

Quarterly Economic Observer

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About NERI and this publication

The Nevin Economic Research Institute (NERI) was established to provide information, analysis and economic policy alternatives. Named in honour of Dónal Nevin, scholar, trade unionist and socialist who gave a life of service to the common good, the Institute aims to undertake research that will be of relevance to the Trade Union movement and the general public across the island of Ireland.

This is the 24th *Quarterly Economic Observer* (QEO) of the Institute. The purpose of the QEO is to provide regular, accessible and timely commentary so as to equip trade unions and others in articulating and advancing a new economic paradigm where the old has failed. Unless otherwise stated, the data cited in this Observer are the latest available as of the 30th November 2017. The final draft of this document was completed on the 1st of December 2017.

This report has been prepared by staff of the Institute. The lead author of this QEO is Paul Mac Flynn with contributions from Dr Tom McDonnell and Dr Lisa Wilson. We are grateful to our external reviewers from the academic and research community who reviewed and commented on an earlier draft of this document. The analyses and views expressed in this publication are those of the NERI and do not necessarily reflect those of others including the Irish Congress of Trade Unions or the unions supporting the work of the Institute.

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The Nevin Economic Research Institute
Quarterly Economic Observer
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Executive Summary

This edition of the NERI's *Quarterly Economic Observer* (QEO) outlines our latest expectations for the economic outlook in Northern Ireland and the Republic of Ireland (Section 1) and examines public finances and the issue of Skills in Northern Ireland (Section 2).

Outlook for Northern Ireland

- Output in the Northern Ireland (NI) economy is still being impacted by significant losses in the manufacturing industry, particularly in *Food, Beverage and Tobacco*. Concerns surrounding the future of operations in Bombardier pose significant future challenges for the wider sector.
- Whilst unemployment in NI fell to an historic low of 4% in the third quarter of 2017, this is masking fundamental weaknesses in the labour market. Economic Inactivity is at its highest rate since 2010 (28.9%) and this fall in economic activity has been much more pronounced for females.
- Growth in wages for 2017 was outstripped by inflation resulting in a real terms decrease for most workers. Wages for part-time, male workers in the private sector saw an inflation adjusted decline of over 5% and this may explain some of the increase in male economic inactivity.
- The Budget for NI passed by parliament in Westminster last month saw an increase in core spending of just 2%. With inflation now running at 3%, this means most departments will see a real terms cut in spending. Excluding spending on redundancies, *Education* spending will fall by 1% even before inflation is taken into account.
- The issue of the border between NI and the Republic of Ireland (ROI) has taken centre stage in the current round of Brexit negotiations. Without a change in policy from the UK government regarding the Single Market and particularly the Customs Union, it would seem highly likely that there will be a 'hard' border of some kind on the Island of Ireland.

A Low Skills Equilibrium in Northern Ireland

- A lack of skilled workers has long been considered one of the central weaknesses of the NI economy. The proportion of people with no qualifications in NI is almost double that of Great Britain.
- However, much of the debate on skills focuses solely on a lack of supply. We propose here that a lack of demand for skills is of equal concern. Furthermore, it is argued that the underperformance in the supply of skills is likely driven by a lack of demand for skills and vice versa.
- A situation of mutual causality between the supply and demand for skills has been referred to in previous research as a Low Skills Equilibrium (LSE). It describes a situation where a country or region is trapped in a cycle of low skilled work leading to low value-added production and consequently low wages.
- Despite NI's comparatively low skills base, there appears to be no mismatch between the skills of the workforce and those required by employers. In fact, NI has the lowest rate of skills mismatch of any OECD economy.
- Workers in NI are also found to have less ambition toward greater skills acquisition and this is matched by the attitude of employers. Firms in NI are significantly less likely to suffer skills shortages and are more likely to have under-utilised staff due to a lack of opportunities for progression.
- The policy implications of a LSE are significant. Boosting the supply of skills in a LSE will be pointless if it is not matched by the level of action in terms of demand.
- Solving a LSE requires coordination within the economy to match the efforts of both firms and workers. The UK economy, including NI, lacks the institutional capability for this type of intervention at the macro level.
- Policy should aim to build on existing examples of coordination at the micro-level, such as collective agreements within firms where skills investment is planned by both the employer and employees. The success of such arrangements should be used as a framework to broaden upskilling to other sectors and industries in the economy.

Economic Outlook for the Republic of Ireland

- Headline output in the Republic of Ireland (ROI) continues to be distorted by tax planning and other activities in the large multinational sector, but broader indicators such as employment growth show that the economy is undergoing a cyclical upswing.
- Growth in personal consumption has been slower this year than in 2015 and 2016 and was up 1.7% on an annual basis in the first half of 2017.
- Average weekly earnings only increased by 1.7% on an annual basis in the third quarter. While CPI inflation in ROI has remained significantly lower than NI, averaging 0.3% over the past 12 months, the rate of inflation in rents nationally is currently running at 11.2%.
- We project that GDP in ROI will grow by 4.5% this year, falling to 3.4% next year and 3.1% by 2019. We also project that the rate of unemployment will continue to fall, albeit at a much slower pace, reaching 5.5% by 2019.

1 Economic Trends and Outlook

1.1 World

Northern Ireland and the Republic of Ireland have small trade-dependent economies. Their performance is sensitive to the health of the global economy and in particular to that of the euro area, the United States (US) and Great Britain. The mid-range of international forecasts is for the euro area and the US to grow by slightly over 2% in real GDP terms in 2018. The outlook for the UK is weaker with forecasts in the region of 1.5%. The OECD's [Composite Leading Indicators \(CLIs\)](#) which are designed to anticipate turning points in economic activity, point to growth gaining momentum in Italy and Germany, but slowing down in the UK over the next six to nine months.

Table 1.1 Dashboard of Macroeconomic Indicators, Selected Regions*

	2012	2013	2014	2015	2016	2017
Real GDP	<i>Percentage volume change over previous year</i>					
Euro area	-0.9	-0.3	1.2	2.0	1.7	2.2
United Kingdom	1.3	1.9	3.1	2.2	1.8	1.5
United States	2.2	1.7	2.4	2.6	1.6	2.2
Unemployment**	<i>Percentage of labour force</i>					
Euro area	11.3	12.0	11.6	10.9	10.0	9.1
United Kingdom	8.0	7.6	6.2	5.4	4.9	4.5
United States	8.1	7.4	6.2	5.3	4.9	4.5
Inflation***	<i>Percentage annual average rate of change</i>					
Euro area	2.5	1.3	0.4	0.0	0.2	1.5
United Kingdom	2.8	2.6	1.5	0.0	0.7	2.6
United States	2.1	1.5	1.6	0.1	1.3	2.1
Compensation per Employee	<i>Percentage change from previous period</i>					
Euro area	1.1	1.4	1.4	1.4	1.4	1.8
United Kingdom	1.7	2.1	0.7	1.2	2.8	2.5
United States	2.4	1.1	2.6	2.6	2.1	2.5
Current Account Balance	<i>Percentage of Gross Domestic Product</i>					
Euro area	1.4	2.2	2.5	3.2	3.5	3.1
United Kingdom	-3.7	-4.4	-4.7	-4.3	-4.4	-3.6
United States	-2.6	-2.1	-2.1	-2.4	-2.4	-2.4
Fiscal Balance	<i>Percentage of Gross Domestic Product</i>					
Euro area	-3.6	-3.0	-2.6	-2.1	-1.5	-1.3
United Kingdom	-7.7	-5.5	-5.6	-4.3	-2.9	-2.9
United States	-7.9	-4.4	-4.0	-3.5	-4.4	-4.3

Notes: *2017 figures for *Inflation*, *Current Account* and *Fiscal Balance* are IMF projections. 2017 figure for *Compensation per Employee* is an OECD projection and 2017 figures for *Real GDP* and *Unemployment Rate* are European Commission projections. **National definitions. ***Average consumer prices.

