



Northern Ireland  
Centre for Economic Policy

# Outlook: Autumn 2014

## Contrasting fortunes in the public and private sectors

### Spectre of cuts looms large

The headline economic data for Northern Ireland remains positive. Employment is growing, unemployment is falling and business surveys all report high levels of confidence and growing order books. Unfortunately, this positive news story has taken a back seat to the very high profile “public sector cuts” debate and the associated political fallout. The latest NICEP forecasts remain positive for 2015, but thereafter a challenging economic environment awaits. Continued downward pressure on public spending and higher interest rates will effect growth in the medium to longer term.

The other big debate has been the Scottish independence referendum. Although the Scots voted to stay within the union, the result is not a status quo outcome. One impact is the increased likelihood of greater devolution of powers from Westminster. In Northern Ireland, the impending decision on Corporation Tax could usher in a new era for economic development, but it will also be a time for making tough choices. This is new territory for the Executive but it is important that all relevant stakeholders engage responsibly in this debate.

### Good news in the private sector

Encouragingly, the private sector has enjoyed a broad based economic recovery both sectorally and geographically. 14 of the 19 sub-sectors in the economy have seen employment stabilise or increase in the last 12 months (see the Sectoral Outlook section). In addition, growth in both the service and industrial sectors partly explains the reduction in unemployment across all 11 new Council areas.

Furthermore, whilst individual companies may face closure or redundancies, overall the level of inward investment promoted since the onset of the recession has been very encouraging.

## Key forecasts

	United Kingdom				
	2014	2015	2016	2017	2018
GVA <sup>(1)</sup> growth rate	3.1%	2.7%	2.2%	1.8%	1.8%
Employment growth	2.6%	1.5%	1.1%	0.4%	0.2%
Unemployment rate <sup>(2)</sup>	3.5%	3.0%	2.7%	2.7%	2.8%
House price growth	9.6%	8.2%	8.1%	8.1%	6.8%
Base rates	0.5%	1.0%	3.0%	3.5%	3.75%
Inflation (CPI %)	1.7%	1.6%	1.7%	2.3%	2.7%
World trade growth	5.2%	5.1%	5.5%	5.4%	5.0%

	Northern Ireland				
	2014	2015	2016	2017	2018
GVA <sup>(1)</sup> growth rate	2.2%	1.9%	1.3%	1.3%	1.3%
Employment growth	1.4%	1.3%	0.5%	0.4%	0.2%
Unemployment rate <sup>(2)</sup>	5.3%	5.1%	5.2%	5.3%	5.5%
House price growth	6.9%	6.1%	6.0%	5.9%	4.7%

Note 1: Gross Value Added (GVA) is the preferred method of measuring economic activity. It is similar to Gross Domestic Product (GDP) but excludes the impact of taxes and subsidies (most notably VAT).

Note 2: Claimant count rate as a % of 16 – 64 population

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Although the specific impact on Northern Ireland has yet to be determined (via the Barnett Formula), it will be significantly greater than the Executive has experienced to date. Northern Ireland Departmental expenditure is £9.7 billion this year (2014/15) and will remain unchanged in 2015/16. This represents a cut in real terms, but it does not take account of reductions for the non-implementation of welfare reforms or repayment of the £100 million facility recently agreed with HM Treasury.

## In this Edition

- **Scale of austerity is becoming clearer:** as the Executive is taken to the brink (again), this time on the issue of agreeing a budget, the wider general public are only beginning to understand the scale of austerity coming in the next few years.
- **Everything on the table:** living within our means will remain the key priority for the Executive for the foreseeable future. If quality of service provision is to be maintained then difficult choices will be required and everything must be on the table for discussion. Areas which may be outside the ideological comfort zone for some political parties and their electorate must be considered.
- **Skills Barometer 'Packaging the knowledge':** Many young people are leaving school and college unable to find employment and at the same time, many employers are unable to fill vacancies because of skills deficiencies. In order to help address this issue NICEP is working with DEL to develop a Skills Barometer to identify the specific skills required by the economy.

One impact of the imminent budget squeeze will be the need to prioritise expenditure, but making hard choices that limits damage to the economy will be very challenging. In this regard Northern Ireland Government Departments could seek insights from their counterparts in the Republic of Ireland who have almost completed their own austerity journey.

