InterAnalysis Report DfE Summary Document

Department for the Economy

November 2022

Introduction

The Department for the Economy engaged InterAnalysis Ltd to undertake an assessment of the possible economic impact of the United Kingdom's exit from the EU.

This study[i] was initiated to help better understand how some of Northern Ireland's complex economic relationships with trading partners could be altered as it leaves the EU, and how the balance of these relationships will affect NI's overall level of economic welfare including both consumers and producers as well as the economic output for key sectors of the economy.

This study, undertaken in conjunction with researchers at the UK Trade Policy Observatory, was prepared using a partial equilibrium model of the economy, which includes 116 different sectors/industries. The model has a multi-market structure and includes trade data from eleven different markets including Great Britain, Northern Ireland, the EU (which for the purposes of this study excluded the UK and Ireland), Ireland, the USA, China, Australia, EU FTA partners, UK continuity agreements partners and the rest of the world. The data used related to trade patterns that existed prior to the end of the Implementation Period.

This paper seeks to provide a summary of the main findings of the InterAnalysis Ltd report, and should be read in conjunction with the full report that provides more detail on the overall assumptions and results.

Scope & Constraints

The results from this study should not be viewed as a forecast of NI's likely economic performance over the coming years. Rather, the results are based on a very specific set of scenarios that make certain assumptions about NI's future trading relationships. These include:

No Deal – This scenario considers how NI trading relationships might have altered had there been a "No deal" outcome between the UK and EU but where the Northern Ireland Protocol would continue to apply. An additional, No Deal (B) variant is included to take account of the potential increased logistical cost of accessing both the GB and wider EU market.

NI Only – Direct trade impacts to NI arising from EU Exit. This excludes indirect effects such as NI firms having any competitive advantage relative to GB firms accessing the EU market.

Deal – Agreement between the UK and EU with the application of the Northern Ireland Protocol. This simulates as close possible the Trade and Corporation agreement (TCA) signed at the end of December 2020, however it does not take into account specific issues that were agreed e.g. on Rules of Origin, Trader Support Services or Trusted Trader Scheme.

Indeed, although this study was commissioned prior to the Trade and Cooperation Agreement (TCA) coming into force, it does replicate to some extent the main trading conditions envisaged with the NI protocol, as well as the wider trading relationship between the UK, EU and rest of the world. However, the study does not take into account the potential impact of new Free Trade Agreements that the UK could sign or the potential implications of the UK diverging from EU product standards and the associated challenge this would present to the competitiveness of NI businesses selling into the GB market.

Furthermore, it is important to note that this is a partial equilibrium analysis of the economy and does not take account of all the dynamic impacts that could be expected within a more holistic general equilibrium analysis. Nevertheless, it does serve to provide a detailed examination of some of the key sectoral impacts, especially within the agri-food, manufacturing and services sectors.

