Research Bulletin 18/1 | An International Perspective on Northern Ireland's Economic Performance

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Summary

Improving competitiveness is the key goal in Northern Ireland's draft Industrial Strategy, with an ambition to rank amongst the top three most competitive small advanced economies (SAEs). However, recent performance on three key metrics of economic performance has been disappointing. Economic growth has been slower than other SAEs and current forecasts suggest that this will continue. GDP per capita has been consistently below the SAE average and has weakened significantly, with the gap almost three times wider than in 2005. Productivity per hour work has followed a consistent and steady trend lagging behind the SAE average. Overall, Northern Ireland ranked in the bottom five (out of 18) small advanced economies across all three economic measures in 2016. Given the ambition shown in the draft Industrial Strategy, there is clearly a lot of work to do.

Introduction

Improving competitiveness is a key objective within the draft Industrial Strategy for Northern Ireland (NI).[i] In seeking to become a leading competitive economy, the strategy highlights the importance of benchmarking against the small advanced economies (SAEs) to learn from their success. In recent years, the Economic Advisory Group (EAG) has produced competitiveness reports in 2013[ii] and 2016[iii], with DfE Analytical Services also producing competitiveness benchmarking in 2017.[iv] The consistent message across all three reports conclude that NI lags behind the leading SAEs on a range of economic indicators.

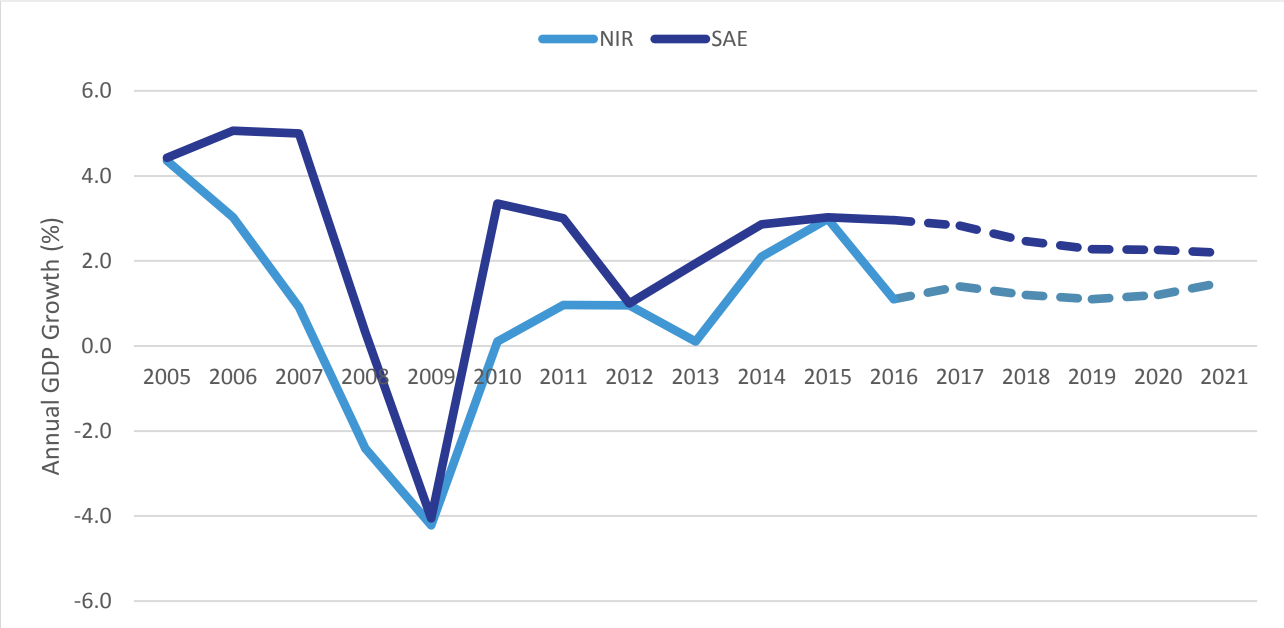
This research bulletin provides an assessment of NI's international economic competitiveness on three key measures of economic performance – economic growth, living standards and productivity. It focuses on 17 other SAEs which are used as benchmarks based on their size and competitiveness rankings. They are:

