

Direct Economic Impact of the Northern Ireland Protocol on the NI Economy

Department for the Economy

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Introduction

The Protocol on Ireland/Northern Ireland (NIP) is due to come into operation on the 1st of January 2021. This will have significant implications for Northern Ireland's trading relationship with the rest of the United Kingdom (UK) as the European Union's Customs rules and regulatory standards will now be applied to all goods coming into Northern Ireland (NI) from Great Britain (GB).

This paper seeks to examine the macro-economic consequences of this new trading relationship and assess the direct long term impact of the Protocol on Northern Ireland's economic performance. This analysis represents an update to work previously undertaken by the Fraser of Allander Institute that examined the Direct Trade Impacts of EU Exit Scenarios on Northern Ireland¹.

Economic Context

Great Britain represents Northern Ireland's largest trading partner both in terms of sales and purchases. Indeed as table 1 indicates, NI purchases approximately 60% of all goods from GB, with 43% of its sales going into GB.

Table 1:

	Purchases	Sales
GB	60%	43%
ROI	14%	20%
Rest of EU	14%	14%
ROW	12%	23%

Source: NISRA BESES

However it is important to note that the NIP will have a potentially significant impact on the purchase of goods from GB. The direct impact of the NIP on the ability of NI businesses to sell to GB is expected to be much more contained given the UK Government's ongoing

¹ <https://www.economy-ni.gov.uk/publications/direct-trade-impacts-eu-exit-scenarios-northern-irelands-long-term-economic-performance>

commitment to unfettered access to the GB market. Therefore the NIP creates a clear distinction in the treatment of NI's sales and purchases.

Furthermore whilst unfettered access to the GB market is important for the many businesses that sell into GB, the potential economic significance of changes to the treatment of purchases should not be underestimated. Indeed changes to the price of purchases will directly affect NI's economic competitiveness and any changes introduced with the NIP will have long lasting implications for jobs, consumer choice and prices more generally.

Modelling Framework

This analysis has been undertaken using a Computable General Equilibrium (CGE) model that was developed by the Fraser of Allander Institute at the University of Strathclyde. This is a type of simulation model widely used by governments and organisations across the world such as HMRC, the Scottish Government and the World Trade Organisation to look at a variety of policy issues including the impact of changes in trade agreements.

The model combines economic data provided by the Northern Ireland Statistics and Research Agency (NISRA) with a complex system of equations to give an accurate representation of the structure of the economy. Economic relationships in the model are based on theory and empirical evidence. This provides a framework to model the impact of policy changes to key economic variables. This model also has the ability to capture the indirect effects of changes to policy at a UK level and assist in understanding how economic shocks at a UK level will transmit through to the local NI Economy.

It is recognised that the Covid-19 pandemic has significantly impacted both the size and structure of the local economy in a way that may have long lasting consequences. However this analysis represents a long term analysis of 15 years and assumes that the structure of the economy will return to historic levels of output over that time period.

Scenarios

In order to assess the potential impact of the NIP on NI's long term economic performance, the following scenarios have been developed to reflect the potential differences that could be expected with the level of frictions/non-tariff barriers applying to NI imports from GB. This will ultimately depend on GB's future relationship with the EU and how far GB diverges from EU customs and regulatory rules that will be applied at EU as well as NI ports.

Scenario 1 – NI NIP, UK FTA - The UK and EU's future trading relationship will be governed by a Free Trade Agreement. For modelling purposes, this scenario assumes that a FTA agreement between the UK and the EU will eliminate all tariffs. However it is recognised, that in reality there may be a small number of tariffs remaining for "at risk" goods arriving to NI from GB.

This scenario also assumes that despite the UK & EU agreeing a FTA, the NIP will result in the application of customs requirements and regulatory checks on goods flows between GB and NI.

Scenario 2 – NI NIP, UK No Deal (NTM Only) - UK trades with the EU on World Trade Organisation (WTO) terms. This will result in the application of more onerous checks & delays relating to customs and regulations on trade flows between the UK and EU/NI. For modelling purposes this scenario assumes no tariffs are applied on NI purchases reflecting the aspiration that only goods at risk of moving to the European Union will have tariffs applied. However depending on the outworking of the joint committee process, it is recognised that some goods, even if destined solely for the NI market, could still face tariffs in a No deal situation under the terms of the NIP.. In other words this scenario could be considered as a best case "UK no deal" outcome for the NI economy..

Scenario 3 – NI NIP, UK No Deal (NTM & Full Tariffs) – This scenario includes the more onerous checks that form part of scenario 2, however it also examines the consequences of NI having to apply the full suite of EU Customs tariffs on imports from GB. In effect it is assumed that a very strict approach is taken to "goods at risk" assessments. In other words this could be considered as a worst case "UK no deal" outcome for the NI economy.