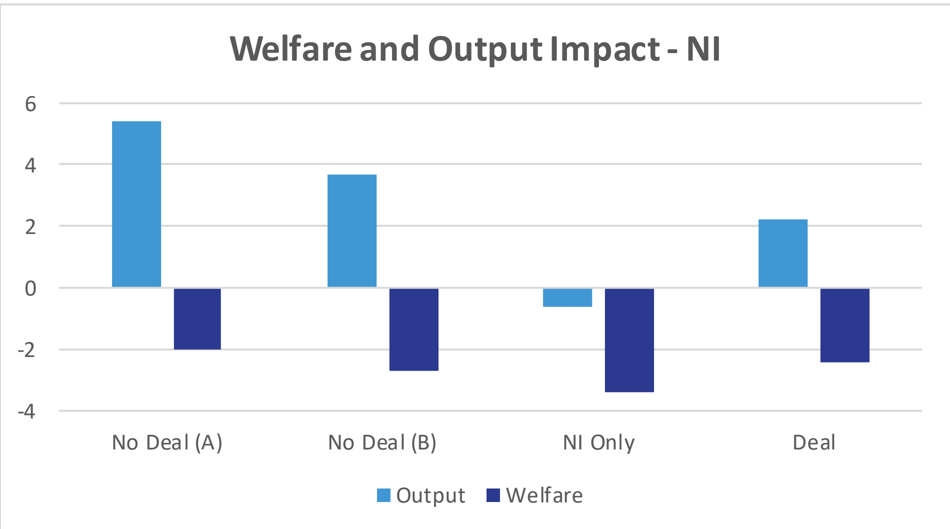
Key messages & results

Aggregate Results

The headline results demonstrate that under all scenarios, there is an overall welfare loss for GB, the EU and Ireland. Furthermore, under the 'deal' scenario that most closely reflects NI's current trading position under the NIP and TCA, the analysis estimates a loss in economic welfare for NI of approximately 2.4%.

This is despite the fact that most scenarios demonstrate a net increase in output for NI as is evident in the following chart:

Chart 1: changes to overall level of output and welfare



Reducing the overall level of welfare whilst increasing output, would at first appear to be contradictory. However, it reflects a very standard ***direct effect*** in models of international trade, whereby increased protection in the form of tariffs and non-tariff barriers serves to increase the cost/price of imports (and additionally in this case, NI purchases from GB). This allows domestic firms to increase output and benefit from being able to supply the domestic market at a higher price. There is also a second reason for the rise in output, which derives from the ***increased relative competitiveness*** of Northern Ireland firms in the EU and in Great Britain vis-à-vis their counterparts In essence the TCA results in a rise in barriers to trade bilaterally between GB and the EU. This gives Northern Ireland improved access for goods exporters (relative to GB) in the EU market, and for goods and services (relative to the EU) in the GB market. This increases exports and hence output.

However, although the research finds that firms in some sectors can increase output from the conditions noted above, when considered in aggregate, this study demonstrates that increasing trade barriers, especially on GB to NI trade flows, predominately serves to reduce overall economic welfare for NI society as a whole, increasing costs to consumers and thereby lowering overall demand/purchasing potential. Indeed, this reduction in welfare is largely being driven by an overall increase in the price level of 4.3%.

Broad Sectoral Results

The analysis produces the following high level sectoral results under the 'deal'/TCA scenario:

Chart 2: Broad sectoral changes in output

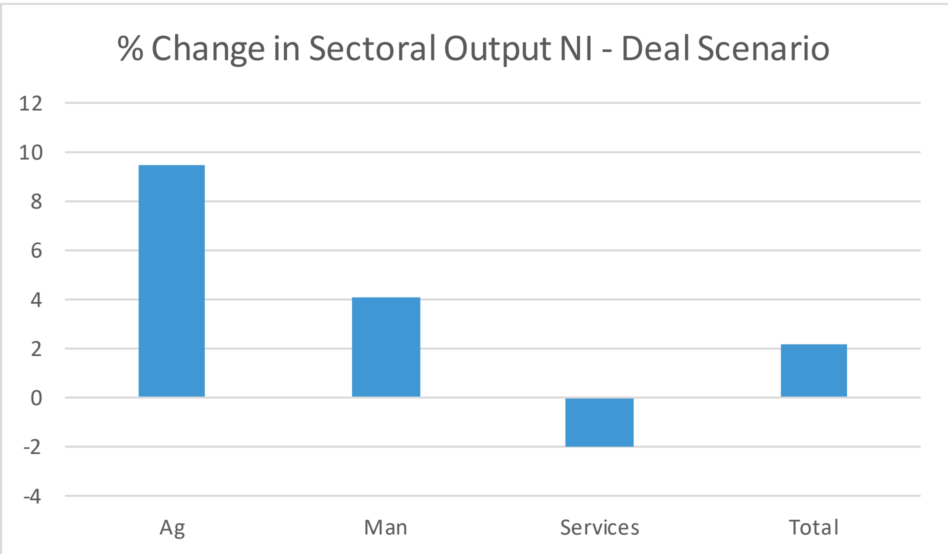


Chart 2 demonstrates that the model anticipates agricultural output to increase the most (7.14%), which reflects the increased protectionism for that industry arising from the Protocol[ii] as well as the agricultural industry's relative advantage, compared to GB, of supplying the EU market and its continued ability to serve the GB market under the commitment to "unfettered access". Conversely, the services sector is predicted to contract by 2.8%. This decline is driven by the increase in regulatory barriers between NI and the EU arising from NI no longer being in the single market for services.