- **Europe:** Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, Iceland, Ireland, Luxembourg, Norway, Sweden & Switzerland
- **United Kingdom:** Scotland
- **Middle East**: Israel
- **Asia Pacific**: New Zealand, Hong Kong & Singapore

Economic Growth

Figure 1 illustrates GDP growth from 2005-2016 for NI compared with the SAE average. At the beginning of this time series, NI was performing at a similar rate to the SAE average and, with annual growth at 4.4%, it was out-performing economies such as Sweden, Luxembourg and Switzerland. However, over the past decade (with the exception of 2009, 2012 and 2015) NI has been performing below the SAE average. Forecasts for 2017-21 suggest that this will continue.

Figure 1: GDP Growth, 2005-2021



Sources: World Bank, ONS, IMF, UUEPC

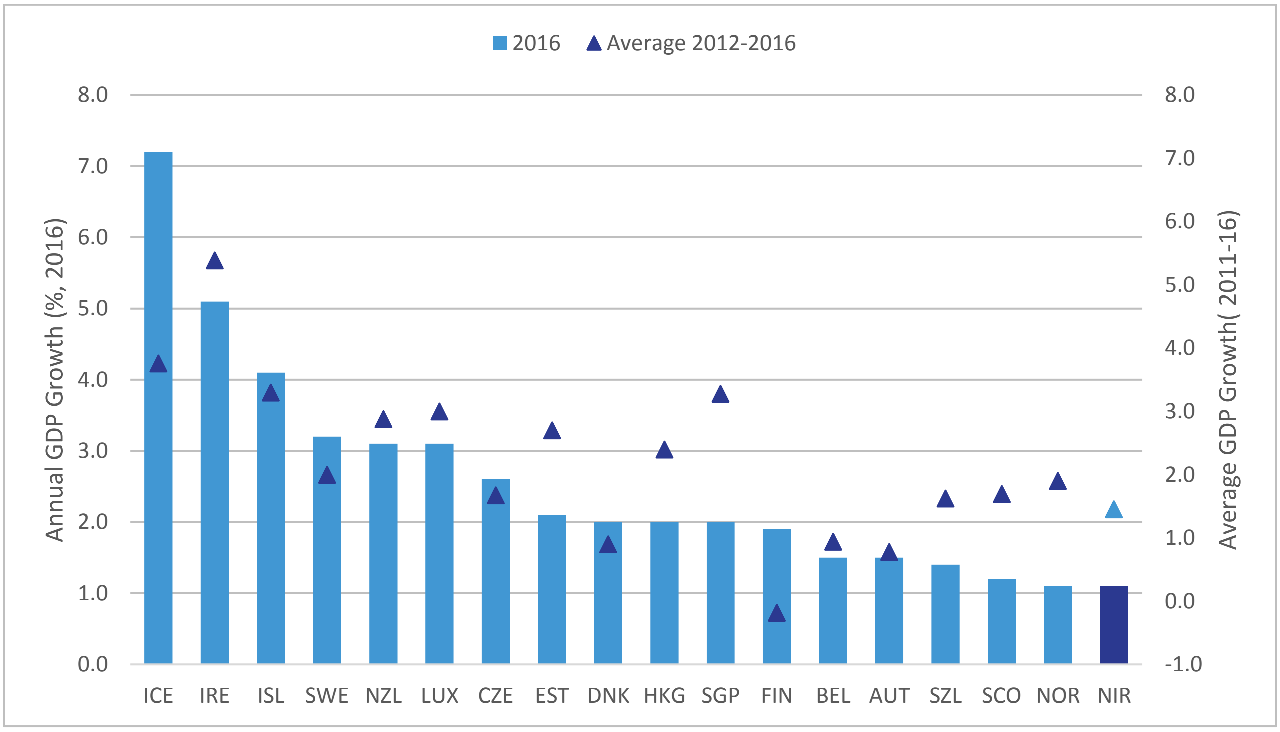
Note: Northern Ireland & Scotland use real GVA growth from ONS regional balanced GVA estimates.