The tariff and non-tariff barriers assumed to be applied in each scenario are as follows:

Table 2:

Scenario	GB – NI (NTM %)	Tariffs
1) NI NIP, UK FTA	8%	0%
2) NI NIP, UK No Deal (NTM Only)	10%	0%
3) NI NIP, UK No Deal (NTM & Full Tariffs)	10%	Full EU MFN

Source: DFE Analysis

These scenarios examine NI's long term economic performance compared to a status quo baseline position where imports from GB are not subject to any customs or additional regulatory checks. It is recognised that any counterfactual scenario involving a land border on the Island of Ireland, would also lead to increased costs. However the purpose of this analysis is to demonstrate the costs of the NIP on GB/NI trade in isolation, so as to better understand its direct consequences for the NI economy.

Results

Scenario 1 – NI NIP, UK FTA

The headline economic impact resulting from the NIP in the situation where the UK does manage to secure a free trade agreement with the EU is as follows:

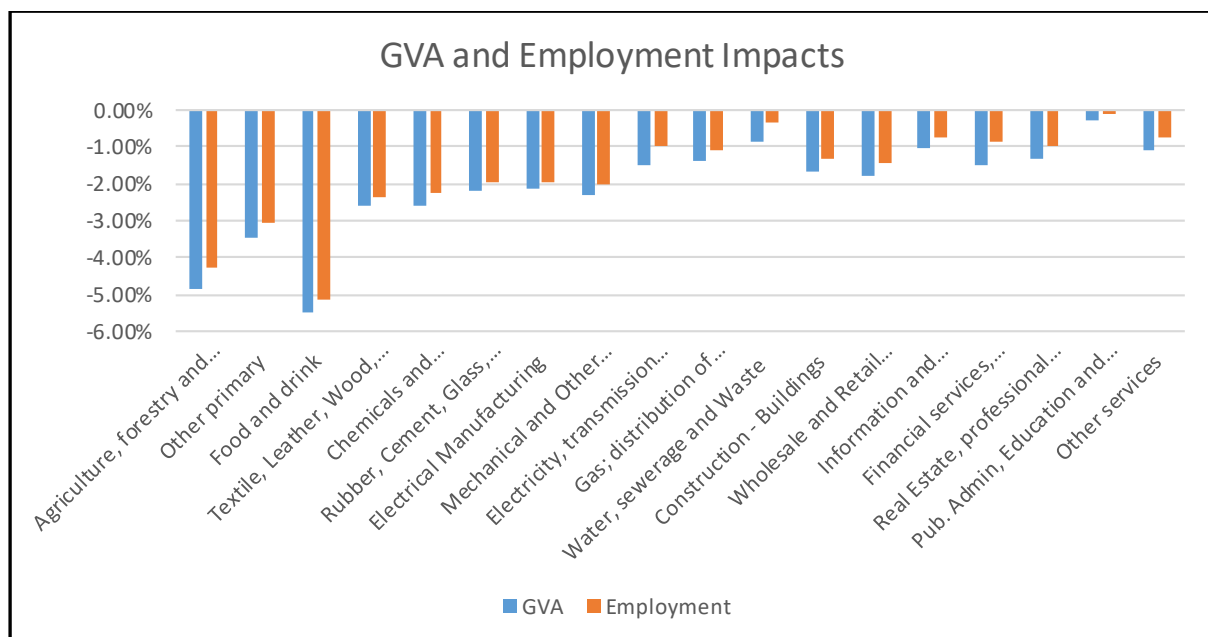
Table 3: Long term impact NI NIP, UK FTA

Headline Impacts	Year 15	Headline Impacts	Year 15
GDP Expenditure Measure	-1.7%	ROW (EU & Non EU) Imports	2.0%
Investment	-2.3%	Interm Imports from GB	-5.6%
Regional Imports	-5.8%	CPI	1.7%
Regional Export	-5.1%	Employment	-1.1%
ROW Export	-5.3%	Private Invest Imports from GB	-6.36%

This analysis demonstrates that increased trade frictions resulting from the EU Custom’s rules and Regulatory Standards will have a material adverse long term impact on the NI Economy. This includes GDP being 1.7% lower than would otherwise be the case, along with a 5.6% reduction in imports from GB. This scenario also suggests that NI could experience a 5.3% reduction in exports to the rest of the world (including ROI & EU) and the overall level of employment in NI could be around 1.1% lower which would equate to around 10,000 jobs based on 2018 employment levels.

Chart 1 below outlines the long-term impact on value added and employment as a percentage change from baseline values at a detailed sectoral level.

Chart 1: Sectoral GVA and employment impacts of NI NIP, UK FTA



This detailed analysis demonstrates that all sectors of the economy will be adversely affected by the NIP, however the most affected is the Food and Drink Sector that could see a 5.5% reduction in GVA and experience 1,200 fewer jobs over the long term.