Sources: IMF [World Economic Outlook](#) and [Fiscal Monitor](#), OECD [Economic Outlook: Annex Tables](#), EU Commission [Autumn Forecasts](#).

The CLIs indicate stable growth momentum for most other major economies with signs of growth gaining momentum in Brazil and in the industrial sector in China. The [ifo Economic Climate indicator](#) for the euro area (fourth quarter 2017) has reached its most positive level since Autumn 2000. The survey of economic experts suggests that the upturn in the euro area will continue in the months ahead, albeit losing impetus somewhat. The expectation for the world economic climate is also generally good with the exception of the Middle East and Northern Africa for geopolitical reasons, and the UK for Brexit related reasons – notably the investment climate uncertainty and the potential for negative trade impacts.

The [IMF's most recent forecast](#) is for **global** growth to rise to 3.6% in 2017 and 3.7% in 2018 as the global economy enters a cyclical upswing. However, growth is expected to be uneven with downward revisions for India, the US and the UK as well as continuing difficulties for some energy exporters on account of low fuel prices and the impact of monetary policy normalisation in the US. There are also concerns about the pace of credit growth in China. Inflation is expected to remain below target in the short-term in most advanced economies. The IMF also point out that the global recovery is incomplete with nominal and real wage growth sluggish in most countries and they highlight the international problems of worsening inequality and slowing productivity. They call for higher levels of education and infrastructure spending in those countries where fiscal space exists noting that this would boost demand in the short-term and productivity in the long-term.

The **UK** economy grew by 0.4% in the third quarter of 2017 and [now-casting](#) suggests real growth of around 0.5% in the fourth quarter. The [Bank of England's](#) latest inflation report projects real GDP growth of 1.6% in 2017 and 2018 while the European Commission is somewhat more pessimistic with growth projected at 1.5% and 1.3% respectively. The Commission expect the unemployment rate to gradually increase between now and 2019, albeit remaining very low by historical standards (it was 4.3% in the three months to September), and for inflation to average 2.6% over the next 18 months causing a decline in real wages over the period. Nominal wages have been lagging behind inflation since March of this year. Investment is likely to remain subdued given the Brexit related uncertainty hanging over the economy.

After a decade of under-performance the **euro area** economy grew 0.7% in the second quarter and 0.6% in the third quarter (2.5% on an annual basis). The Commission now

expects real growth of 2.2% in 2017 and 2.1% in 2018. The volume of retail trade was up 3.7% annually in September. Even so, the euro area unemployment rate is set to average 9.1% in 2017 and to remain in excess of 8% until well into 2019. Euro area inflation was 1.4% over the previous year in October and was up just 1.2% if we exclude energy. Wages and salaries per hour worked were up 2% in the second quarter meaning there is now positive real wage growth in the Euro area. With significant remaining labour market slack and relatively modest wage and other price pressures we can expect monetary policy to remain loose until at least 2019.

Finally, the **US** economy grew by 0.8% in real terms in the third quarter and was up 2.3% on an annual basis. The labour market is tightening with the unemployment rate down to 4.1% in October marking the lowest rate recorded since December 2000. However, the employment rate at 60.2% remains well below the pre-crisis level suggesting a significant scarring effect from the great recession. Annual inflation was 2% in October while average hourly earnings were up 2.5% year-on-year in September and wages were up 3.2%. Given this context we can expect monetary policy to tighten gradually over the next 18 months. Tightening monetary policy will impact on borrowers domestically and will increase economic instability in emerging economies with dollar liabilities.

1.2 Republic of Ireland

Trends and analysis

On an annual basis real GDP grew by 5.2% in the first quarter of 2017 and 5.8% in the second quarter. Headline output is being distorted by the tax planning and other activities of the large multinational sector thereby limiting the usefulness of GNP and GDP as barometers of economic performance and cyclical position. Even so, it is clear from other data (Table 1.2) such as the scale of employment growth that the economy is undergoing a cyclical upswing. However, as argued in previous editions of the [NERI's Quarterly Observer](#), there is very little evidence of overheating in the economy.

Certain areas of the economy are growing very quickly in real terms most notably *information & communication* (up 27.9% and 21% respectively in the first two quarters of 2017) and investment in *building & construction* (up 20.1% in the first half of the year). While the gains in the ICT sector may partially be accounted for by

multinational tax planning, the increase in investment in building & construction reflects a genuine increase in economic activity occurring within the Republic of Ireland. Growth in personal consumption has been slower this year than in 2015 and 2016 and was up 1.7% on an annual basis in the first half of 2017. Overall, the CSO's new modified domestic demand indicator which strips out intellectual property investment and purchases of aircraft by leasing companies grew by 4.8% in real terms in 2016 and by 2.4% on an annual basis in the first half of 2017. Finally, activity indicators such as volume retail sales have been reasonably strong with annual growth averaging 3% over the first three quarters of 2017.

Table 1.2 Dashboard of Macroeconomic Indicators, Republic of Ireland

	2012	2013	2014	2015	2016	Latest
<i>Percentage volume change over previous year</i>						
Gross Domestic Product	0.0	1.6	8.3	25.6	5.1	5.8 (Q2'17)
Domestic Demand	2.3	-1.7	8.3	9.2	21.3	-2.5 (Q2'17)
Personal Consumption	-0.9	-0.7	2.0	4.2	3.3	1.7 (Q2'17)
Retail Sales (SA)	-0.9	1.3	8.2	9.5	6.7	2.7 (Q3'17)
Industrial Production	-1.5	-2.2	22.9	34.8	0.7	-4.0 (Q3'17)
<i>Percentage annual average rate of change</i>						
Employment	-0.6	2.4	1.7	2.6	2.9	2.4 (Q2'17)
Average Hourly Earnings	0.2	-0.3	-0.1	0.2	0.6	2.3 (Q3'17)
Average Weekly Earnings	0.6	-0.5	0.3	1.2	1.1	1.7 (Q3'17)
Inflation (HICP)	1.9	0.5	0.3	0.0	-0.2	0.5 (M10'17)
<i>Percentage of annual GDP or quarterly GDP</i>						
Investment	19.6	18.7	20.8	20.3	31.8	32.6 (Q2'17)
Current Account Balance	-2.6	2.1	1.6	10.9	3.3	-1.2 (Q2'17)
Government Balance	-8.0	-6.1	-3.6	-1.9	-0.7	-0.3 (Q2'17)
Government Gross Debt	119.5	119.4	104.5	76.9	72.8	74.3 (Q2'17)
<i>Percentage of labour force</i>						
Unemployment	14.7	13.0	11.3	9.4	7.9	6.0 (M10'17)
Long-term Unemployment	9.0	7.8	6.6	5.3	4.2	3.1 (Q2'17)
<i>Percentage of households</i>						
Deprivation	26.9	30.5	29.0	25.5	-	25.5 (2015)
At Risk of Poverty	17.3	16.5	17.2	16.9	-	16.9 (2015)
<i>Percentage</i>						
Gini Coefficient	31.8	32.0	32.0	30.8	-	30.8 (2015)

Notes: Quarterly ('Q') and monthly ('M') data is compared to same period of the previous year. Rates of change represent the average value over the four quarters, or twelve months. *Gross Debt* is end-year figure as a % of annualised GDP or latest quarterly figure as % of annualised GDP. *Unemployment* is average for four quarters or latest quarter seasonally adjusted. All data is CSO.

