visitors increasing by 6.2% to 2.3 million over the year to July – September 2005. In 2004, earnings from all tourist visits contributed €4,067m to the RoI economy; however €4,180m was spent by Irish visitors abroad leading to a negative balance of -€114m.

RoI Key Labour Market Statistics

Table 3

	Period	Level	Change over 12 months
Total Employment ¹	June – August 2005	1,989,800	5.0 %
Unemployment Rate ¹	June – August 2005	4.6%	-0.1 % ³
Economic Activity Rate ²	June – August 2005	63.2%	1.4% ³
Manufacturing Output (2002=100)	Q 3 2005	129.3	3.0%
Average House Prices	September 2005	€ 268,040	6.2 %

¹Not seasonally adjusted

²RoI economic activity rate is based on all aged 15+ rather than working age

³Change in percentage points

Source: CSO Quarterly Household Survey, CSO Volume Indices of Production for Manufacturing, Permanent TSB / ESRI House Price Index

NORTHERN IRELAND REVIEW AND OUTLOOK

NI economic growth has remained modest, with OEF/RF predicting growth to be 2.4% in 2006. Within its Economic Outlook and Business Review, the First Trust Bank indicates that while growth in public expenditure is expected to fall over the next two years, public investment in infrastructure will cushion the economic impact.

The NI labour market continues to perform well. The number of NI employee jobs increased by 1.4% over the year to 693,450 (September 2005) – the highest figure on record. While employment within the manufacturing sector has continued to decline, this has been offset by increases in service sector employment.

The NI unemployment rate (September-November 2005) decreased by 0.6

percentage points over the year to 4.6% and is unchanged on the previous quarter. The rate remains below the UK average of 5.0%.

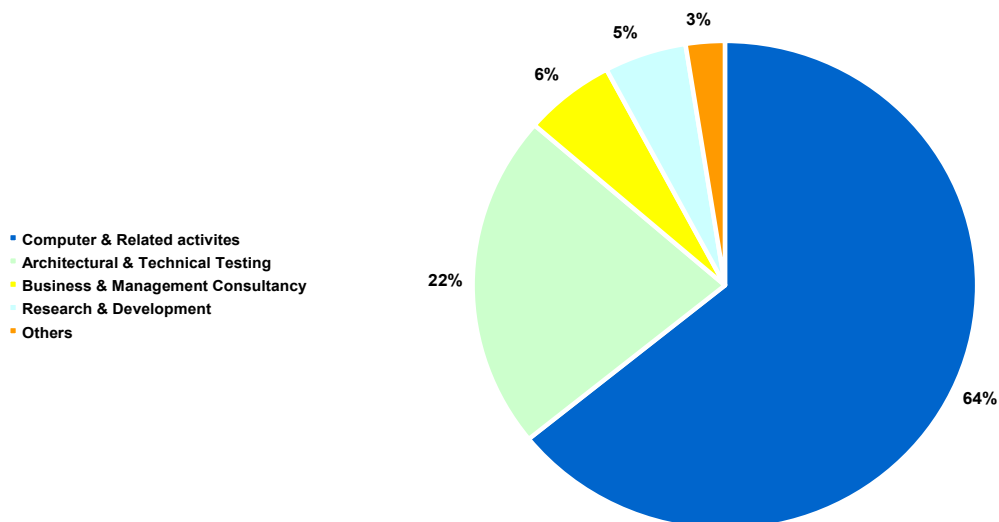
NI's working age inactivity rate is 27.4% which is the highest of all the UK regions, higher than the UK average of 21.4%.

The number of graduates of working age has almost doubled since 1995. Graduates in NI make up 14.8% of the working age population compared to 17.5% in the UK as a whole.

The new (experimental) survey on exporting services indicates that firms classified within the high export potential group exported services valued at £126.4m in 2003, with computers and related activities contributing the largest share (64.1%).