### New powers new responsibilities

The Scottish referendum has ushered in a new era for the devolved regions but new powers also bring new responsibilities. A final decision on the powers to be devolved has yet to be announced, but any reduction in taxes must be paid for locally through a reduction to the Block Grant. The focus to date has largely been on tax reductions, but similarly additional revenue raised from tax increases should also be retained locally.

This presents a range of new choices not previously available to the Assembly, but is Northern Ireland ready to exercise these choices effectively? Put simply, the current evidence is not overwhelmingly positive, but at least a draft budget has been agreed and a robust debate within Government on spending priorities is to be expected and encouraged.

## Scale of Austerity becoming clearer

The spending reductions incurred in the UK as a result of welfare reform is only the tip of the iceberg and the reality of the post-election spending plans proposed by the Coalition Government (and broadly supported by the Labour party) is beginning to set in. UK Central Government expenditure is forecast to fall by approximately £29 billion between 2014/15 and 2018/19 (down 9%). The capital spending budget is forecast to increase by 5% over the same period, but in absolute terms it is much lower.

This task is made more complex by the current political structures in Stormont. If the Executive is to retain a mandatory coalition with the existing power of veto, then all parties must be more willing to compromise. Unfortunately it seems that agreement is only reached when pressure is applied from London, Dublin and Washington. This approach is not sustainable in the long term and either compromise becomes a more regular feature of Assembly politics or the structures themselves must change.

Whilst frustration at the inability of the Executive to make the difficult and unpopular decisions is evident, critics on the side lines must also be willing to suggest their own policy solutions.

**Table 1: UK Government Spending Plans**

	2014/15 £'bn	2015/16 £'bn	2016/17 £'bn	2017/18 £'bn	2018/19 £'bn
Departmental Expenditure <sup>(1)</sup>	318	313	303	292	289
Capital Spending <sup>(2)</sup>	37	37	38	37	39

Source: Office of Budget Responsibility 2014

Note 1: Resource DEL

Note 2: Capital DEL

### Public engagement

The historic nature of voting patterns in Northern Ireland, makes it difficult to ascertain the views of the public on economic policy. Therefore, given the scale of the challenges Northern Ireland will face in the next few years, wider public engagement on key policy matters is justified. With a clearer picture on informed public opinion our politicians should be better placed to make the tough decisions.

## Everything on the table

Against this backdrop, overall public spending in Northern Ireland is still generous relative to other regions in the UK. Total expenditure was approximately £19.8 billion in 2012/13 and tax receipts were only £10.5 billion, therefore we remain very dependent on financial support from Westminster. One consequence of the Scottish referendum is the heightened awareness among English voters of the cost of supporting the devolved regions. Therefore, it is unlikely that Northern Ireland would be better off following any renegotiation on the current approach to allocating funding across the UK regions.

**Table 2: Government Spending per head (2012/13)**

	£
Northern Ireland	10,876
Scotland	10,152
Wales	9,709
England	8,529
North East of England	9,419
North West of England	9,252

Source: HM Treasury PESA, HMRC, ONS

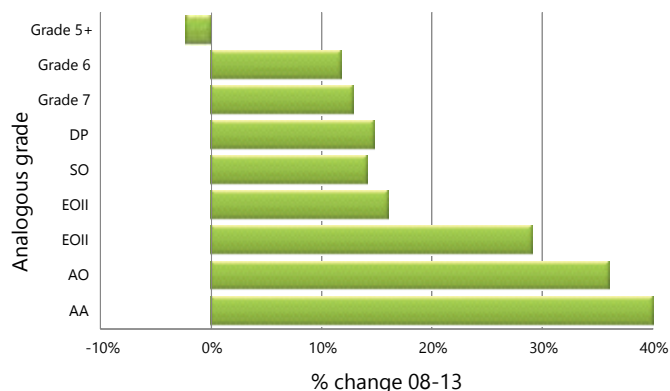
In this context, delivering 'more for less' will be essential to meet public expectations in terms of service delivery. Moving forward, the public policy debate must focus on the facts rather than ideology and therefore everything must be on the table in these conversations. For example, the issue of delivery structures in place to provide public services, whether those are in the public, private or voluntary and community sectors, should be secondary to the quality of service provided. It should be about how well a service is delivered not who delivers it.

The latest budget discussions have also raised the issue of public sector pay and voluntary redundancy (a difficult area for a University based research centre to discuss!). The general assumption to date has been that in order to live within a reduced budget, either services are cut or jobs lost, but another option would be to reduce pay.