Sources: CSO: [Quarterly National Accounts](#), [Retail Sales Index](#), [Industrial Production](#), [Quarterly National Household Survey](#), [Earnings and Labour Costs](#), [Balance of International Payments](#), [Consumer Price Index](#), [Government Finance Statistics](#), [Survey on Income and Living Conditions](#).

Labour market conditions continue to improve. There was an annual increase in employment of 2.4% or 48,100 in the year to the second quarter of 2017. The seasonally adjusted unemployment rate was 6% in October compared to 7.2% in 2016. The tightening labour market has yet to translate into fast wage growth although average hourly earnings were up 2.3% on an annual basis in the third quarter. Real wages are increasing with limited price inflation in the economy (the CPI has averaged 0.3% over the last 12 months). Average weekly earnings up by 1.7% on an annual basis in the third quarter. While inflation is low there are price pressures in the housing market reflecting the mismatch of supply and demand in that market. The [rate of inflation in rents](#) nationally is currently running at 11.2% meaning that the real value of wages are likely to be in decline for many renters.

Outlook

In the Autumn edition of the QEO we projected the economy's cyclical upswing would continue in the short-term with real GDP growing by 4.5% in 2017 and 3.4% in 2018 (see Table 1.3 which is reproduced from the Autumn QEO). The [Department of Finance's](#) forecasts from budget day were broadly in line with our projection (4.3% and 3.5%) although other forecasters are somewhat more optimistic. For example the [Central Bank](#) is forecasting growth of 4.9% this year and 3.9% in 2018, the [ESRI](#) is forecasting growth of 5% and 4% respectively while the EU [Commission](#) is forecasting growth of 4.8% and 3.9%. The general consensus is therefore that the cyclical upswing will continue for at least the next 18 months or so. We expect that underlying domestic demand will be the main driver of growth in 2018 driven by an increase in housing output as supply responds to demand. Strong job growth and a tightening labour market (falling unemployment rates and increasing job vacancy rates) should increasingly feed through into faster wage growth.

There is a high degree of uncertainty around 2019 projections given the lack of precedent for an event like Brexit and the uncertainty surrounding the outcome of negotiations. In addition the economy should be close to potential output by 2019 which implies slower rates of baseline GDP and employment growth post-2018. Monetary policy should remain supportive in the short-term although the ECB will start to tighten policy eventually and this process could be accelerated if the economic recovery in the euro area becomes more established.

There are a number of downside risks to the forecast. These include rising interest rates and geopolitical shocks leading to higher energy prices. Most significantly the outcome of Brexit negotiations will have a major impact on the Republic's economic performance. At this stage it is impossible to quantify the scale of the impact but a hard Brexit scenario in which the UK exits from the single market and customs union along with the imposition of tariffs would be particularly damaging. A hard Brexit outcome would also weaken Sterling thereby damaging Irish exports. The agri-sector is particularly vulnerable to a hard Brexit outcome and the tourism sector is also likely to be badly affected. In the longer-term the UK's weaker growth potential will mean structurally lower demand for exports from the Republic. However, the period leading up to the exit could actually be characterised by temporarily higher growth as companies attempt to boost their inventories in advance of trade barriers going up.

There are a number of other downside risks to the Irish economy including the potential for changes to corporation tax policy in the US and the EU. The Republic's apparent facilitation of aggressive multinational tax avoidance is likely to come under increasing pressure from momentum towards a *Common Consolidated Corporate Tax Base* at EU level. The unsustainability of the current model suggests the need to develop a more balanced industrial strategy focused on a policy of developing indigenous companies.

Table 1.3 Macroeconomic performance & projection, Republic of Ireland

	2016	2016	2017	2018	2019
Real Output		<i>Percentage real change over previous year</i>			
Gross Domestic Product	€275.6bn	5.1	4.5	3.4	3.1
Personal Consumption	€96.6bn	3.3	3.3	2.8	2.6
Government Consumption	€28.4bn	5.3	2.6	2.1	2.0
Investment	€87.7bn	61.2	0.9	5.8	3.7
Exports	€335.0bn	4.6	5.1	4.4	3.7
Imports	€274.4bn	16.4	3.5	5.0	3.7
Earnings		<i>Percentage nominal change over previous year</i>			
Average Hourly Earnings	€22.04	0.6	2.1	2.6	2.7
Government Finances		<i>Percentage of GDP</i>			
General Government Balance	-€1.9bn	-0.7	-0.4	-0.1	0.1
Gross Debt	€200.6bn	72.8	70.0	68.6	66.8
Labour Force		<i>Percentage change over previous year</i>			
Employment	2,020,000	2.9	3.4	1.7	1.6
		<i>Percentage of labour force</i>			
Unemployment	173,100	7.9	6.3	5.8	5.5

1.3 Northern Ireland

Northern Ireland's (NI's) economy has faced significant challenges over the last number of months including the continuing political uncertainty at Stormont, systemic threats to the manufacturing industry and the on-going Brexit negotiations. Brexit, and the issues most related to NI, are discussed in more detail in Box 1.1. Statistics show that employment and output levels in NI's manufacturing sector are still processing losses from the closure of significant plants that began in 2016. The on-going threat to Bombardier, NI's largest manufacturing employer remains a significant risk for the whole economy. The latest round of NI's political crisis culminated in a Budget Bill being brought before Parliament in Westminster, in the absence of a devolved NI Executive. The budgetary situation in NI, like that in the rest of the UK, remains tight and with inflation now running at 3%, most departments will experience a real term cut in public spending this year. The Northern Ireland economy shrank by 1% in the second quarter of 2017 according to the Northern Ireland Composite Economic Index (NICEI). This is the first contraction since the dip in growth in the third quarter of 2016 in the wake of the vote to leave the European Union.

Table 1.4 Dashboard of Macroeconomic Indicators (Northern Ireland)

	2012	2013	2014	2015	2016	Latest
<i>Percentage volume change over previous year</i>						
Gross Value Added	1.1	1.1	0.2	1.6	-	1.6 (2015)
NICEI	-1.4	0.0	0.7	1.5	1.6	-1.0 (Q2 2017)
Index of Services	-1.4	0.5	1.2	1.3	3.2	-1.0 (Q2 2017)
Index of Production	-1.4	1	2.3	2.0	0	-3.6 (Q2 2017)
<i>Percentage annual average rate of change</i>						
Employment Rate	-0.3	-0.6	1.8	0.3	1.5	-1.0 (M6-M9 '17)
Average Hourly Earnings	1.5	2.5	-1.3	4.2	1.5	2.8 (2017)
Price Inflation (UK)	2.8	2.6	1.5	0	1	3.0 (M10 '17)
<i>Percentage of GVA</i>						
Exports	28.9	30.0	28.4	26.5	-	26.5 (2015)
Government Spending	61.6	60.2	60.6	-	-	60.6 (2014)
<i>Percentage of labour force</i>						
Unemployment	7.5	7.5	6.4	6.1	5.8	4.0 (M6-M9 '17)
Youth Unemployment	20.1	22.5	19	19.3	14.9	11.6 (M5-M7 '17)
Long-term Unemployment	3.8	4	3.4	3.6	2.6	2.3 (M6-M9 '17)
<i>Percentage of population</i>						
Relative Poverty	19	21	22	18	-	18 (2015)

Notes: Employment Rate refers to all persons in employment (ILO definition) aged 16-64 as proportion of all persons 16-64. GVA is deflated using UK GDP deflator. NI Exports refer to sales outside the UK. Exports refers to both goods and services sold from NI beyond the UK. Government Spending refers to Total identifiable expenditure on services apportioned to NI.