Value of Exports made by High Export Potential Companies

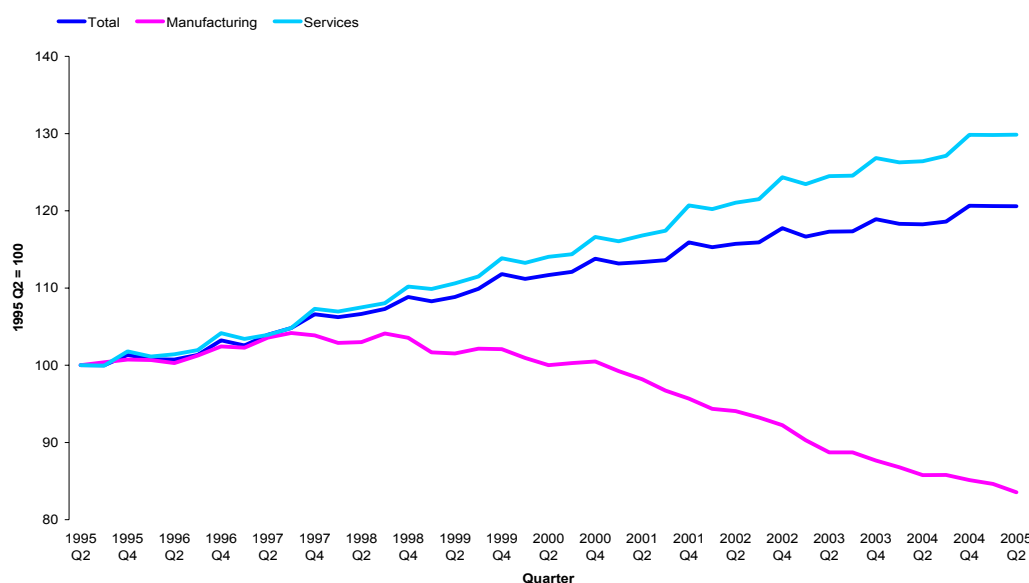
Figure 4



Source: DETI Exporting NI Services Study (Experimental)

Seasonally Adjusted Employee Jobs

Figure 5



Source DETI January Monthly Labour Market Statistics

In 2004 Gross Value Added (GVA) was £23.058bn and accounted for 2.3% of the UK total.

Over the latest five year period for which data is available (1999- 2004) GVA per head grew by 25.2% compared to the UK rate of 26.7%. This growth rate is higher than two other regions in the UK, London and the West Midlands.

The Annual Business Inquiry reported a 5.9% increase in turnover of NI based companies and organisations between 2003 and 2004. The service sector accounted for approximately 55.8% of the £45.2bn turnover, while the manufacturing sector contributed 30.3%.

The December Ulster Bank Purchasing Manufacturing Index reported evidence of an upturn in NI private sector business conditions, with firms reporting strengthening export demand. However, inflationary pressures on costs have remained substantial and competitive pressures have resulted in firms having to

absorb the majority of these cost increases.

The latest CBI Business Confidence Survey (January 2006) reports low levels of confidence in the NI economy mainly driven by the manufacturing sector. However it is encouraging to note that 'own business' confidence has been rising across all sectors, with manufactures more optimistic since January 2005.

Manufacturing output increased by 3.1% over the year to Q3 2005 compared to an annual increase of 0.1% in the UK. The index of manufacturing productivity increased by 5.2% over the year.

The NI Index of Services (experimental) shows that for the third quarter of 2005 output increased by 5.9% compared to the third quarter of 2004. Overall this is the highest level that the index has reached in any third quarter period since it began in 2001. Other services and the hotel and restaurants sector showed the largest

increase over the year while business services and finance showed a small decrease at 0.2% over the year.

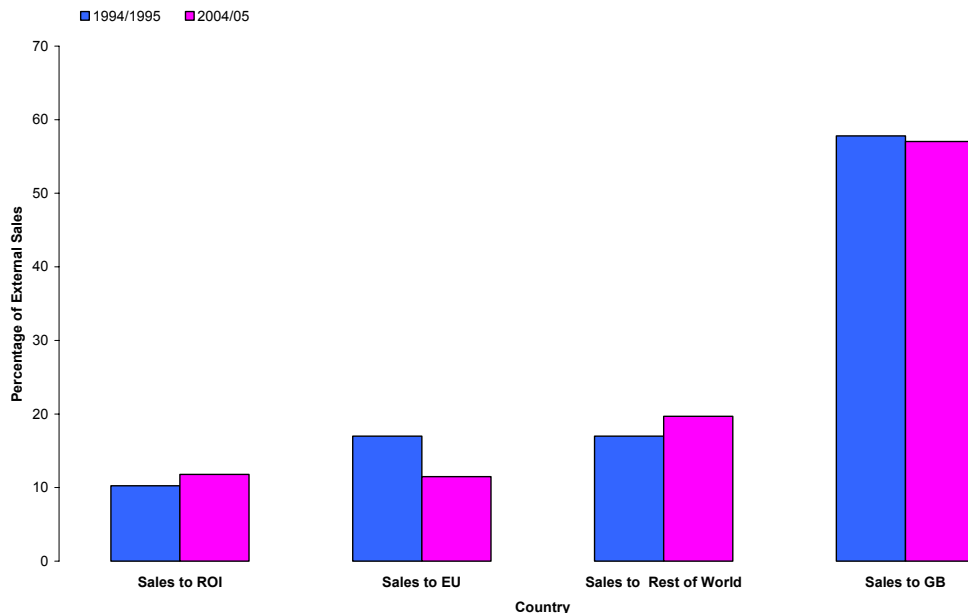
Total sales by manufacturing businesses grew by 2.5% in 2004/05 and are now estimated to be worth £13.8bn. This is an increase of 10.2% over the five year period 1999/00 to 2004/05. Food, drink and tobacco is the largest contributor to total