This is clearly challenging but in spite of the general perception of pay restraint, data from the official statistics show public sector pay is still rising. Although 'cost of living' increases have been low over many years, automatic increments and the Pay and Grading Review in 2011/12 has ensured that many salaries have continued to rise.

It is interesting that the trend in the public sector is the reverse of that often reported in the private sector. Clerical grade staff in the public sector (AA and AO) have seen a substantial rise in their pay packets, well above inflation, whilst those at the top have seen very significant restraint.

## Change in NICS earnings by grade (2008-13)



Source: [www.nisra.gov.uk/publications/Pay\\_Statistics\\_NICS.html](http://www.nisra.gov.uk/publications/Pay_Statistics_NICS.html)

Note: % change in median earnings (£) of NICS non-industrial staff

### Cuts will hurt (at least in the short term)

Maintaining budgetary discipline is important but reductions in public sector spending will have a negative impact on the economy. Opponents to austerity are correct to highlight that during periods of low or negative growth, removing money from the economy will only depress demand further. Taking a longer term view, the argument is made that benefits may accrue if spending reductions act as a catalyst for change through reducing structural inefficiencies and redirecting resources towards higher productivity activities.

The evidence globally shows that austerity during this recession has negatively impacted growth. However, Northern Ireland is no longer in recession, therefore the rationale for further delaying spending cuts to balance the budget is not as strong as it was in 2008.

Given this context, it is of concern that there appears to be a very limited understanding that we have been largely spared from the scale of austerity implemented elsewhere.

The NICEP economic model suggests that the public sector spending reductions will not be fully off-set by an increase in private sector activity. Therefore, whilst a challenging time lies ahead it creates the 'burning platform' to rebalance the economy with a greater private sector focus. It may be difficult, but delaying root and branch reform now will only cause greater problems further down the line.

### Reform as a positive catalyst

Can the forthcoming spending squeeze be used as a catalyst for change? In short yes, but it will take courage from our political leaders and understanding from the electorate. Reform will require a detailed analysis of all expenditure areas and if the planned outcomes are not being delivered then funding should be questioned.

The decision to protect specific budgets from spending cuts may bring some relief to those areas but it has a number of negative consequences. Firstly, it places a significantly greater financial burden on other parts of Government and secondly reduces the catalyst for reform in the areas protected.

The public sector employs large numbers of talented and innovative staff who could thrive in an environment of lower bureaucracy and an outcome driven culture. Just as many private sector firms had to fundamentally review their activities and delivery structures following the start of the recession in 2008, the public sector is now heading into its own recession and will need to travel that same difficult journey.

**Tax rises – who and how much?**

Are we to follow the high tax, high public spending model of Scandinavia or a lower tax, lower public spending model of the USA? We cannot do both.

An increase in taxes seems inevitable, either to pay for services we wish to retain or for tax cuts elsewhere. There is currently a debate around a reduction in Corporation Tax, but who pays? Firms will receive a windfall in terms of retained profits, therefore should they fund a lower tax rate with a reduction in economic development grants or the removal of rate relief schemes? There are increasing calls for additional funding to be made available for health, but who pays? Prescription charging is in place in other parts of the UK. Water charges could fund a more generous welfare system but are the public prepared to pay for it?

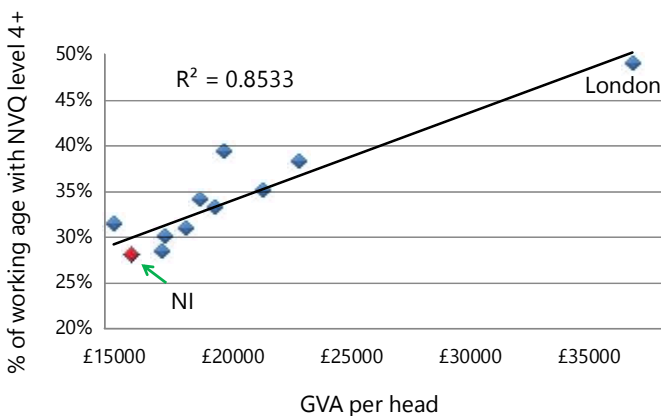
Every suggested tax rise will be unpopular somewhere, but the questions must be asked (and answered).

**Skills Barometer 'Packaging the knowledge'**

The need for investment in skills and the benefits derived from an educated workforce have been recognised for a long time. However, it is clear that the appropriate information is not available for young people to take well informed decisions about their future careers.