NI and other SAEs both experienced a sharp decline in growth during the global financial crisis, although NI had already begun to slow down by 2006 and 2007 before the crash in 2008. The peak decline for both NI (-4.2%) and the SAE average (-4.1%) was in 2009. The biggest contractions in SAEs were in Estonia (-14.7%), Finland (-8.3%), Iceland (-6.9%) and Ireland (-4.6%), the latter of which led to the Irish government requiring a bailout from the European Commission and IMF worth around €85bn.[v]

Post-2009, the SAE group experienced a strong recovery before a slowdown in growth in 2012, with countries such as Scotland, Czech Republic, Finland and Luxembourg experiencing a double-dip recession. By contrast, NI experienced a much more muted recovery with lower growth rates and a second slowdown in growth of just 0.1% in 2013 whilst other SAEs had started to pick up.

More recently, SAE GDP growth has been strong at around 3% per annum from 2014-16. NI also experienced a pickup in growth in 2014 and matched the SAE average in 2015, but has since experienced a further slowdown in growth of just 1.1% in 2016. Figure 2 highlights that NI was the slowest growing small advanced economy in 2016, with Norway, Scotland and Switzerland also posting similarly disappointing growth figures.

Figure 2: GDP Growth in Small Advanced Economies, 2016



Source: World Bank, ONS & Central Statistics Office

Note: Ireland experienced GDP growth of 26% during 2015 due to the reclassification of multinational corporation activity (MNC). As this was a statistical rather than real increase in economic activity, the 2015 figure for Ireland have been updated using the CSO Modified Gross National Income (GNI), a supplementary indicator for GDP which strips out the effects of MNC activity.

Iceland, Ireland, Israel, Sweden and New Zealand topped the economic growth ranking for 2016 and, when we look back over the last five years, it is clear that this strong performance has been maintained in most of these countries. Some key factors underpinning their performance include:

- **Iceland** (7.2%) had export-driven growth with strong tourism performance even as the value of the currency has appreciated;[vi]
- **Ireland** (5.1%) was the fastest growing EU economy, with record levels of foreign investment projects and jobs[vii], strong services exports and buoyant ICT and construction sectors;[viii]
- **Israel** (4.1%) reported strong levels of capital investment by businesses alongside an increase in the exports of goods and services (particularly services);[ix]
- **Sweden** (3.2%) maintained loose monetary policy[x] which supported high levels of consumer spending, particularly on houses, although concerns are apparent in high levels of consumer debt.[xi] The need to support an influx of refugees and immigrants also provided a temporary economic boost;[xii] and

- **New Zealand** (3.1%) has benefitted from high net immigration and record tourism income.[xiii] There has been rapid growth in housing construction, with low interest rates encouraging borrowing which has also led to rising household debt.[xiv]

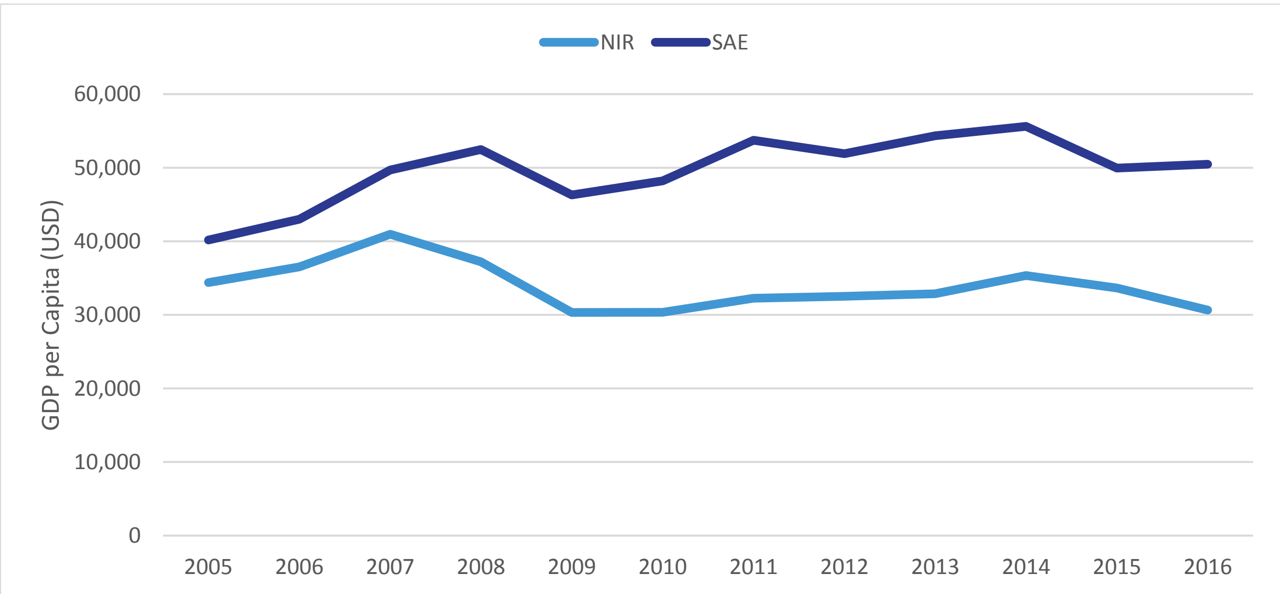
Growth forecasts from the International Monetary Fund (IMF) suggest that SAEs will continue to perform well over the coming years, at an average rate of 2.8% in 2017, 2.5% in 2018 and 2.3% in 2019. Iceland, Ireland and Estonia in particular are all expected to grow strongly.[xv] Scotland has the lowest forecasted economic growth of those SAEs analysed (less than 1% annually from 2017-2021), with the Scottish Fiscal Commission suggesting one of the key factors for this relates to low trend productivity.[xvi]

