Written evidence submitted by the UK Trade Policy Observatory (UKTPO), relating to the Investment in Northern Ireland inquiry (INI0032)

Given the unique position of Northern Ireland as part of the EU Single Market and the UK Internal Market what has been the impact on post-Brexit trade with Northern Ireland, and opportunities (or lack thereof) for investment in the region.

As part of the Investment in Northern Ireland Inquiry, the UKTPO was asked to comment on the question posed above with regard to the impact on trade and in consequence investment. We would like to also point the Committee to the evidence we submitted to the inquiry on Brexit and the Northern Ireland protocol (https://committees.parliament.uk/writtenevidence/37759/pdf/), which inevitably covers some of the same ground.

In addition to the recommendations made in our previous submission which focussed more narrowly on trade between Northern Ireland and Great Britain, we have one central recommendations to the committee, based on the material below, and which builds on the fifth recommendation given in our preceding evidence.

Recommendation: The impact of Brexit on firms production, trade and investment in Northern Ireland (NI) is complex because of the trade-off between some improved access for NI firms relative to GB and EU firms and increased barriers to trade in goods (between NI and GB), and in services (between the UK and EU), and reduced labour mobility between the UK and the EU. While there is anecdotal evidence on the impacts there is little systematic evidence on trade and investment. Given the time lags involved in producing the official NISRA and ONS results from the Annual Business Inquiry we strongly recommend that smaller scale surveys of firms both in goods and services areas of activity are undertaken. It is important that these are undertaken regularly and with consistency in the questions posed over time regarding the questions posed. These should identify both the opportunities and constraints to investment faced by NI firms, with a particular focus on the post Brexit changed conditions.

1. With regard to goods, Brexit has directly impacted on the costs of market access between (a) Northern Ireland and the rest of the UK (Great Britain), and (b) between Great Britain and the EU. With regard to services, the impact has been on the costs of market access between the UK as a whole (NI and GB) and the EU. The changes in the costs of market access are complex as they involve (possible) changes in tariffs, changes in 'non-tariff barriers' which range from the need to prove regulatory compliance to various administrative and border barriers, as well as changes with regard to labour mobility between the EU and NI which may impact on the composition of the work force in NI.

There are two key Brexit-related factors that will impact on investment in Northern Ireland:

A. **Costs of market access:** The changes in the costs of market access described above have an impact on the relative attractiveness of trade for firms both from NI, GB, the Republic of Ireland, or indeed the rest of the EU, but also to any of these markets. Changes in the relative attractiveness of trade with particular markets will impact on the desirability of investment.

B. **Uncertainty:** It is well documented that investment tends to be lower where there is uncertainty. Since 2016, the Brexit process has generated considerable uncertainty. Initially this was concerning the potential agreement between the UK and the EU, and the position of Northern Ireland in any such agreement. Since the Northern Ireland Protocol (NIP) and the Trade and Co-operation Agreement (TCA) were signed uncertainty has nevertheless continued over the operation, feasibility and sustainability of the NIP.

It is too early to consider the official evidence on changes in investment flows since the agreement on the NIP and the TCA as sufficient data are not yet available. Indeed, there is also comparatively little data on trade flows. The UKTPO is undertaking research in this area with a particular focus on trade flows and labour force composition, and below we provide a brief summary of some of the evidence on trade, and some of the preliminary results from our research.

The period prior to the NIP and the TCA:

2. The available evidence on NI trade, which includes sales to GB is until 2019 for imports and 2020 for exports. While this is prior to the NIP and the TCA it does cover the period of uncertainty since 2016. The data on sales and purchases, taken at face value, suggest some reorientation of NI trade away from the GB market and towards the Republic of Ireland and the rest of the EU. Hence the share of imports by firms from GB has declined from just under 70% of all purchases, to 62.9% over the period 2015 to 2019 (we exclude 2020 to avoid the issue of Covid impacting on trade), whiles the share of NI firms' sales to GB has declined from 59% to 48%. The shares of purchases and sales with the Republic of Ireland (RoI) and the rest of the EU have increased over this period. However, it is important to be careful in looking at this data because, for example, the decline in the share of sales is very much dominated by the decline in tobacco sales due to the closure of the Gallaher tobacco plant in 2017.

3. We have therefore undertaken more formal and preliminary (statistical) analysis of the data, which allows us to control for an array of potential confounding factors including the closure of the tobacco plant.
    - The key finding is that in the years immediately following the referendum, NI firms actually increased the value of trade undertaken within the province both in terms of sales to and purchases from domestic companies. There is evidence of an increase in the value of purchases from the Republic of Ireland though the impact on sales is less clear-cut. There also appears to be some very marginal evidence of a negative effect on manufacturing firm purchases from GB but no effect on sales.
    - In regard to trade with the rest of the EU the picture is less clear-cut. In the years subsequent to the referendum, the sales of Northern Irish manufacturing firms to other EU countries appeared to be sensitive to the size of the potential tariffs. In particular, sales were found to contract slightly for those firms that were likely to be subjected to higher tariffs rates. This finding could be interpreted as reflecting the greater degree of uncertainty with which Northern Irish firms were confronted with respect to EU countries (excluding the Republic of Ireland) prior to the signing of the withdrawal agreement.