sales accounting for 48.0%. GB is the most important market for sales followed by NI and ROI.

Manufacturing exports were estimated to be worth £4.5bn in 2004/05. This represents an increase of 3.5% over the year.

Change in Destinations of External Sales over the Last Ten Years

Figure 6



Source: DETI Manufacturing Sales and Export Survey 2005

Tourism continued its expansion, with the NI Tourist Board's visitor tourism figures showing that there were 2,093,000 visits to NI in 2004, indicating 4% growth. Just over 40% of all visits to NI are to visit friends and family. The number of holiday visitors increased by 11% to 405,000.

NI's key tourism markets are GB and RoI. However the highest growth markets were North America and Other Overseas markets (which exclude GB, ROI, North America, EU, Australia and New Zealand) which demonstrated increases of 16% and

29% respectively. Total revenue from visitor tourism reached £325million in 2004, a 7% increase in real terms from 2003.

The average house price in NI was £136,231 in November of 2005, an increase of 17.0% on November 2004. This represents the highest growth of all the UK regions and is considerably above the UK average growth of 2.5%.

NI Key Economic Statistics

Table 4

	Period	Level	Change over 12 months
Total Employment ¹	September-November 2005	754,000	2.9%
Unemployment Rate ¹	September –November 2005	4.6%	-0.6% ³
Economic Activity Rate ²	September-November 2005	72.6%	0.6% ³
Manufacturing Employee Jobs	September 2005	86,840	-2.0%
Service Employee Jobs	September-November 2005	549,190	1.8%
Total Gross Value Added	2004	£23.058bn	5.0%
Manufacturing Output (2001=100)	2005 Q3	105.4	3.1%
Average House Prices	November 2005	£136,231	17.0% ⁴

¹ All aged 16 and over

² Working Age

³ Change in percentage points

⁴ Change in house prices is calculated from ODPM index (February 2002 = 100)

Sources: DETI Labour Market Statistics, ONS Regional GVA, DETI Index of Production, ODPM Monthly House Price Statistic

OVERALL CONCLUSION

The NI economy has continued to perform well within a global economic context.

Global and UK economic growth moderated in 2005, however growth is expected to rally in 2006. The outlook for NI remains generally positive, with real growth expected to be 2.4% in 2006 which is broadly inline with the UK.

However, a number of key economic challenges remain. Within the local labour market - NI has the highest level of economic inactivity in the UK, while there are reports of specific skill shortages in certain sectors. Despite showing signs of improvement, the private sector needs to be further developed. Due to its relatively high reliance on the public sector, any reduction in the growth of public expenditure presents risks to the NI economy. However any impact will be cushioned by the planned programme of investment in infrastructure.

STRATEGIC IMPLICATIONS

This section draws out a number of the strategic implications of this economic assessment.

INNOVATION

In the context of innovation, business must maintain a continual stream on inventions and innovations of both new technologies and improved working practices. Increasing competitive pressures have created an environment in which NI can no longer compete purely on cost, and businesses must seek to increase the value they add to their products and services.

This is underlined by evidence from the economic research undertaken for DETI by A.D Little, comparing BERD expenditure in NI with comparator regions. The research conclusions and recommendations highlight that there is particular scope to increase the targeting and hence effectiveness of a range of interventions covered by the Regional Innovation Strategy. Furthermore, given the move to a more service based economy, DETI is currently framing a research programme to assess the nature and degree of innovation in the tradable services sector.