The outlook for NI is much more muted than for almost all other SAEs. The Ulster University Economic Policy Centre (UUEPC) forecasts growth of 1.4% in 2017, slowing down to 1.2% and 1.1% in 2018 and 2019 respectively, before increasing slightly to 1.5% by 2021.[xvii] Other forecasters such as Danske Bank[xviii] and PWC[xix] also report a similar outlook. UUEPC suggest that this lower outlook may be explained by the external uncertainty following the decision to leave the EU and the internal uncertainty around the Northern Ireland Executive. In addition, high inflation and weak productivity have impacted household spending.

Living Standards

GDP per capita – output per head – is a proxy for living standards in an economy. Since 2005, NI GDP per capita has been consistently below the SAE average and has weakened significantly (see Figure 3).

Figure 3: GDP per Capita, 2005-2016



Source: World Bank & ONS

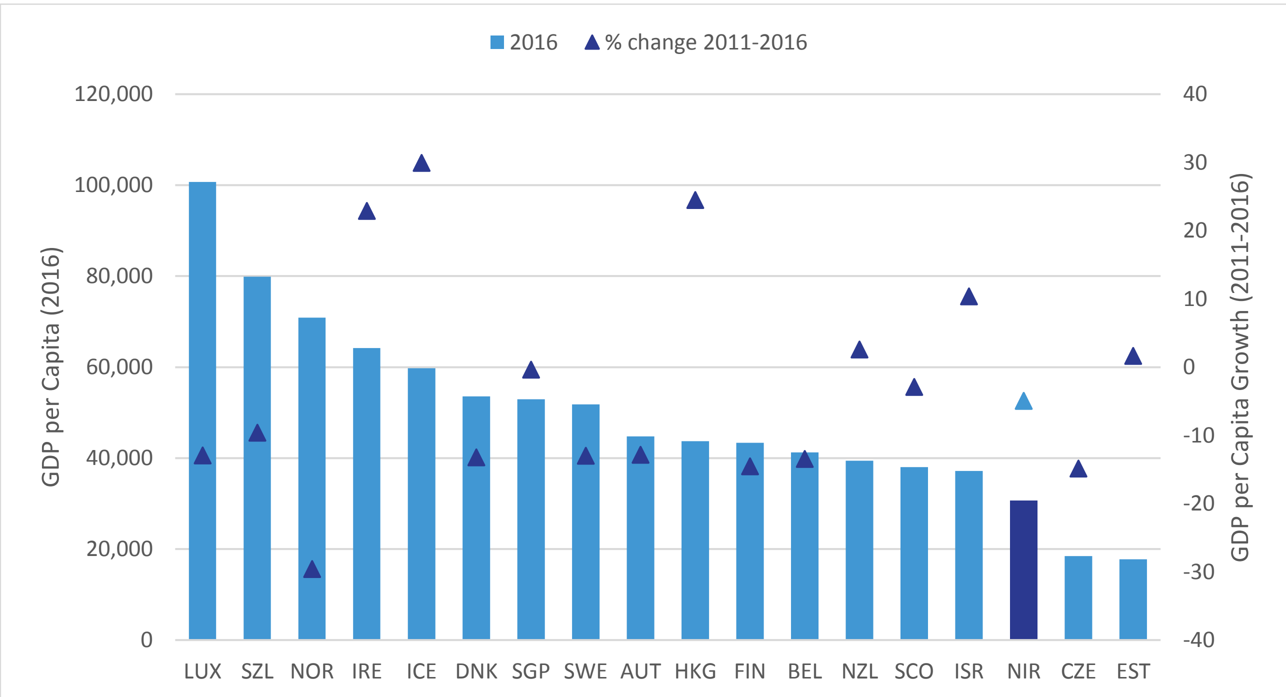
In 2005, NI living standards were 86% of the SAE average, with this gap broadly maintained up to 2007. Whilst SAEs experienced a sharp fall in GDP per capita during the global downturn, in NI this fall lasted for two years compared with one year elsewhere. As a result, GDP per capita in NI fell to just 66% of the SAE average in 2009.