4. Although the foregoing analysis is preliminary, it does appear to suggest some change in the behaviour of manufacturing firms in the aftermath of the referendum and prior to the completion of the withdrawal agreement. Specifically, the analysis does suggest some re-alignment in trading patterns influenced by the uncertainty that emerged after the referendum. The anecdotal evidence available from other sources suggests that the re-alignment in trading behaviour

described in our analysis has gathered more traction since the UK's formal exit from the EU in January 2021.

Since the NIP and the TCA:

5. There is no officially published data on the sales and purchases of NI firms with the rest of the UK since January 2021, which means that any analysis is more anecdotal and thus more speculative. The anecdotal evidence suggests that there has been a negative impact on sales in both directions. That negative impact has arisen because of the increased bureaucratic costs in particular on sales from GB to NI, but which can in turn impact on NI sales to GB.

6. There is evidence produced by the Republic of Ireland (RoI) on trade between Ireland and NI. This suggests a reorientation of RoI trade towards more trade with NI at the expense of GB. This can be seen in the charts below:
   - Charts 1 and 2 track the ***level*** of trade between Ireland with NI and GB by month both before and after January 2021. In each case we take the value of trade in any given month (eg. January 2021, Feb 2021) relative to the average value of trade for the same month over the period 2017-2019 (eg. average of Jan 2017-19, average of Feb 2017-2019). The chart, therefore, shows whether trade had increased or decreased relative to the preceding years. We see that:
     - Imports by RoI from NI rose dramatically post Jan 2021, while imports from GB fell
     - Exports to NI rose substantially post Jan 2021, while exports to GB have fluctuated more
   - Chart 3 gives the share of NI in the Republic of Ireland's trade with the UK, from which a similar message emerges – a substantial increase in NI exports to Ireland, and an increase in imports.

7. The preceding, of course, is with regard to trade as opposed to investment flows. What it does suggest is the increasing attractiveness of Ireland as a partner market both for sales and purchases. This does not necessarily, however, imply a positive impact on investment flows in order to support this expansion of trade. While this is certainly possible and plausible, it will depend on the extent to which the increased exports by NI to Ireland represent an overall expansion of sales or the extent to which it merely reflects a switch away from the GB market. More data and research is required to establish the extent to which this is the case.

8. We would expect that in some industries the overall net effects may be positive, while in others the changes reflect a switching of trade. It is too early to separate out these differences, nor to have any precision over which industries are most likely to be affected. The evidence (above) on the period prior to January 2021 gives some support to the notion that NI sales to the EU declined post Brexit more in sectors where the EU's import tariff is higher – hence where uncertainty over future arrangements may have more significant consequences for firms. Analogously, and to the extent that NI now has improved access to the EU market relative to GB, one might expect that these will be industries which might experience the biggest increase in trade with the EU post January 2021.[1] By extension, these therefore may be the industries with the greatest likelihood of increased investment.

9. Note however, and as discussed earlier, this will depend not simply on market access costs driven by tariff costs but also on:

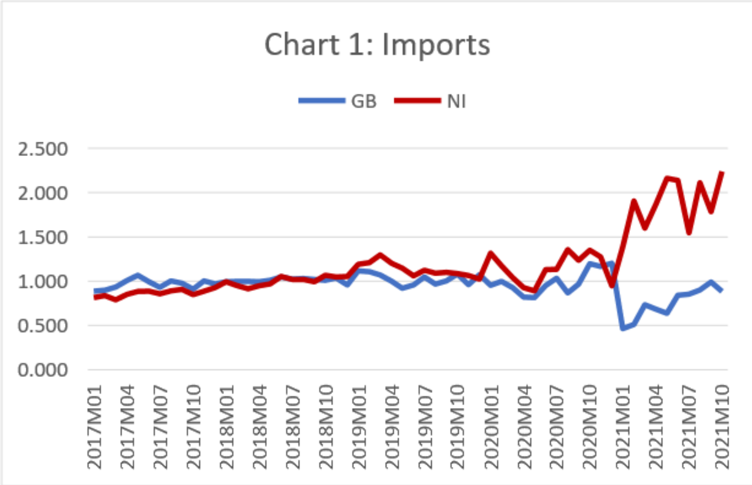
---

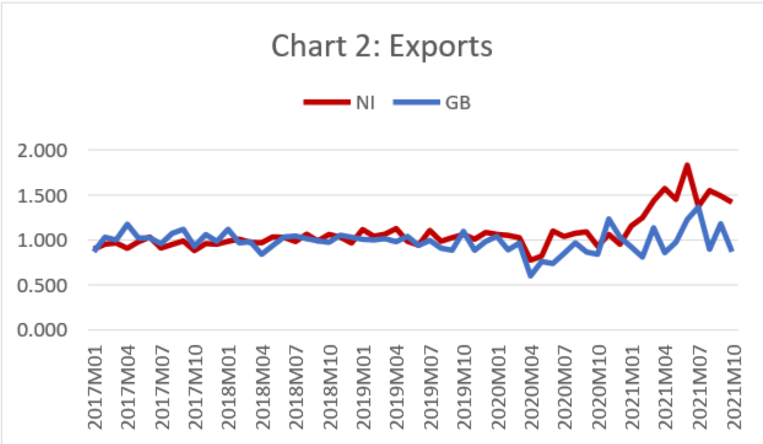
[1] On the face of it, and given that the TCA allows for tariff free trade between the UK and the EU, it might seem strange to point to the ongoing impact of tariffs. However, it is important to note that the agreement is tariff free ***providing*** firms can meet the underlying rules of origin. Evidence up to October 2021 suggests that almost 30% of UK exports to the EU actually eligible for preferential tariff free access to the EU market in fact paid tariffs. So, tariffs are still likely to matter.

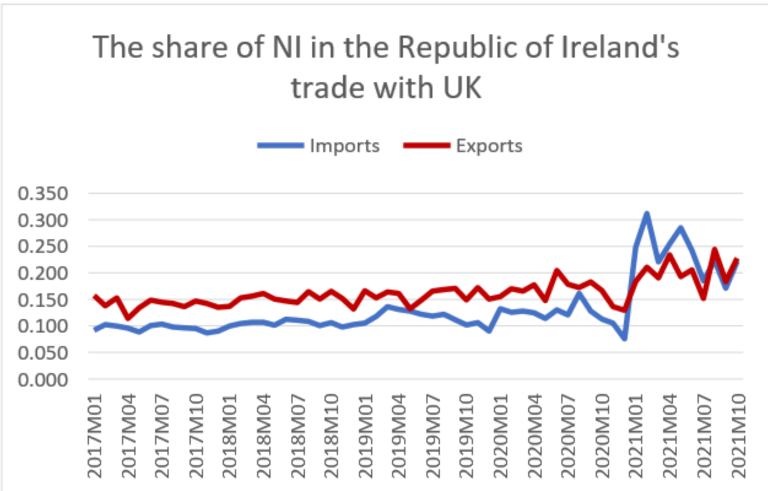
a. Differences in regulatory barriers with regard to goods trade between the UK and the EU. GB has left the EU's single market while NI has not. In principle this is likely to have a negative impact on the degree of market access and the costs of market access for GB firms relative to NI firms. There is a lack of evidence on the extent or significance of such barriers, but previous work by economists on 'non-tariff barriers' suggests these could be substantial.
b. Services barriers and the link between services and goods trade. The data presented in this submission focuses on goods trade – as the data on this is more accessible. However, arguably services trade may be more affected given that NI is no longer in the Single Market for services. Given that 52.3% of value added in Northern Ireland derives from the services sector, more data and analysis of Northern Irelands services trade flows and investment is needed.
c. Barriers arising from changes in labour mobility: This was also discussed earlier and concerns the availability of migrant workers – both unskilled (eg. in food processing) and skilled (eg. in advanced manufacturing) in Northern Ireland. Anecdotal evidence with regard to both of these suggest NI firms may be having difficulties with recruitment. The greater those difficulties the less attractive NI becomes as an investment location.

Modelling the impact of the NI protocol on trade

10. The UKTPO has undertaken modelling work, using a 'partial equilibrium model' of trade (similar to that used by DIT and other government departments) to model the impact of the TCA and the NI protocol on Northern Ireland. The model used includes 116 sectors including agriculture, manufacturing and services. The modelling does not seek to assess the impacts of any grace period, and effectively should be seen as modelling the longer term outcomes without the temporary easements. In this model Northern Ireland is treated separately to Great Britain.
11. Our research indicates that there is an overall welfare loss for Northern Ireland (where welfare is defined as the sum of the impact of changes to consumers, producers and government revenue). This welfare amounts to -2.4% (of base expenditure).
12. While there is a welfare loss, at the same time aggregate output in NI rises by 2.2%. This is a very standard result in models of international trade which show how protection can increase domestic production but at the expense of total welfare. The reduction in total welfare arises from price increases for consumers and firms purchasing intermediate inputs.
13. The disaggregated results suggest that that output increases for 63 industries in NI, and decreases for 53 industries. On average for those industries that see output rise the increase in output is 11.7%; and for those industries that see their output decline the average decline is -4.5%
14. There are two reasons why the combination of the TCA and the Northern Ireland Protocol results in output in NI rising. First there is the direct effect of Brexit which results in higher barriers on trade from GB to NI. This serves to 'protect' the domestic industry in NI and induces a rise in domestic production. The second reason derives from the increased relative competitiveness of Northern Ireland in the EU and in Great Britain. The TCA results in a rise in barriers to trade bilaterally between GB and the EU. This gives Northern Ireland improved access (relative to GB) in the EU market, and (relative to the EU) in the GB market. This increases exports and hence output.







January 2022