SKILLS

In the context of Skills, the challenge is to develop the labour supply in NI with the necessary skills to meet the needs of the modern economy. Developing workforce skills will lead to improved productivity, increased competitiveness and more sustainable employment.

In partnership with DEL, DETI is considering the importance of researching the impact of managerial skills on productivity.

COMPETITIVENESS

In the context of Competitiveness, the challenge is to promote measures that will improve the financial and corporate resilience of the NI economy (so that it is better able to seize future opportunities and withstand the future downturns), and to continue to improve the functioning and efficiency of markets in general, and in particular in the energy markets, so enabling greater competition and choice for NI consumers. Since the last edition of this publication, ERINI has published their report on the cost of operating business in NI (Nov 2005).

ENTERPRISE

In the context of Enterprise, the challenge is to continue to move enterprise beyond the NI market and encourage firms to seek opportunities to internationalise, building and strengthening networks and strategic alliances.

This is underlined by the findings of the DETI-commissioned study (undertaken by PwC in 2004) into the impact of EU enlargement on the NI economy. The report recommended that DETI consider a range of awareness raising, network building and promotional activities to ensure that NI business is aware of and can maximise the opportunities arising from EU enlargement. Pro-active and co-ordinated measures are crucial, since the research also finds that NI is not without sectors that are at risk from an enlarged EU. In response, Invest NI organised or contributed to a wide range of awareness raising events around the time of EU enlargement. Joint trade mission with Ireland to India has taken place. Future trade missions in 2006 include Germany, Asia Pacific region and the US.

Special Topics

2

ENHANCING NORTHERN IRELAND'S INFRASTRUCTURE BASE

Previous editions of this publication focused on innovation, enterprise and skills as drivers of productivity. This quarter's specialist chapter turns to the fourth key driver of productivity and economic prosperity - infrastructure.

The importance of infrastructure to the local economy is highlighted in the Economic Vision which states that the social and economic well being of NI is enhanced by the provision and maintenance of quality infrastructure and related public services.

The timing of this article is perhaps appropriate given that NI is set to benefit from a substantial programme of investment in infrastructure over the next decade. The main beneficiaries of the programme include health, education, roads, public transport, water and sewerage. The investment plan of potentially £16bn has recently been

outlined in the Investment Strategy for NI (2005-2015).

This chapter initially discusses how infrastructure impacts on economic growth, before providing a brief overview of the current state of NI's infrastructure. The programme of expenditure envisaged under the Investment Strategy is then outlined as is the expected impact on the NI economy.

1. Infrastructure and economic growth

The quality of infrastructure provision in an economy affects competitiveness and economic growth in a number of ways. Inadequate infrastructure can increase traffic congestion, reduce productivity and increase costs. This not only affects existing firms but also the region's attractiveness as an investment location and its general quality of life.

The linkages between infrastructure and economic growth have been widely researched and the World Bank has

published extensively in this area. In one such paper, Kessides (1993)¹ makes three key conclusions:

A) Infrastructure contributes to economic growth by reducing the cost of production, contributing to the diversification of the economy and providing access to modern technology. The longer term impact is that it raises the economic returns to labour by reducing workers' time in non-productive activities and/or improves health and well-being.

This positive relationship between infrastructure and economic growth reflects the findings of Aschauer (1989)². In his seminal research into the economic impacts of infrastructure, he argued that the decrease in public investment spending explained the productivity decline in the USA in the 1970s and early 1980s.

B) Kessides also highlighted that infrastructure contributes to raising the quality of life by creating amenities, providing public services (transport and communication services) and contributing to macroeconomic stability.

Improving the quality of life within a region increases its ability to attract skilled workers. In their recent assessment of the Quality of Life in NI³, the Economic Research Institute of NI (ERINI) scored NI above the UK in terms of social and environmental factors (including housing, water quality, health and education), but lower in terms of economic indicators (including unemployment, earnings and income distribution).

c) Kessides's third finding was that infrastructure alone does not create economic potential but rather aids development where the appropriate

conditions exist. Therefore, while it is important to ensure an economy's infrastructure does not constrain economic growth, developing infrastructure beyond current and future growth capabilities will simply result in under-utilisation.