Source: [ONS Regional Gross Value Added](#) (Income Approach); [HMT GDP Deflators](#); NISRA [Northern Ireland Composite Economic Index](#); NISRA [Index of Production](#); NISRA [Index of Services](#); NISRA [Labour Force Survey](#); NISRA [Annual Survey of Hours and Earning](#); ONS [Consumer Price Inflation](#); HMT [Public Expenditure Statistical Analyses](#); NISRA [Households Below Average Income](#)

The *Production* sector was responsible for the largest decline in overall output in the economy. The 20% fall in Food, Beverage and Tobacco manufacturing, which accounts for more than a quarter of total manufacturing output, explains much of the decline. As noted in the Autumn Quarterly Economic Observer, much of this is due to the cessation of production at the Japan Tobacco plant in Ballymena. The fact one factory closure could have such a dramatic effect on overall output puts the concern surrounding the future of Bombardier's Belfast operation in context. The decline in the *Services* sector (-0.5%) contributed almost as much to the quarterly decline in the NICEI as that of the *Production* sector (-0.6%) due to a continuing slump in Retail and Hospitality. The Public Sector index also decreased slightly by 0.3% leaving the Construction sector as the only sector in the economy to record growth.

Figures from [Her Majesty's Revenue and Customs](#) showed that the volume of goods exported from NI, beyond Great Britain, increased by 4.3% over the quarter and by 18% on the same quarter in 2016. Figures from the [Central Statistics Office](#) also showed that, in September this year, goods imported into the Republic of Ireland from NI (or NI exports to the Republic of Ireland) increased by 20% from September 2016. So far, this year, NI export levels to the Republic of Ireland (ROI) are up by 19.5%. Much of this increase would be attributed to the depreciation in the value of Sterling, which fell in value by just under 6% between September 2016 and 2017. However, the CSO figures show that imports from the ROI into Northern Ireland also increased by 20%. Overall, imports into Northern Ireland increased by 10% in the year between Q2 2016 and Q2 2017. So, while a weaker Sterling is most likely favouring NI's external trade balance, not all trends are conforming to the expected pattern. Furthermore, while the data show that trade between NI and the ROI has survived the impact of the Brexit vote, the prospects for trade post-Brexit are still very uncertain.

House prices in Northern Ireland increased by 3% in the third quarter of 2017 compared with previous quarter and increased by 6% over the year. Annual house price growth had been averaging 7.5% in the year prior to the Brexit vote but it had fallen to just 4.1% in Q2 of this year. Some of the largest increases in house prices were in the North and West of Northern Ireland with Belfast seeing the second lowest rate of growth of any council area. This pattern reflects the current experience in the Republic of Ireland where the largest house price increases of late have been concentrated in the West of Ireland. Many of the more economically peripheral regions in ROI are

simply catching up with growth rates in urban areas which recovered earlier from the property crash.

The failure to restore the Northern Ireland Executive resulted in the Secretary of State bringing a budget for Northern Ireland through parliament in Westminster. Core public spending on public services (excluding the Voluntary Exit Scheme) is now set to increase by just over 2% in 2017/18. Adjusted for inflation, this means that most departments will see real terms cuts, with some such as *Education* seeing a nominal cut in spending. While an additional £50m was made available under the terms of the political deal between the DUP and Conservatives at Westminster, there is no indication when or if the remainder of the agreed £1bn package will be disbursed in NI.

The UK budget delivered by the Chancellor of the Exchequer on the 22nd of November outlined a series of growth downgrades for the UK economy owing to a significant re-evaluation of productivity growth. There was a modest increase in capital spending along with policies aimed at stimulating the housing market including an increased threshold for stamp duty. However, the housing initiatives are unlikely to have much of an impact in NI as a large proportion of properties here already fall under the current threshold (£125k). There was an increase in current spending for NI of £120 up to 2021, but this will not be sufficient to avoid real terms cuts in spending over these years. There was an additional £540m in capital spending over the same period, but 70% of this amount is Financial Transactions Capital which is funding in the form of loan facilities to the private sector. Overall NI's fiscal position over the next number of years remains challenging.

Much attention has been given to the resilience of the Northern Ireland labour market by way of the historically low unemployment rate of 4%. It is at its lowest level in almost 10 years and below the UK average for the first time since 2013. However, whilst these figures continue a positive trend in terms of a long-term fall in unemployment it is worth noting that the proportion of the unemployed who are long-term unemployed continues to rise. The proportion of long-term unemployed increased by 1.9% over the quarter, and by 14% over the year, indicating that some workers are facing an increasing gradual detachment from the labour market.

This detachment is further borne out if we look at what is happening in terms of employment and economic inactivity. The latest figures show that net employment is down in Q3 2017 by 1.7% year-on-year, whilst the economic inactivity rate for the population aged 16 to 64 years is up by 3% over the year in Q3 2017. At 28.9% of the population aged 16 to 64 years, the economic inactivity rate is the highest since 2010.

Labour market trends also show a significant gender dimension. Whilst the unemployment rate is much lower for females (Q3 2017 2.9%) than that of males (Q3 2017, 5%), if we look at trends over the year we see that the employment and economic activity rate has fallen much more steeply for females. In Q3 2017 the female employment rate was down by 3.4%, while the female economic activity was down by 2.8% year on year. The comparative figures for male employment and economic activity rate were 0.5% and 2.6% respectively. Over the longer term however it is worth noting that we are seeing increasing proportions of men exiting the labour market who do not want a job. At 23.6%, male economic inactivity amongst those aged 16 to 64 years is at its highest in the quarterly series since November-January 2010. A gendered analysis of [recently published wage data](#) might help explain why men are increasingly opting to exit the labour market.

Whilst median gross weekly wages for all employees increased by 5% in the private sector over the year, figures on how this is broken down by full-time and part-time and by male and female workers reveal some noteworthy results. In the private sector, male full-time workers were the only group to obtain a real increase in gross weekly wages. There was a 2.6% fall in wages for male part-time workers in the private sector, which amounts to a 5.1% decline when adjusted for inflation. In light of changes in the structure of the labour market, and in particular the increase in part-time employment as a share of total male employment, the decline in wages for this group affects an increasingly larger share of workers. This simultaneous decline in the nature of male employment (part-time and full-time), and the declining earning power of male employment in these forms of employment, might help explain why men are exiting the labour market.

Box 1.1 Brexit: A Hard border on the Island of Ireland

As the Brexit negotiations continue, several issues remain to be resolved regarding the Island of Ireland. It is currently the stated objective of both the UK and EU negotiators that the final agreement on Brexit should maintain a 'frictionless border' on the Island of Ireland. The issue of the border is one of the three key items for agreement in the first phase of the Brexit negotiation process. Issues surrounding the free movement of people and maintaining the Common Travel Area are central to any such discussion, but trade has been the issue which has held up agreement in this area. The future trading relationship between the UK and the EU is intended to be the subject of the second part of the Brexit negotiations. However, the assertion by the UK that it does not intend to re-join either the Single market or the Customs Union post-Brexit has significant implications for the border between the ROI and NI.