An analysis of economic activity per head in each of the 12 UK regions and the levels of qualifications in those regions shows a very clear correlation between these two factors. London is the clear 'winner' but unfortunately Northern Ireland is one of poorest performing regions. This makes a very strong case for further investment in skills development.

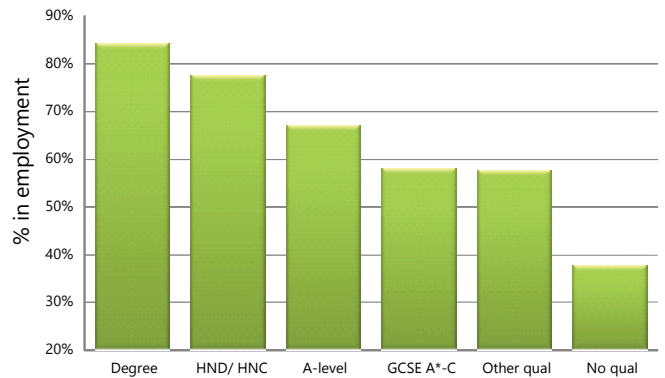
**Workforce qualifications & regional wealth 2012/13**



Source: Office of National Statistics

At the individual level too, the research shows that those with higher qualifications also enjoy higher employment prospects.

**Employment rate by skill level (NI)**

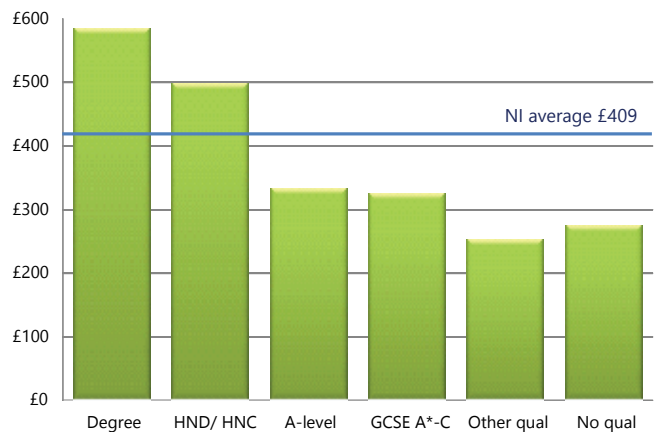


Source: Labour Force Survey

The results are unsurprising and provide the rationale for significant Government investment in reducing the number of people with no qualifications, where only 36% are in employment.

In addition, those with tertiary level qualifications are also better rewarded in the labour market.

**Gross weekly pay by skill level (NI)**



Source: Labour Force Survey

Interestingly, at the secondary education level, earnings are broadly similar across all qualifications including those with no qualifications. Therefore schools have a very important role in encouraging young people to continue their studies beyond secondary level whether that be academic and / or vocational.

**Providing a Skills Barometer**

NICEP and DEL have agreed to explore ways in which comprehensive labour market information can be collated and accessed by all relevant stakeholders. This will take the form of a Skills Barometer which will be designed to assist young people in making well informed career decisions, employers to raise awareness about their skills needs, Government to prioritise limited funding and education institutions to tailor their courses and curricula.

## Sectoral outlook

### Production and Manufacturing

The manufacturing sector continues to be one of the real positive stories of the recovery, job levels are 6,500 higher than at their low point of September 2012 and business intention surveys remain upbeat. The economic growth in the UK and the US will have been helpful, as will the return to growth of the Republic of Ireland. Modest demand from the Eurozone is still a negative feature of the outlook but the NICEP forecast for the sector remains relatively upbeat. Manufacturing also has the benefit of being only marginally exposed to public sector spending cuts.

### Construction

The construction sector has now returned to growth from its low point in late 2012 / early 2013. Though employment growth stalled in Q2 2014 the sector is finally looking at more favourable trading conditions. With house building levels starting to increase and house prices moving upwards (as NICEP forecast) the extent of pent up demand should ensure relatively good short term prospects for the sector. Anticipated interest rate rises should not significantly impact the sector. In terms of commercial property, the demand for new Grade A office accommodation from inward investors, which could increase further in a lower corporation tax environment, also provide positives for the sector.

### Private sector services

The performance of professional services remains surprisingly disappointing. In employment terms, the sector is equivalent in scale to its position in mid-2007. This is in stark contrast to the UK where the sector has grown by 26% over the same period. If Northern Ireland had seen an equivalent level of growth an additional 8,000 jobs would have been created. These figures are more surprising given the significant number of inward investment announcements made in the last few years. One potential explanation is linked to the downturn in construction which supports significant professional services activity (such as engineers, surveyors, architects etc.). Moving forward the outlook remains positive for private sector services as a whole, and the forecasts suggest that growth will be in line with wider economic growth.