It has been argued⁴ that the RoI economy's endowment of infrastructure was too large in the 1960s, resulting in overly burdensome maintenance and operation costs. However, this position is now reversed, with recent research (A&L Goodbody Consulting, 2005) estimating the RoI government needs to invest €140bn in the country's infrastructure over the next 15 years in order to address backlogs and keep pace with economic and population growth.

2. NI's Infrastructure

Infrastructure is defined as the basic physical and organizational structures (e.g. buildings, roads, power supplies, schools) needed for the operation of a society or enterprise.

NI's infrastructure has been under increasing scrutiny in recent years. The first Programme for Government for NI (2001) stated:

'A competitive, knowledge based economy requires the right education, skills and infrastructure policies. While we have good physical infrastructure in certain fields, for example, ports and airports, in recent years we have become acutely aware of deficiencies in the roads, public transport, energy, telecommunications and water and sewerage infrastructure.'

While Public Expenditure per capita in NI has been higher than for other regions within the UK, a range of other factors have resulted in lower expenditure on

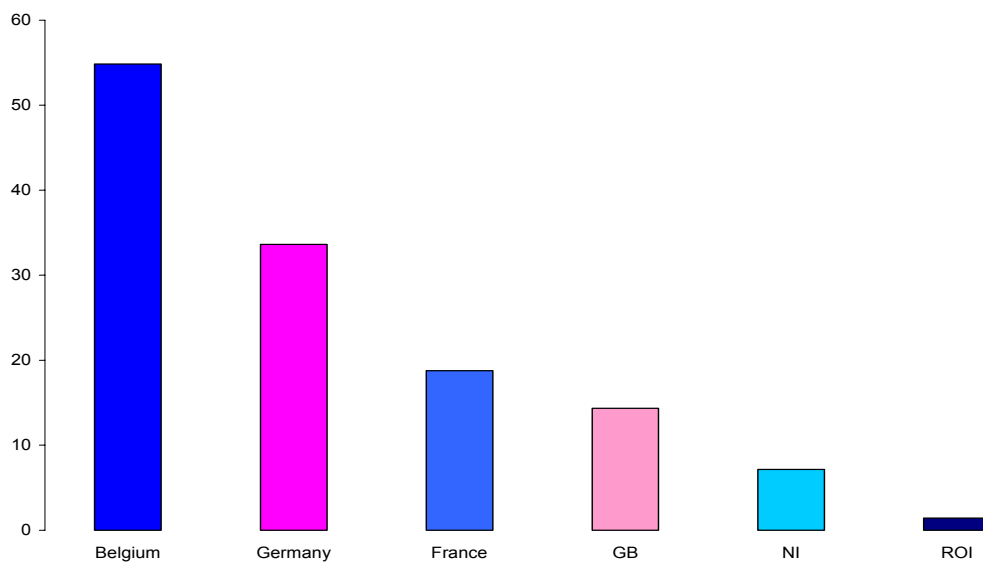
infrastructure. In his analysis of NI Public Expenditure, Hewitt (1990)⁵ highlighted the ‘relatively steady decline in the proportion of public expenditure in NI accounted for by capital expenditure since 1968/69’.

The impact of this public expenditure profile can be observed in a variety of

settings. For example, figure 1 demonstrates how NI’s motorway provision compares with other EU economies. While NI’s road network per 1,000 Km² is broadly in line with the provision in the UK and considerably above that of the RoI, NI has a relatively low density of motorways.

KM of Motorway per 1,000 KM²

Figure 1



Source: Transport Statistics Great Britain

However, in comparing motorway provision, it must be remembered that there are considerable differences in other factors such as the population density of the economies listed above, which may impact on the need for motorway provision in each particular area.

The Institute of Civil Engineer’s 2005 report on infrastructure ‘The State of the Nation 2005’ draws on a panel of expert engineers to assess the quality and sustainability of the UK’s physical infrastructure, at both a regional and national level. NI’s overall infrastructure provision is graded as average (C). The

report concludes that while advances are being made in some areas, NI is having difficulty matching the progress being made in other UK regions.

Scotland was awarded an above average (B-) rating, which represents an improvement on the previous year’s assessment. This has been attributed to huge investments in water and waste infrastructure and policy developments in transport and planning.

Table 1 shows NI’s ‘report card’ for its main infrastructure endowments.