Scenario 2 – NI NIP, UK No Deal (NTM Only)

The following results provide an insight into the scenario whereby the UK fails to secure a FTA with the EU. This would mean that a more onerous system of customs requirements and regulatory checks would be applied on imports of goods to NI from GB.

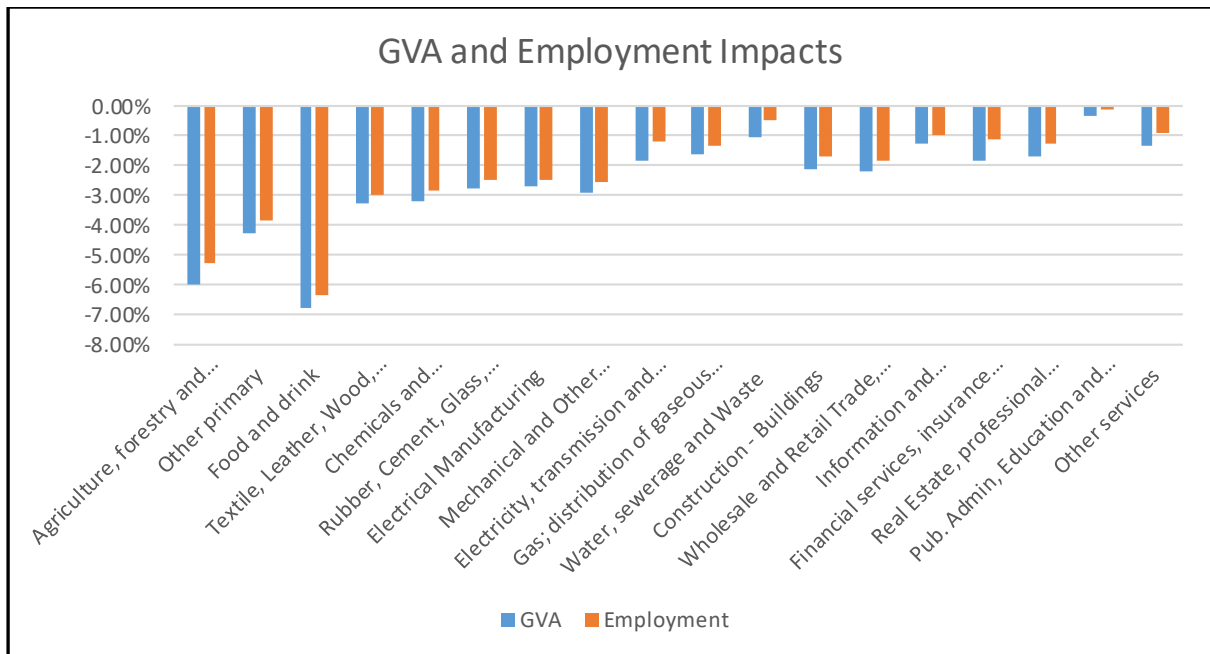
Table 4: Long term impact NI NIP, UK No deal

Headline Impacts	Year 15	Headline Impacts	Year 15
GDP Expenditure Measure	-2.0%	ROW Imports	2.6%
Investment	-2.8%	Interim Imports from GB	-6.9%
Regional Imports	-7.1%	CPI	2.2%
Regional Export	-6.3%	Employment	-1.4%
ROW Export	-6.5%	Private Invest Imports from GB	-7.8%

These results demonstrate that the NI economy would be impacted in broadly the same manner albeit more significantly. This is perhaps unsurprising given the increase in the trade friction that has been assumed. As with the FTA scenario, it is also apparent that imports from the rest of the world e.g. EU increase by around 2.6%. This highlights the likely reorientation of some supply chains to make up for the reduction in regional imports from GB.

The detailed sectoral impacts of the potential scenario whereby the UK fails to agree a FTA is demonstrated in chart 2.

Chart 2: Sectoral GVA and employment impacts of NI NIP, UK No Deal



Whilst most sectors are negatively affected by the imposition of the NIP, the worst affected are agriculture as well as food and drink with these sectors losing approximately 6% and 7% in GVA respectively, as well as 3,000 jobs between them. Overall this scenario suggests that there could be around 12,300 fewer jobs in the economy over the long term.

In the event of a no deal situation it would be reasonable to expect a more onerous system of customs checks and standards e.g. SPS, Veterinary etc to apply the agricultural produce as well as food and drink products. If the trade frictions for these two sectors were more onerous than for standard manufactured goods and had an assumed trade friction of 22% instead of 10%, this would result in a long term impact on GDP of -2.7% and lead to around 17,000 few jobs being available over the long term.