Post-downturn, living standards in SAEs began to rise; this increase was caused by large jumps of almost 20% in GDP per capita in both Switzerland and Estonia. Explanation of these jumps may have been due to the Swiss National Bank introducing an exchange rate ceiling in 2011 ensuring the country's exports were not impacted by the Franc getting too strong.[xx] In addition, in January 2011, Estonia joined the euro. The resultant currency stability, along with low corporate taxes (zero on reinvested profits), increased investment. Exports also increased significantly reaching 1bn euro in the summer of 2011.[xxi]

More recently, living standards in the SAE group have not shown consistent growth, with a significant fall in 2015 and little growth in 2016. NI performance has also been poor during this period, and it still has not re-gained its pre-recession levels of living standards. Overall, NI living standards stood at 61% of the SAE average in 2016. In recent years, the NI economy has been challenged with rising inflation and slow wage growth,[xxii] alongside high inactivity and low productivity,[xxiii] which consequently has resulted in a decline in living standards.

Figure 4 highlights that Luxembourg, Switzerland and Norway had the highest GDP per capita of all SAEs in 2016. However, all three of these economies have seen their living standards drop over the past five years, by 13%, 10% and 30% respectively. NI ranked 16th in living standards in 2016, above only Czech Republic and Estonia. Of the 18 SAEs reviewed, only six had an increase in GDP per capita over the period 2011-16.

Figure 4: GDP per Capita in Small Advanced Economies, 2016



Source: World Bank & ONS

Ireland and Iceland have been leading performers, ranking within the top five highest living standards but also showing signs of continued growth; Iceland's GDP per capita in 2016 is almost 30% above 2011, whilst Ireland's is 23% higher. Hong Kong and Israel have been the only other SAEs to post strong growth. NI has experienced a decline in living standards of 5% over this period.

Productivity

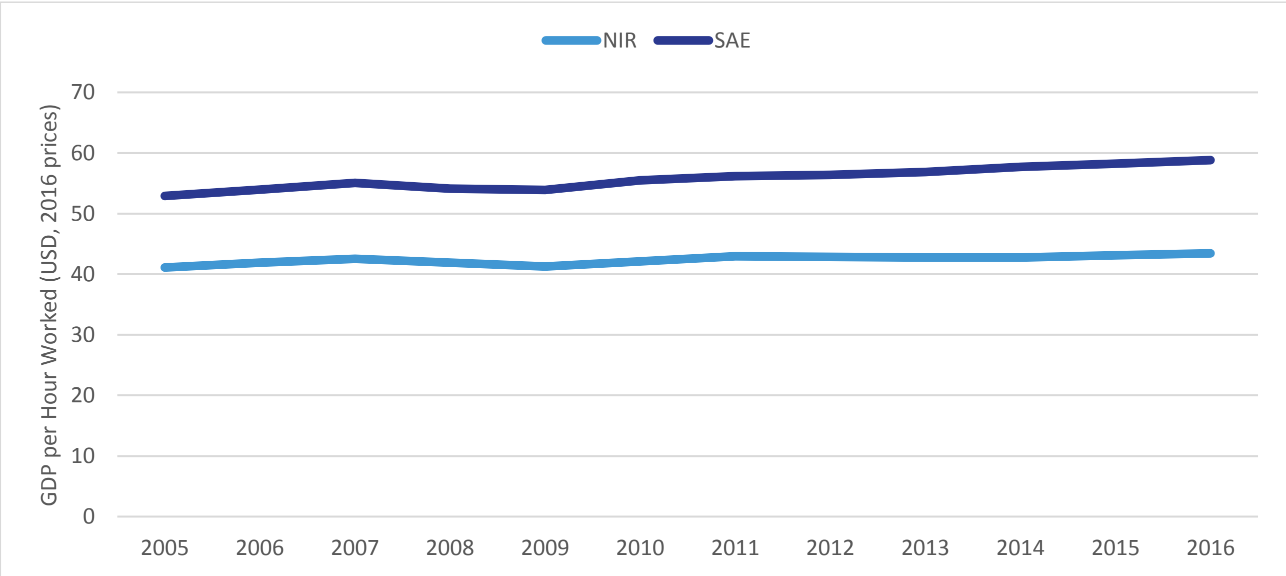
Productivity is vital for an economy's competitiveness. As Krugman (1994)[xxiv] stated:

> *"Productivity isn't everything, but, in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker."*

When looking at productivity there are two key measurements, productivity per hour worked (PHW) and productivity per person employed (PPE). The latter of these measurements does not take into account the time that workers put in to produce their output (e.g. will not consider weekly working hours, part time working, work patterns and overtime) and therefore PHW is a more realistic measurement of productivity. There is generally relatively little difference between these measures across SAEs, except for Singapore and Hong Kong where productivity PPE is much better than PHW; this is likely to reflect much longer working hours.

This article focuses on comparing PHW. Over the period 2005-2016, productivity PHW in NI has followed a consistent and steady trend below other SAEs (see Figure 5). The gap has, however, widened since 2005; NI productivity was 78% of the SAE average then but fell to 74% of the SAE average in 2016.

Figure 5: GDP per Hour Worked, 2005-2016

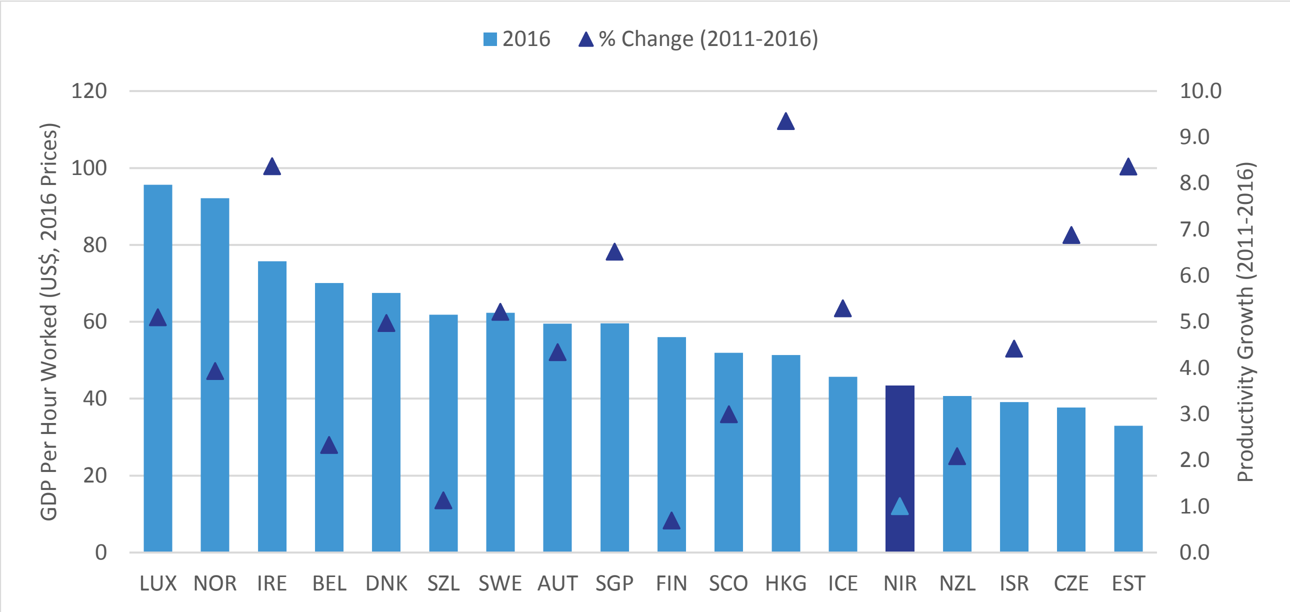


Source: The Conference Board, ONS

NI's low productivity performance may be explained by a number of structural weaknesses such as its employment structure, where a large volume of employment is concentrated in low value, low productivity sectors such as retail, finance and the service sectors, the skills gap and the dominance of the public sector. [xxv]

Internationally, NI's productivity lags behind most other small advanced economies. Comparing NI against the top performers, PHW productivity is some 120% higher in Luxembourg, 112% higher in Norway and 74% higher in Ireland. Figure 6 shows that NI ranks within the five least productive SAEs, above just Estonia, Israel, New Zealand and the Czech Republic. Of these four economies, three have had much faster productivity growth than NI, suggesting they may not remain behind for long.

Figure 6: GDP per Hour Worked in Small Advanced Economies, 2016



Source: The Conference Board & ONS

The top five most productive economies in 2016 were Luxembourg, Norway, Ireland, Belgium, and Denmark; of these. Slow productivity growth is clearly an issue in some highly developed economies such as Finland, Switzerland and Belgium, with many of those currently in the mid-to-low productivity group catching up in many cases. Hong Kong experienced the fastest productivity growth (at 9%) since 2011, despite having slowed somewhat since the global financial crisis.