Assessment of NI's Key Infrastructure

Table 1

	Grade
Communities for the Future	C
Energy	C+
Water and Wastewater	D+
Transport	C
Bus	C
Rail	C
Roads	C
Airports	B+
Seaports	B

Source: Institute of Civil Engineers

As can be seen, NI scores relatively well in its provision of air and sea ports; however, there is considerable scope for improvement in the standard of local infrastructure. When compared to their performance a year earlier, it is clear that significant challenges remain for energy. Airports and water are the key areas which have experienced improvements on the previous year. Although the D+ grade awarded to NI's water and wastewater infrastructure indicates further progress is still needed in this area.

The 'communities for the future' category assesses the overall provision of healthcare, work opportunities, housing, and urban and rural environments. The report states that the rating for this category reflects the underinvestment in schools estates, health buildings and housing. However, it is acknowledged that the recent progress in urban development, schools, hospital plans and retail parks have started to alleviate real and significant problems.

While the overall assessment may appear negative, it must be placed in the context of the UK, which was awarded a lower

rating overall (D+) and was below NI on energy, airports and seaports.

Despite this relatively favourable comparison with the UK, it must be remembered that NI's assessment has demonstrated the need for sustained improvement. In areas where NI is performing well, resources are still required to retain any comparative advantage.

One area not covered in the above assessment is Telecommunications. NI recently became the first region in Europe where every household and business has access to broadband.

However, as outlined in section one of this assessment, infrastructure alone does not create economic potential and Government is keen to encourage take-up of broadband amongst business users in order to boost productivity and reduce costs. As the then Minister of Enterprise, Trade and Investment put it:

'Growth in NI's economy depends on our ability to make the best use of e-business technologies to tackle global markets.'

(Ian Pearson, Minister for Enterprise, Trade and Investment, November 2002)

The importance of broadband to future economic development is widely understood by international economic bodies (including OECD). A recent analysis of micro-data by National Statistics concluded that the exploitation of broadband enabled ICT will increase the productivity and overall performance of firms, but only where the firms appropriately implement and utilize the technology.

3. Investment Strategy for Northern Ireland

The Investment Strategy for NI (ISNI) was launched in December 2005 and set out a long term, high level view of planned investment over the next ten years, of potentially £16bn.

The goal of ISNI is to put in place the infrastructure that is needed to enable government to deliver public services throughout NI for the 21st Century.

Figure 2 highlights how public expenditure will be allocated under ISNI.

As can be seen, schools, health and social services, social housing, roads and water and sewerage are the main recipients of

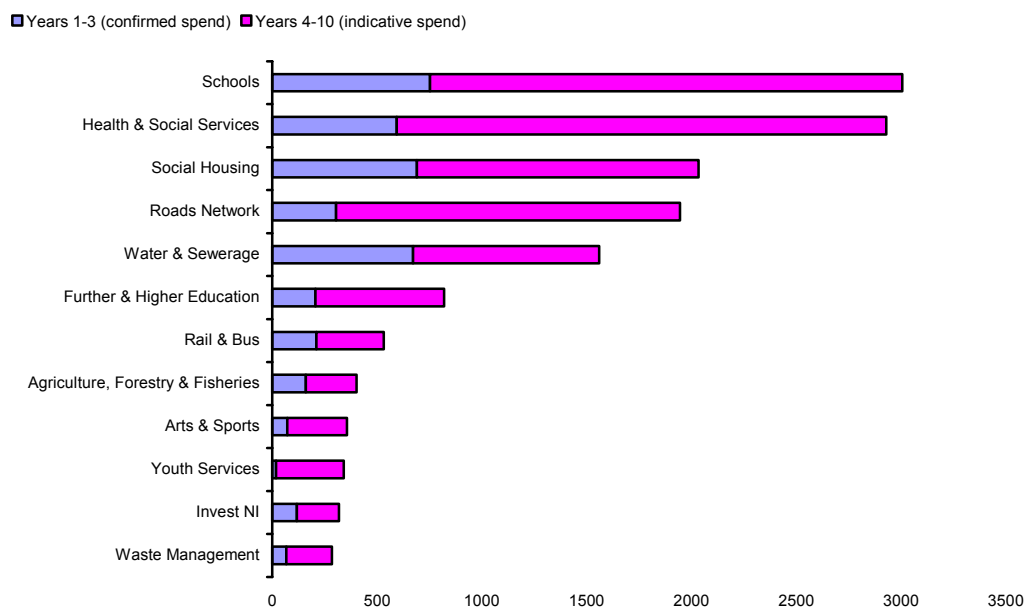
the enhanced expenditure programme.