Scenario 3 – NI NIP, UK No Deal (NTM & Full Tariffs)

The results associated with the scenario whereby the UK does not secure a FTA with the EU and is required to apply the full customs code including tariffs on all goods imported to NI are presented in the following table

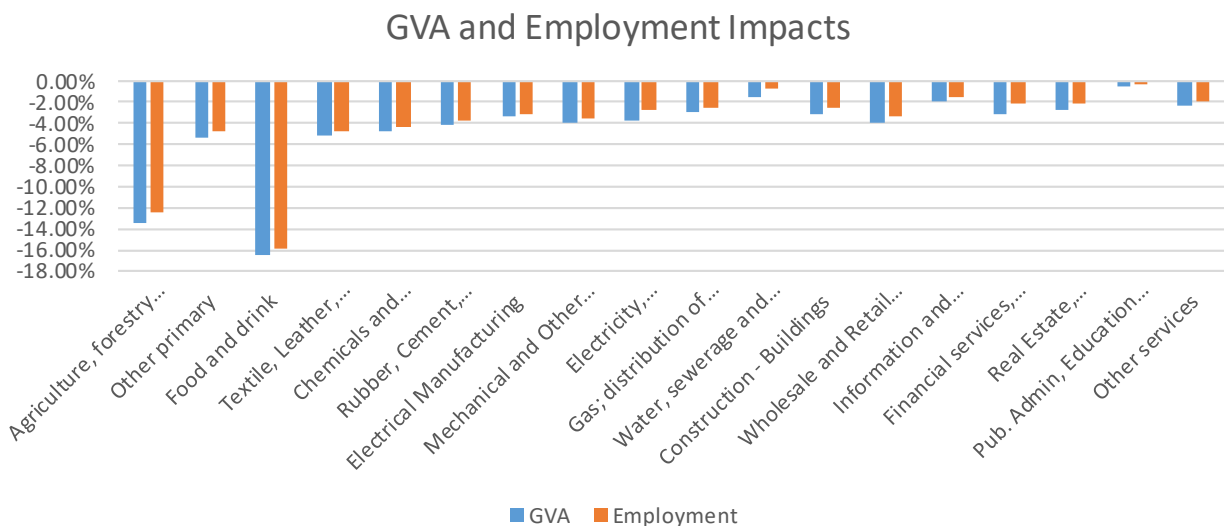
Table 5: NI NIP, UK No deal & tariffs

Headline Impacts	Year 15	Headline Impacts	Year 15
GDP Expenditure Measure	-3.5%	ROW Imports	3.8%
Investment	-4.9%	Interim Imports from GB	-11.5%
Regional Imports	-12.3%	CPI	3.3%
Regional Export	-11.7%	Employment	-2.5%
ROW Export	-10.4%	Private Invest Imports from GB	-11.5%

It is evident from this table that the imposition of tariffs significantly increases the negative overall economic impact of a no deal scenario as the GDP impact is increased by approximately 75%. Furthermore this scenario suggests that there could be 23,000 fewer jobs available over the long term than would otherwise be the case.

The sectoral results presented in chart 4 below also clearly indicate the significance of this scenario for both the Agricultural and Food and Drink sectors. This highlights the fact that these two sectors will be sensitive to trade frictions that will be created on goods trade across the Irish Sea and also recognises that tariffs on agri-food products tend to be higher than for other goods.

Chart 4: Sectoral GVA and employment impacts NI NIP, UK No deal & tariffs.



Conclusion

The introduction of the NIP will represent a significant shock to the NI economy irrespective of what future trading relationship is established between the UK and the EU. This is due to the fact that applying the EU customs code at NI ports will inevitably lead to increased cost for firms importing from GB, in the form of customs declarations, Sanitary and Phytosanitary Certificates as well as increased checks and surveillance.

This report has sought to highlight some of the consequences of these new arrangements and although the scenarios modelled are illustrative, they provide a useful indication of both the scale of impacts as well as the channels through which they will be transferred.

Indeed the analysis outlined above suggests that it is likely that some combination of the following will form part of the economic adjustment that will follow the introduction of the new arrangements:

- Increased cost for business that will ultimately affect competitiveness and reduce economic output.
- Increased cost for consumers..
- Less investment, especially from UK firms that are only willing to operate on an All-UK basis, however this will be partially offset by increased investment from the ROW.
- Re-orientation of supply chains. The extent to which this will happen will depend on the viability of those supply chains and the availability of product substitutes.
- Increased domestic production – increasing the price of imports from GB may make local firms more competitive in the domestic market.
- Reduced exports and external sales e.g. businesses will be less competitive if intermediate inputs sourced from GB or elsewhere become more expensive.

Given the significance of these potential impacts it will be vitally important to ensure any new trade frictions are minimised and eliminated where possible.