A [NERI paper](#) published in August of this year examined the options open to the UK government regarding the EU Customs Union when it leaves the EU. The main conclusion of the paper was that in order to avoid a 'hard border' on the island of Ireland, the UK would need to either re-join the EU Customs Union or adopt the structures of membership of the EU Customs Union and remain only nominally outside it. Short of these options either the Republic of Ireland would have to leave the EU Customs Union or Northern Ireland would have to re-join the EU Customs Union whilst the rest of the UK remained outside it. The latter two options have been effectively ruled out by both sides. Membership of the EU Customs Union is mandatory for the Republic of Ireland's continued membership of the EU. The UK government has rejected any suggestion that Northern Ireland could be treated any differently to the rest of the UK with regard to trade.

In a position paper which outlined the thinking of the UK government with regard to the EU Customs Union, the [Department for Exiting the EU](#), conceded that it could form a new customs union with the EU that maintained current internal and external tariff rates and regulations. However, such a structure would only be acceptable to the UK government on an interim basis during a proposed 'transition period' or 'implementation phase'. This would leave only one option to avoid a hard border and that is for the UK to apply the EU Common External Tariff and Union Customs Code, but remain outside the EU Common Commercial Policy. This proposal would see the UK leave the EU Customs Union in name only. The UK would technically have an independent trade policy, but it would have to mimic the trade policy of the EU in order to maintain a relatively open trade border with the EU. However, the UK government position paper effectively rules out applying the EU Common External Tariff beyond the transition period. The UK government believes that it can achieve a frictionless border without either membership or alignment with the EU Customs Union. They have so far outlined two alternative proposals.

The first proposal envisages a suite of technological innovations which will streamline customs declarations and procedures to the extent that they negate the need for any border controls. The second proposal outlines a dual tariff system where companies may pay a higher EU tariff rate when importing into the UK, but this could be recouped following final sale within the UK. Neither of these solutions represents a plausible or permanent method of avoiding a trade border on the island of Ireland. Without a change in UK government policy, there will be a trade border between NI and the ROI and it will require border controls.

2 A Low Skills Equilibrium in Northern Ireland?

2.1 Introduction

One of the most commonly cited problems for the NI economy is that the workforce is relatively low-skilled. A cursory glance at the main statistics shows where this concern emanates from. In 2016, 16% of 16 to 64 year olds did not have a level 1 National Vocational Qualification (NVQ) (ONS, 2017). To have less than a level 1 NVQ means less than 5 GCSEs at A-C grade. The equivalent for the UK as a whole was half that at just 8%. NI's skills problem is quite well-known and has been the focus of attention of policymakers for some time. There have been schemes designed to boost skills attainment for those at the beginning of their working life and those already in employment, unemployment or economically inactive. *Skills to Succeed* is the overarching NI Executive programme to deliver Essential Skills, Apprenticeships and Work-based Learning. It is aimed at both employees and employers, but the majority of individual programmes are skewed toward the former (Department for the Economy, 2016).

NI's skills problem has been linked to many other weaknesses in the economy, and in particular the performance of wages and the value of output. The average wage in NI has performed below the UK average every year since 2002 and NI is consistently ranked amongst the three lowest paid regions of the UK. The median weekly wage in NI was 92% of the UK average in 2016 up from 91% in 2006 (NISRA, 2016). NI also comes at the bottom of the league table when it comes to the value of output in the economy. Gross Value Added per head in NI has never reached the UK average and has recently been falling increasingly further behind. In 2005 GVA per head was 80.6% of the UK average, by 2015 that had fallen to 73.8%. Other measures of output show a gap of 20% to 25% between NI and the UK average and a persistent gap between NI and its regional comparators (ONS, 2016).

In the late 1980s researchers began to explore the connection between persistently low wages, low skills and low value-added output ultimately leading to the idea of a Low Skills Equilibrium (LSE).

2.2 What is a Low Skills Equilibrium?

The term LSE was first coined by Finegold and Soskice (1988) when examining the system of education and training in the United Kingdom. They defined it as a situation in which:

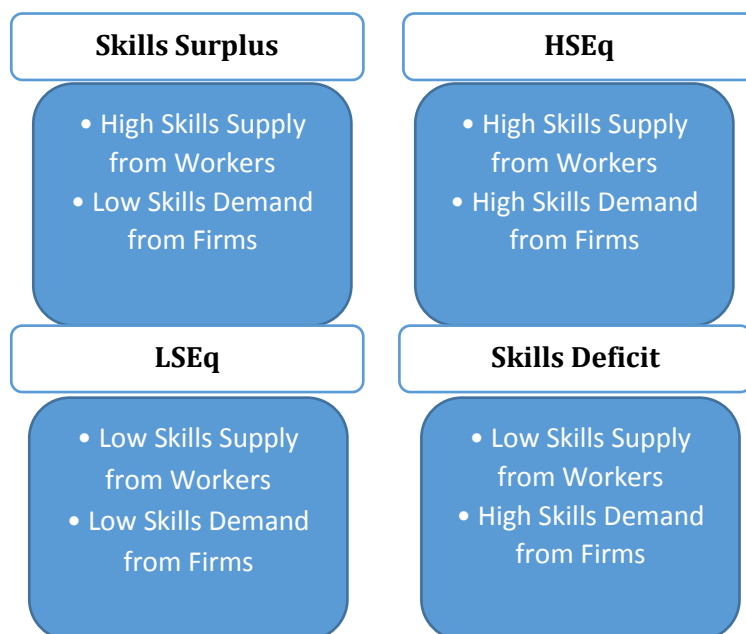
“the majority of enterprises are staffed by poorly trained managers, and workers produce low quality goods and services”

Subsequent research has refined the term “*low quality goods*” to *low specification goods* in order to convey the idea that the products of firms in LSE are not inferior, just simply less advanced than counterparts in other economies (Wilson and Hogarth, 2003). Moreover, researchers have sought to remove the emphasis on managerial skills alone in order to identify the broader issue of skills attainment amongst the entire workforce. This situation however only describes one component of the LSE. Finegold and Soskice also emphasise that the low skill profile of the workforce is matched by the low skill profile of firms. They see a LSE where the;

“concentration of the country's firms is in those product markets which have the lowest skill requirements”

This means that in a LSE, not only are there low skilled workers producing low specification products, but that this situation best represents what is required in the labour market. In other words, there is both a low skill supply from workers and a low skills demand from firms. To show this more intuitively it is instructive to place the LSE in the context of the other permutations of supply and demand for skills which are possible. Chart 1 shows what other combination of skills profiles are possible.

Chart 1 Skills Supply and Demand Scenarios



Sources: Green et al (2003)

The top left-hand box describes a Skills Surplus and the bottom right hand corner describes a Skills Deficit. Both of these situations have a mismatch between workers and firms. In the Skills Surplus situation, the issue is demand for skills from firms and policy should be focused on incentivizing firms toward increasing their range of products or greater specification in their existing output. In the Skills Deficit scenario, the problem is a lack of supply available from the workforce and policies should be centred on boosting uptake of further education or incentivizing workers to upskill within firms. The situation in the top right-hand corner describes a High Skills Equilibrium and the bottom left describes the LSE. In both these situation, there is no mismatch between what is demanded by firms and what is supplied by workers. Unlike the Deficit and Surplus scenarios, in both of the Skills equilibria, no action is necessarily required. This may seem counterintuitive for the low skills scenario, but it is only counterintuitive because of what is eventually produced in the low skills scenario.