Ireland has performed very well at both productivity levels and growth, with a large number of foreign owned multinational corporations active in Ireland and contributing to the high levels of productivity. Whilst this represents positive performance for the Irish economy, a key issue is the large gap in productivity performance between multinationals and indigenous firms.[xxvi] Recent research by Di Ubaldo et al (2018)[xxvii] has shown that there have been relatively limited productivity spillovers from foreign firms in Ireland to local firms, with the exception of some sectors (particularly services). Productivity spillovers are more evident where indigenous Irish firms have high levels of absorptive capacity (i.e. they are innovative and skilled) and are part of the supply chain of multi-nationals. This suggests that simply attracting FDI, without developing linkages with indigenous firms, does not boost their productivity. The OECD recommends rebalancing productivity growth in Ireland by unblocking the productivity potential of local Irish firms, which will require improving the business environment and encouraging the benefits of new ideas and technology in high performing foreign companies to spill over to local firms.[xxviii]

Conclusions

Northern Ireland lags behind most other SAEs on key measures of economic performance (see Table 1). In summary, the economy is growing slower than elsewhere with large gaps on both living standards and productivity with the top and (most) middle performers. Particular cause for concern is the fact that these gaps have been widening rather than improving. Economic growth is at the centre of all three of these measures; without higher levels of GDP/GVA, NI cannot improve its performance. Disappointingly, the latest growth outlook for NI is muted and will lead to further widening of living standards and productivity with elsewhere if these are accurate.

Table 1: Northern Ireland Economic Rankings against Small Advanced Economies

Measure	2016	Growth 2011-16
GDP Growth	18/18	14/18
GDP per Capita	16/18	9/18
GDP per Hour Worked	14/18	17/18

Source: The Conference Board, World Bank, ONS, DfE calculations

SAEs as a whole have been performing well in recent years, in particular Ireland which ranks amongst the top economies across all three measures. Many of the historically strong performers, such as Switzerland and Norway, have had muted growth and fast-movers, such as Ireland and Iceland, have been catching up. Considering Northern Ireland's trend against these high-performers, it is clear that Northern Ireland has a lot of work to do to meet the draft Industrial Strategy's ambitious target to be in the top three most competitive SAEs by 2030.

This article has focused exclusively on three relatively traditional metrics of economic performance. It is, however, important to note that GDP does not necessarily feed through into higher levels of wellbeing for citizens; measures such as income, equality and perhaps even happiness may better reflect how well the economy is working for everyone. DfE will therefore continue to take forward and expand this work programme of international competitiveness benchmarking to cover a wide range of economic variables that underpin competitiveness.

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