The analysis also suggests that the output of the manufacturing sector will increase by 4%, again driven largely by increased protectionism and NI's relative advantage compared to GB of supplying the EU market.

Detailed Industry Results

Under the 'deal' scenario NI sees an increase in output in 63 out of 116 sectors with an average increase in output of 11.7%, while 53 sectors see a decline in output of -4.5% on average. This contrasts to the results for the other countries within scope of the analysis that tend to have predominately negative outcomes, albeit the scale of which may be less, as is evident in the following table 1:

Table 1: Balance of output changes by country

Disaggregated sectoral results, output changes					
	Count of sectors			**Average change %**	
	positive	**negative**		**positive**	**negative**
Deal					
GB	18	98		4.3	-12.6
NI	63	53		11.7	-4.5
EU26	4	112		0.6	-0.9
IRL	22	94		3.3	-6

Table 2 demonstrates the impact on those sectors of the NI economy that have the highest base production value (that are within the scope of the analysis). This includes Crop and animal production that is estimated to have an increase in output of 9.4%. Similarly, the manufacture of dairy products is also expected to increase output by 7.5%. Both of these impacts likely reflect the increased potential to replace GB based producers in the EU market and replace EU producers in the GB market.

Table 2: Impact on top sectors in NI by Value (Deal Scenario)

ISIC4Name	With Intermediates				
	Prices	Output	Exports	Imports	share
Construction	0.5	-0.4	-0.1	-0.5	14.6
Processing and pres. of meat	5.5	0.1	2	-3.7	5.8
Crop and animal prod., hunting	2.3	9.4	-0.1	-27.1	4.7
Man. of pharmaceuticals	1.7	1.1	1.3	-9.3	4.1
Admin & support service	1.7	-2.6	-11.8	-1.6	4
Man. of prepared animal feeds	2.3	5.9	2.3	-48.9	3.2
Land transport	1	0.1	0	-7.1	3.2
Financial and Insurance	1.2	-2	-1.5	-0.5	3.1
Man. of machinery for mining	3	-0.7	-0.2	-5.8	3.1
Man. of dairy products	3.7	7.5	-1.3	-27.5	2.9

Finally, a significant reduction is anticipated within the Admin & support service sector, reflecting the barriers to services trade that arise from the UK (including NI's) exit from the EU and the limited arrangements in place under the TCA to ease non-tariff barriers to services trade.

Conclusions

This analysis demonstrates that NI's future trading relationships arising from the UK's exit from the EU will have differential effects across society in NI. Indeed, the evidence clearly points to their being potential winners and losers depending on precise regulatory and tariff barriers faced by that industry. However, the analysis also demonstrates that when considered in totality, there is an overall welfare loss, arising largely from the increase in prices consumers will face.

Finally, it is important to note that the simulations covered by this analysis do not represent a forecast or prediction. Rather they simply identify the direction of possible changes and relative orders of magnitude of those changes for the specific industries under consideration.

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[i] The research underpinning this work was undertaken largely in 2021 and therefore it might not take account of more recent changes to the economic context.

[ii] It is recognised that this analysis does not fully reflect the terms of the NIP at it is likely that the actual average tariffs potentially placed on agri-food products imported to NI from GB may be less given the specific ROO requirements and operation of the Trusted Trader Scheme. Consequently, the change in output could be much less that this analysis suggests.