It is unlikely that policymakers would seek to take action in the High Skills Equilibrium because such a scenario produces high specification goods with high skilled jobs that theoretically offer high wages. The LSE produces the opposite-

low skilled jobs offering low wages, but unlike in the Skills Surplus and Skills Deficit scenarios, it may not be immediately obvious what the problem is. This is further complicated by the fact that in most cases a LSE is characterised by high rates of employment. Once again this is intuitively correct, when supply and demand in the labour market are equally matched, there would be little room for structural unemployment. Wilson and Hogarth (2003) also point out that many firms in a LSE may be profitable. The problem lies in the fact that a LSE produces low value-added output and this has implications for living standards particularly through wages.

Wilson and Hogarth (2003) note that low skills and low value-added production are a necessary but not sufficient condition for a LSE. An equilibrium represents a balanced state of affairs where opposing forces are equalised. In an LSE the economy is stalled at a particular level because neither side is willing to move from their current position. Finegold and Soskice (1988) see this equilibrium as being sustained by:

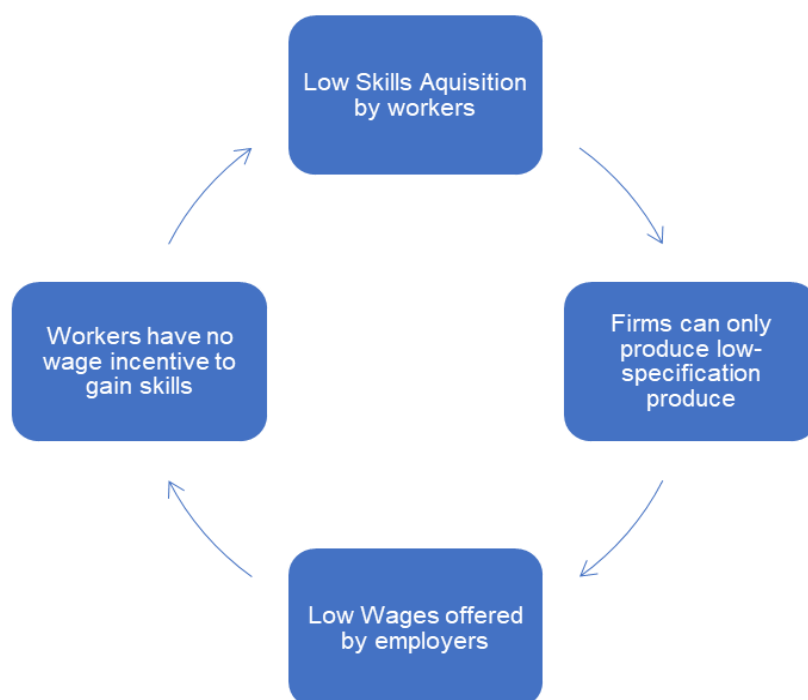
“a self-reinforcing network of societal and state institutions which interact to stifle the demand for improvements in skill levels”

This attribute is key to the conception of a LSE. Something is present in the economy which has prevented it from moving toward a High Skills Equilibrium. While state institutions have been highlighted in previous LSE work, societal institutions such as peer groups are also issues for both workers and firms. Why is there no demand for skills from firms, why do workers not seek to gain skills? Wilson and Hogarth (2003) and Finegold and Soskice (1988) both emphasise that in a LSE all economic actors are behaving rationally. Workers have no incentive to acquire skills if firms have no demand for them. As Toynbee (2003) notes, qualifications are worth little to employees unless employers are willing to utilise them. On the other hand, firms in a LSE have no incentive to boost product specification if they cannot get skilled workers to carry it out. In this scenario, the two central weaknesses of the economy *may* be mutually causal.

Looking at the two trends identified in NI, it is possible to conceive of a situation where causation could run both ways. NI has low skills accumulation which is likely a cause of the low value-added nature of production in the economy. Lower

skilled workers are less likely to be able to produce higher specification products or interact with new technology, therefore production is low value-added. One can therefore identify a causation between low skills and low value-added. However, it is also possible for the causation to run the other way. Firms in NI produce low value-added output and therefore workers have little or no incentive to invest in skills that will not be utilized or rewarded in the workplace. Consequently, overall skills accumulation is lowered. This need not be an either/or causation, it is possible that both explanations are valid and more worryingly from a policy point of view they may be mutually reinforcing making solutions more complex.

Chart 2 A Low Skills Equilibrium



2.3 Is Northern Ireland a Low Skills Equilibrium?

The first stage in determining a LSE must be outlining a profile of low skills and low value-added production. The second stage will involve identifying an equilibrium, and subsequently identifying the drivers of that equilibrium.

Low Skills

The statistics mentioned in the introduction to this section deal with

qualifications, but this is not the only metric by which to judge skills. Mac Flynn (2017) outlines that, in terms of low qualifications, NI has among the highest rates in Europe. As Quintini (2011) notes though, qualifications only describe certified skills, mostly those gained in the initial years of education. Much of the skills that are required by firms are acquired by workers in employment. A prospective employee may leave school with no upper secondary education, but it may be the case that the skills and training offered by employers may turn an unqualified worker into a skilled worker. To see this in context Table 1 shows NI's skills profile in comparison to other OECD countries and regions.

Table 1 Combined PIAAC Proficiency Scores by OECD country 2015

Country	PIAAC Score	Country	PIAAC Score
Chile	440.8	Slovak Rep.	575.2
Turkey	453.7	Canada	575.6
Greece	519.8	Estonia	576.6
Israel	532.8	Austria	577.0
Slovenia	539.4	Germany	577.5
Poland	545.9	Czech Rep.	582.8
Rep. of Ireland	547.4	Australia	586.0
Lithuania	551.6	Denmark	587.8
Singapore	552.0	Flanders	590.4
United States	553.7	New Zealand	596.0
Northern Ireland	556.6	Norway	597.7
OECD	561.8	Sweden	602.3
Korea	566.4	Netherlands	605.8
England	569.4	Finland	611.3
Russia	571.0	Japan	619.0

Sources: OECD (2017)

The combined PIAAC proficiency scores combine literacy, numeracy and problem-solving skills. NI is outperformed by England, though only just and falls behind many European counterparts. Interestingly NI outperforms both the Republic of Ireland and Singapore on all three measures. Nevertheless, compared to all other western European economies NI is only underperformed by Greece on all three measures. The weakness in workforce qualifications in NI is most well-known, but as Table 1 shows it is the skills base where NI is comparatively most weak. On these measures therefore, NI can be considered to be a Low Skills economy.

Low Value-Added

The other initial condition necessary in identifying a LSE is to assess whether NI is a low value-added economy. One way of evaluating this is to look at the UK national accounts and the NI share of Gross Domestic Product. In order to make international comparisons it is obviously necessary to make a basic size adjustment for countries or regions. Table 2 shows NI's regional GDP per capita compared to other EU countries adjusted for purchasing power parity. NI falls behind most western European economies with the exception of Greece and Portugal which have recently experienced severe and sustained periods of recession. Importantly NI is significantly outperformed by Scotland and the UK average. The Republic of Ireland's performance comes with the usual caveat that accompanies all reporting of its GDP (NERI, 2016).