### Public sector services

The outlook for public sector services is very challenging and this is reflected in the outlook. Total employment in the health sector is now 8,000 higher than it was in 2008,

and this was the single largest area of employment growth across the public sector. The forecasts suggest further falls in public administration and in education and only a modest rise in health employment. This is in stark contrast to the ten years from 1997 to 2007, which saw health and education sectors create 31,000 net additional jobs.

### Sectoral employment actual and forecast

Industry:	2008-12 (Recession)	2012-14 (Recovery)	2014-18 (Forecast)	2014-18 (% Growth)
Agriculture	750	4,250	2,500	6.4%
Mining and quarrying	-	(250)	100	4.1%
Manufacturing	(10,750)	6,500	3,500	4.1%
Utilities	(500)	1,000	0	0.1%
Water supply & waste	-	(250)	200	4.7%
Construction	(25,500)	5,000	3,300	5.8%
Retail	(12,250)	(2,000)	500	0.4%
Transportation	(500)	(750)	1,200	4.0%
Accommodation	(1,000)	-	2,600	5.7%
ICT	(750)	500	1,700	8.7%
Financial activities	(1,500)	(1,250)	800	4.1%
Real estate	500	200	300	3.8%
Professional & scientific	(500)	500	3,000	8.9%
Administration services	(4,000)	1,750	2,400	5.0%
Public Admin	(4,250)	500	(3,300)	-5.6%
Education	(1,750)	500	(1,200)	-1.7%
Health	1,500	6,500	1,440	1.1%
Arts and entertainment	750	1,500	500	2.7%
Other services	(250)	1,250	300	1.5%
<b>Total</b>	<b>(60,000)</b>	<b>25,550</b>	<b>19,840</b>	<b>2.4%</b>

### Headline sectoral GVA forecasts (% p.a.)

	2014	2015	2016	2017	2018
Production and Manufacturing	2.5%	2.2%	2.3%	1.8%	1.7%
Construction	7.8%	2.2%	1.9%	2.2%	2.2%
Private sector services	1.8%	2.0%	1.7%	1.8%	1.7%
Public sector services	0.9%	1.6%	-0.2%	0.1%	0.1%
<b>Total</b>	<b>2.0%</b>	<b>1.9%</b>	<b>1.3%</b>	<b>1.3%</b>	<b>1.3%</b>

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## Outlining the research agenda

The NICEP research agenda is focused on the strategic economic priorities of the Northern Ireland economy and in consultation with our sponsors, the Centre is taking forward the following projects:

**NICEP Macro-economic model** – this economic model is being developed to provide the framework and empirical test bed to measure the impact of a wide range of policy options as well as form the basis for the forecasts produced.

**Devolution of Corporation Tax** – NICEP has updated forecasts of the potential economic impact of a reduction in Corporation Tax in Northern Ireland. This is a priority project given the impending decision on the devolution of this power.

**Impact of Air Connectivity** – this review, also nearing completion, has been undertaken in partnership with York Aviation to explore the economic impact of changes to air fares.

**Evaluation of the Small Business Rate Relief scheme** – this evaluation assesses the level of value for money provided by the scheme and identifies recommendations for its future operation. This report will be completed shortly.

**Development of a Northern Ireland Skills Barometer** – the skills barometer will seek to identify the skills requirements across the NI economy.

**Knowledge Economy Index (KEI)** – NICEP, in partnership with the NI Science Park, has recently published the second Knowledge Economy Index report which confirms Northern Ireland as one of the fastest growing Knowledge Economy regions in the UK.

**Economic Advisory Group (EAG) Competitiveness Index** – NICEP will develop a tailored competitiveness index for Northern Ireland in order to inform Government policy on economic development matters.

## New sponsors

NICEP is pleased to have signed new sponsorship agreements with the Department of Employment and Learning (DEL) and the Department of Finance and Personnel (DFP). We look forward to having a mutually beneficial research relationship with both Departments throughout the sponsorship period.



## About NICEP

**NICEP is an independent economic research centre focused on producing evidence based research to inform policy development and implementation. It engages with all organisations that have an interest in enhancing the Northern Ireland economy. The Centre's work is relevant to Government, business and the wider public with the aim of engaging those who may previously have been disengaged from economic debate.**

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