This expenditure will have a real impact on budgets in the coming years, with planned capital expenditure set to increase in real terms by more than 52.1% between 2002/03 and 2007/08, to around £1.3bn annually.

The Department of Regional Development (DRD) has been allocated £4.06bn of capital expenditure under ISNI and over £1bn of this will be spent on strategic road improvements. Among this programme's high profile projects are the region wide upgrades of major road networks, including the Westlink, the A1 and the A6 from Dungiven to Londonderry.

ISNI Key Investment Programme Allocation

Figure 2



Source: Investment Strategy for Northern Ireland 2005

Also under the DRD budget, Water Service plans to invest some £735m, augmented by two significant Public Private Partnership (PPP) schemes, in upgrading water and waste water infrastructure and associated technology over the three years to

2007/08. This investment will be targeted at enhancing the quality of drinking water delivered to the customer and the quality of discharges from waste water treatment works.

Further examples of expenditure programmes under the ISNI are the planned improvements to the schools' estate. The current Budget allocation of £3.9bn will enable a significant programme of investment to be undertaken in the schools' estate to ensure that both accommodation and equipment address the needs of the curriculum reform and new approaches to learning and teaching.

The impact of this enhanced programme of public expenditure will be twofold.

A) Short to medium term impact

The initial impact will be the injection of money into the local economy in the form of contracts for the capital works. There will be increased demand for both construction workers and professional advisors as well as supply chain linkages as materials are sourced.

Basic economic theory indicates that in instances where demand outstrips supply, there will be inevitable increases in prices, both in terms of commodities and wages. Although the investment is spread across a ten year period it is possible that wages may rise in key construction and professional services. The equilibrium may even out, particularly with the immediate entrance of skilled workers from abroad reducing or even eliminating any upward pressure on wages.

In order to better understand the potential impacts of this investment, the Office of the First Minister and Deputy First Minister in partnership with the SIB have commissioned research into the capacity and capability of NI's construction and professional services to deliver the required build programme. This research is expected to be published in February 2006.

B) Long Term Impacts

The most obvious long term impact of the ISNI is the much needed improvement of NI's infrastructure. As outlined earlier, inadequate infrastructure capacity will undermine an economy's growth, increasing the cost base of firms, limiting the health and skills level of the workforce and introducing inefficiencies into the flow of information, goods and people. By improving the quality of NI's infrastructure, ISNI will make a considerable contribution to regional economic growth.

ISNI also has the potential to create long term benefits to both the capacity and capability of local construction and professional services companies. Besides the opportunity for local firms to secure contracts to deliver the capital programmes under ISNI, there will also be opportunities to work alongside major international companies.

An example of the benefits an infrastructure project can bring is the recent construction of the new Invest NI building which was designed, built and managed by a locally based property developer. Throughout the duration of this work valuable experience in PPP projects has been gained, with the potential of developing skills that could be deployed further a field.

Conclusion

[The Economic Vision for Northern Ireland highlighted that in order to achieve the goal of a high value-added, highly skilled, innovative and enterprising economy; NI must address the key drivers of innovation, skills, enterprise and infrastructure.](#)

Previous editions of the Quarterly Economic Review explored the innovation, enterprise and skills drivers, highlighting

how they impact on productivity and presenting key performance indicators.

This particular Review has focused on the recent launch of the Investment Strategy for NI, and the platform it provides for economic growth. The provision and maintenance of a quality, modern infrastructure is essential to support and underpin the economic growth which is necessary if NI is to make real progress in closing the productivity gap with the rest of the UK.

¹ Kessides, Christine, The Contributions of Infrastructure to Economic Development: A Review of Experience and Policy Implications. World Bank Discussion Paper 213, 1993

² Aschauer, David, Is public Expenditure Productive. Journal of Monetary Economics 23 (1989) 177-200.

³ Iparraguirre D'Elia J, The Quality of Life, ERINI Monographs - No. 1 - Mar-05

⁴ ESRI Medium-Term Evaluation 2005/2012

⁵ Hewitt, V, The Public Sector, The NI Economy, A comparative Study in the Economic Development of a Peripheral Region, 1990