Table 2 PPP-Adjusted Regional GDP per capita 2015 (€)

Country	Regional GDP	Country	Regional GDP
Albania	8.6	Spain	25.9
Bulgaria	13.6	Malta	26.8
Romania	16.5	Italy	27.8
Croatia	16.7	Scotland	28.9
Greece	19.6	France	30.6
Hungary	19.7	United Kingdom	31.2
Poland	19.8	Finland	31.6
Estonia	21.6	Belgium	34.2
Estonia	21.6	Sweden	35.7
Wales	21.9	Germany	35.8
Portugal	22.2	Denmark	36.6
Slovakia	22.3	Austria	36.9
Northern Ireland	22.6	Netherlands	37.0
Cyprus	23.5	Norway	46.3
Slovenia	23.9	Rep. of Ireland	51.1
Czech Republic	25.2		

Sources: Eurostat (2017)

An Equilibrium?

Having established that there is both low skills and low value-added output in the NI economy, it is necessary to identify if there is an equilibrium arrangement between the two. Workers can be either under-skilled/qualified, over-

skilled/qualified or well-matched to their jobs.

Table 3 Skills Mismatch by OECD country 2015 %

Country	Mismatched Skills	Country	Mismatched Skills
Northern Ireland	9.34	Norway	13.49
Netherlands	9.59	New Zealand	13.92
Poland	9.83	OECD	14.58
Finland	10.08	Turkey	15.27
Canada	10.17	Slovak Rep.	15.89
France	10.25	Germany	15.89
Sweden	10.79	Cyprus	17.03
Flanders	11.74	Italy	17.70
Estonia	11.77	Russia	17.87
Denmark	11.95	Czech Rep.	18.02
Australia	11.98	Jakarta	19.18
Slovenia	12.27	Austria	19.50
Israel	12.32	Spain	19.53
Korea	12.52	Rep. of Ireland	19.58
Singapore	12.78	Lithuania	22.74
United States	12.84	Chile	25.78
Japan	12.85	Greece	34.37
England	13.42		

Sources: OECD (2017)

If NI had a larger than average proportion of over-skilled/qualified workers, the economy could be classified as suffering from a Skills Surplus and similarly a larger than average proportion of under-skilled/qualified workers would point to a Skills Deficit. In order to establish a LSE, NI's firms and employees would need to seem comparatively well-matched. Data from the OECD PIAAC survey measures how workers perceive their skills profile in relation to their job. Table 3 shows, NI has the highest proportion of well-matched workers in terms of skills. Only 9% of workers in NI are either over or under equipped in terms of skills for their current job. Denmark and the Netherlands in particular would appear to be well-matched. In their case though, the combinations of high value added and a higher skills profile would indicate the presence of a High Skill Equilibrium.

The same data can also be applied to qualifications. It shows that NI has an above average percentage of workers who feel either over or under qualified (Mac Flynn, 2017). However, the measure for qualifications mismatch is self-reported and therefore less robust and more subject to bias than the skills mismatch. The skills mismatch is based on actual testing and therefore gives the best indicator of how the competency and proficiency of workers matches their work.

Attitudes of the Workforce

According to PIAAC data, workers in NI are just as likely as those in comparator regions to have sought a qualification in the last year, but they are significantly less likely to have taken part in other forms of training. Yet, in order to identify an attitude toward skills, it is necessary to look beyond participation rates. The task is to assess the motivations of those who did or did not take part in any training rather than simply the proportion of those involved. Denmark and the Netherlands are included as comparators because they have a similar level of low qualifications to NI, but perform better on both skills and value-added.

The first two questions in Table 4 are asked of those who have gained a qualification or engaged in other training in the last 12 months. For both formal qualifications and other training, NI workers were significantly less likely to be engaged in this activity for job related reasons. Workers in the Netherlands were less likely to gain a qualification for job related reasons, but far more likely to engage in other training for job-related reasons. The implication of this result is that workers in NI who engage in training are less likely to be reacting to a skills demand from their employer.

Table 4 Reasons for Skills Acquisition 2015 %

	NI	England	Denmark	Netherlands	ROI
The main reasons for this Qualification was job related	70.6	84.2	89.5	63.2	81.0
The main reasons for this Other training was job related	66.7	72.7	76.5	82.1	70.0
There were learning activities you wanted to take part in but did not?	18.3	24.5	33.3	23.2	30.5

Sources: OECD (2017)

The final question presented in Table 4 is the only question posed in the survey which gives some insight into what workers declined to do. As mentioned earlier, it is difficult to measure the attitudes of people toward tasks they have not engaged in. In essence this would require a question in the PIAAC survey which queries the motives of those who did not engage in upskilling. Absent this, the final question in Table 4 does capture some of this behaviour. Fewer people in NI identified skills opportunities that they were not subsequently able to take up. The important result is that workers in the comparator countries are more likely

to identify opportunities for skills progression even if they are eventually unable to pursue it. That proportionately fewer people in NI have responded in the same way does point to a lack of ambition in this direction.

While the answers provided in Table 4 do not amount to conclusive proof that workers in NI have less ambition to attain skills, they do provide some evidence that there is somewhat less enthusiasm for such activity and that skills acquisition is less work related. It would not be possible at the macro level to identify a labour market wide apathy toward skills acquisition but what the data does show is that the attitude of workers in NI does play a part in the development of a low skills base.

Attitudes of Firms

On the other side of the equation, employers and firms must be shown to have proportionately less interest in upskilling than comparator regions in a LSE.

Table 5 Firm demand for Skills by UK region 2015 %

	UK	England	NI	Scotland	Wales
All Employed					
Skills Shortage Vacancies only	4	4	2	4	4
Skills gaps only	12	12	8	12	12
SSVs OR Skills gaps	18	18	12	17	17
All establishments with difficulties retaining staff					
Too much competition from other employers	38	39	30	39	35
Lack of career progression	30	29	36	29	34
Not enough people interested in doing this type of work	56	55	61	53	65
Establishments with under-utilised staff					
They are not interested in taking on a higher-level role with more responsibility	26	26	24	28	22
Lack of jobs in the desired higher-level role	11	10	21	13	14
We actively seek staff with qualifications and/or skills beyond those needed	4	4	2	4	5

Sources: UKCES (2017)

For this the UKCES Employer Skills Survey (ESS) provides an insight into the

attitudes of employers with regard to upskilling and in particular reasons why they do not require further skills. Table 5 shows how NI firms compare on skills and also looks at how firms see their business operation in comparison with other firms. The first part of Table 5 deals with all employees and shows that NI firms have proportionately fewer skills gaps or vacancies that arise because of a skills shortage. When the sample is reduced to firms that have trouble retaining staff, firms in NI are less likely to be facing this situation due to competition from other firms. Firms in NI are also much more likely to lose staff owing to an absence of career progression prospects. Not only are NI firms lacking in routes for employee advancement, they have little reason to change this because of a lack of market pressure to do so. Interestingly firms in NI are more likely to report a lack of interest from employees which would seem to reaffirm the findings of *field of study* mismatch in NI identified previously.

When the ESS sample is reduced to firms with under-utilised staff a number of important differences emerge. Under-utilised workers are almost twice as likely to be under-utilised because of the absence of any higher-level roles with more responsibility. Firms in NI are also less likely to seek over-skilled or over-qualified workers. This does not contradict the PIAAC finding that NI has an average number of over-qualified workers. This question relates to the suitability of the skills and qualifications of the employee when they are hired rather than when they are in the job. The idea being that a firm might hire at a higher level with an intention to upgrade the role at a later date.

Bringing all this evidence together it can reasonably be argued that NI has a comparatively low skills base and consequent low value-added output. The skills profile of the workforce appears to be well-matched to the employment offered by firms at the present time. Workers and firms in NI also seem less inclined toward increasing skills acquisition or utilisation and this would indicate that the current skills situation is likely to persist. From the available evidence it would appear that NI is in a skills trap and/or that part of the economy is stuck in a LSE. If this is the case, there are implications for policy on many fronts.

2.4 How should policy react?

In an LSE, the skills trap can be thought of as a Prisoner's Dilemma. Both workers and firms would benefit from coordinating their decisions and reaching the most advantageous outcome. Without coordination workers and firms are destined to make suboptimal decisions and continue to lose out. As most of the literature has emphasised, in a LSE; all economic actors believe that they are behaving rationally. Both firms and workers believe that their chosen level of skills attainment or mode of production is optimal for their purposes. As in the Prisoners Dilemma, there is no incentive on the part of any actor to change their behaviour, the solution requires a third force to break the pattern of behaviour. Government is the obvious third force, but while state intervention is required, it must not be one-sided.

The UK economy lacks the institutional capability to coordinate economic actors and is therefore relatively ill-equipped in a LSE scenario. Edwards et al (2008) sees institutional weakness as the key policy imperative for tackling a LSE in the UK. Lauder (1999) looks at the issue of coordination in East Asian economies and how Korea and Singapore respectively tackled a Skills Surplus and a Skills Deficit through 'social contracts'. In Singapore, the social partners came to a common understanding about the need for upskilling and participated in various programmes to achieve it. In Korea, the state targeted investment funds to upscaling small enterprises in order to create demand for skills. While the social contract was more explicit in Korea, in both examples a consensus was established about the nature of the problem and this was key to finding a sustainable solution.

A New Skills Framework

Finegold and Soskice (1988) and Wilson and Hogarth (2003) are both highly critical of the further education system that exists in the UK and argue that moving toward a vocational education system as in Germany and other Nordic countries is central to solving the gap in supply and demand. This ensures a supply of skills that is embedded in local industry and one which is responsive to the current and future demand of firms. Building a vocational education system need not involve the creation of new institutions. Rather it requires linking the existing educational structure to the workplace and coordinating education

efforts with industry and social partners.

In terms of upskilling, Finegold and Soskice (1988) argue that financial incentives should be offered to companies to induce on-the-job training. To this end they propose a ‘training levy’ on companies that do not carry out training. This is a demand side measure which would both incentivize low skills firms to engage in upskilling and provide funding for smaller firms to do the same. This policy has in fact recently been adopted by the UK government in the form of the Apprenticeship Levy. The problem with the current Apprenticeship Levy, and particularly so in NI, is that it is not linked to a supply side measure. It is obviously beneficial to seek to boost the number of apprenticeships in firms, but without a policy to incentivise take up amongst potential trainees, it is likely to fail. As Finegold and Soskice (1988) noted, a training levy does not work in isolation. Without coordination between firms and employees, such a measure is likely to be treated as a new tax and provide little additional training. There needs to be an institutional framework whereby companies are encouraged toward greater investment and government interventions to boost supply is matched to that ambition.

Wilson and Hogarth (2003) and Coffield (2004) raise the issue of standardisation of qualifications and how work based training in particular needs to become more homogenous across the board. They note that qualifications do not have an inherent value in themselves, they are valuable to an employee so long as they are sought out by an employer. Standardisation allows qualifications to perform their primary function of signalling competencies in the labour market. This is a key coordination measure. It incentivizes employees to seek training that is more likely to provide advancement and it allows employers to give more accurate rewards to skilled employees. Furthermore, it allows for qualifications in further education to be linked to qualifications achieved in the workplace. This not only incentivises prospective workers to gain skills in advance but also incentivizes workers to build on those qualifications throughout their career.

A Size Problem?

The weakness of NI’s private sector is often attributed to the size of the economy and consequently the size of firms. As Mac Flynn (2016) points out, NI’s productivity gap is not uniform across the economy and the size of firms does not

explain as much of NI's weakness as is commonly thought. Nevertheless, NI is an SME economy and Vadenberg and Trinh (2016) show that not only are SMEs far less likely to carry out training of staff, they are also less likely to want to do it.

Echoing some of the ESS findings for NI in the previous section, Vadenberg and Trinh (2016) found that SMEs do not see staff training as necessary and are found to be more comfortable in a low skills, low value-added mode of production. The authors however stress that this is not inevitable. It is a market failure, because SMEs do not see the value of such investment or they see the cost of training as too high. Tackling such a misconception is a key demand measure for SME economies such as NI's. The evidence of a market failure for training amongst SMEs shows that they should be a focus for government intervention. However, not all SMEs will be capable of moving up the value chain and Wilson and Hogarth (2003) emphasise the need to channel state support in the short term to those firms with the greatest propensity for change. Boosting performance amongst all firms is a bigger task and one that should be targeted in the medium term.

Where to start?

For NI the policy challenge therefore is to build a new skills framework that provides for standardised training both in work and for those entering the labour market. This new framework requires coordination amongst employees and employers. It also involves aligning development and investment plans of sectors and industries with government skills strategies. This would require government to survey firms and industries and construct a development plan whereby state support is tied to involvement and commitment to skills investment and product innovation.

Whilst much literature focuses on institution building, NI does not lack government programmes or an infrastructure for training and qualifications. It lacks coordination between such structures and the economy. Creating a dynamic of coordination between firms and workers is the most important policy ingredient to solving a LSE. Finegold and Soskice (1988) and Heyes and Stuart (1994) both pick up on the decline of Trade Union membership as a key missing piece in coordinating policy responses to a LSE. Collective agreements are examples of instances where firms and employees coordinate activities in order to boost productivity and output for the wider benefit of all involved. Situations

where employees collectively bargain for pay allow employers to plan investment and skills strategies that can be coordinated with training amongst the workforce. Declining trade union density means that examples of these structures are harder to find. However, those that remain may allow the state to start to build momentum for coordination in key sectors and industries. Lauder (1999) notes the example of the Skills Redevelopment Project in Singapore which was a joint initiative between the state and the National Trade Union Congress to provide nationally certified skills training. 27 companies volunteered 5,000 workers for subsidised training in the first wave.

To this end, a future Northern Ireland Executive should form a cross-departmental group composed of representatives of further education, industry and trade unions in order to build an agreed framework for a coordinated programme of upskilling. Building on examples of existing cooperation, the framework would be widened to include sectors and industries where low skills are most acute and where there is agreement for a way forward.

2.5 Conclusion

A skills deficit has long been considered a key structural weakness of the NI economy. This has been linked to NI's chronically weak output and consequent low wages. What this section has attempted to show is that a comparatively low supply of skills is contributing to weak output but that the low supply of skills is linked to a low demand for skills. The lack of demand is also linked to the lack of supply and this has trapped the NI economy in a mutually causal skills trap.

Understanding that the attitudes of employees may be linked to the attitudes of employers is key to formulating a policy response to the skills problem. This is an issue of coordination and economies which lack the institutional capacity for industrial coordination will find it more difficult to address these problems. Identifying cooperation and coordination at the firm level may be the best way to build a national framework and inform broader policy interventions.

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