Department for the Economy Northern Ireland - Written evidence (PBS0056)

ECONOMIC CONTEXT

1. Similar to the UK as a whole, Northern Ireland is a services economy. Latest figures indicate that the services sector contributes around 75% of gross value added (GVA) and accounts for around 80% of employment.

2. While much of this is domestic activity, NI's trade in services is a significant, and increasingly important, part of the economic picture. NI sells £6.5bn of services outside the region. GB is, by some distance, NI's biggest marketplace for external sales of services (accounting for £4bn of the total). A further £1.5bn of services is exported to the EU, over £1.1bn of which are services destined for the Republic of Ireland, making it our most important export market. A further £1bn of services is sold into Rest of World markets, including the US.

3. In 2017, total sales of non-financial services by companies in Northern Ireland were estimated to be worth £20.8bn.[1] In the same period the total services sector accounted for £29.3bn (74%) of GVA (£39.6bn) in Northern Ireland.[2]

4. In 2017, 7,822 businesses in Northern Ireland were involved in external sales of services. Some businesses sold services to multiple external markets. The vast majority of businesses (95%) involved in external sales employ less than 50 people, and 74% (5,819 businesses) are microbusinesses employing less than 10 people.

5. In terms of the number of business selling externally, Great Britain (GB) was the primary market for the external sales of non-financial services for micro, medium and large size business (0-9, 50-249 and 250+ employees), while the Republic of Ireland (RoI) was the primary market for small businesses (10-49 employees). RoI was the second most important market in 2017 for micro, medium and large businesses, with GB the second most important market for small businesses.[3]

6. Medium and large businesses dominate the share, by value, of non-financial services sales to GB (37% and 26%), the Rest of the EU (30% and 34%) and

[1] NISRA (2019) Broad Economy Sales and Exports Statistics (BESES) 2017
[2] ONS (2018) Regional economic activity by gross value added (balanced), UK: 1998 to 2017
[3] NISRA (2019) Broad Economy Sales and Exports Statistics (BESES) 2017 – additional requested analysis (unpublished)

the RoW market (40% and 39%). Micro and small business accounted the largest share of sales to RoI (25% and 37% respectively).[4]

7. In 2017, 14% of all service firms (excluding the financial and insurance sector, agriculture and the public sector) had sales to external markets. 13% of micro businesses, 19% of small businesses, 23% of medium and 27% of large businesses sold services in external markets.

8. The number of large businesses involved in external sales of non-financial services is evenly balanced across the markets (59 to GB; 56 to RoI; 37 to REU; 29 to ROW). External trade by large businesses with the GB, RoI and ROW markets generated significantly more value than trade with the REU markets. Sales by large businesses to GB were more than 4 times larger than sales by similar companies to RoI. Sales to ROW are close to 3 times the level of sales to REU, despite there being fewer larger firms selling to ROW.[5]

9. The largest proportion of external sales of services was, not surprisingly, from the Services sector[6] which made up 59% (£3.4bn) of all external sales of services.[7] The next largest sector for external sales of services was the Construction sector with 34% (£1.9bn), followed by the Manufacturing sector with 7% (£374m) of external sales of services in 2017. [8] The Other Production & Agriculture sector represented just 1% (£50m) of external sales of services in 2017.[9]

PROFESSIONAL AND BUSINESS SERVICES IN NI

10. The professional and business services (PBS) sector has grown rapidly in Northern Ireland in recent years, becoming strategically important to the NI economy. It comprises a range of sub-sectors, including legal services, consultancy, business process outsourcing and shared services, a number of which form part of the growing Knowledge Economy in the region. Northern Ireland has also developed a role as a near shore centre for middle and back office activities, offering a high quality, cost competitive location for international firms. The bulk of activity sits within 90 firms.

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[4] NISRA (2019) Broad Economy Sales and Exports Statistics (BESES) 2017 – additional requested analysis (unpublished)

[5] NISRA (2019) Broad Economy Sales and Exports Statistics (BESES) 2017 – additional requested analysis (unpublished)

[6] This includes Wholesale And Retail Trade; Repair Of Motor Vehicles And Motorcycles; Transportation And Storage; Accommodation And Food Service Activities; Information And Communication; Real Estate Activities; Professional, Scientific And Technical Activities; Administrative And Support Service Activities; Education; Human Health and Social Work Activities; Arts, Entertainment and Recreation; and Other Service Activities.

[7] NISRA (2019) Broad Economy Sales and Exports Statistics (BESES) 2017

[8] The construction category covers work done on construction projects and installations by employees of an enterprise in locations outside the resident economic territory of the enterprise. Manufacturing services covers activities such as maintenance and repairs delivered outside the resident economic territory of the enterprise.

[9] NISRA (2019) Broad Economy Sales and Exports Statistics (BESES) 2017

How business and professional services[10] benefits Northern Ireland

- **Business and professional services are a driver of economic growth** accounting for 4.6% of NI GVA in 2018[11].

- **A wealth generator** that has been a key driver of the recovery in the NI economy over the last number of years and a significant contributor to the wider policy objective of rebalancing the NI economy from the public sector to the private sector.

- **A job creator** accounting for 54,470 jobs, making up 7% of total Northern Ireland employee jobs in March 2020[12]. But this is a smaller than the share across the UK as a whole where it represents 13% of the employee jobs[13].

- **An export generator** with 12.7% of total sales taking place outside the UK in 2017[14].

11. One of the important features of the sector is the spread of job roles across the skills spectrum, particularly given the long-standing challenge to tackle high levels of unemployment and economic inactivity in the region. There are a number of contact centres and shared service centres, for instance, serving international clients which have provided substantial entry level employment opportunities for individuals with low/intermediate skills. Securing the projected growth in the sector is seen as an essential element of further improvement in the Northern Ireland labour market.

12. Foreign direct investment has been a key driver in the growth of the sector in NI. For instance, Northern Ireland has gained international recognition as a proven location of choice for mobile foreign direct investment in legal services. In the last decade numerous major law firms and legal services providers have established, scaled and expanded successfully in the region, including Citi, Herbert Smith Freehills, Allen & Overy, Axiom Law, and Baker & McKenzie.

13. These centres are sometimes erroneously perceived as 'back office' operations. However, the work being undertaken by NI legal teams is often complex and client facing in areas such as litigation and document negotiation

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[10] Business and Professional Services include SIC codes 69-71, 73-74 and 78 as noted in the DExEU pro forma. See Annex for full list.
[11] Source: ONS: Regional gross value added (balanced) by industry: all NUTS level regions
[12] Source: NISRA (2020) Quarterly Employment Survey
[13] Source: ONS (2020) Employee Jobs by Industry
[14] Source: NISRA Broad Economy Sales and Exports Statistics (BESES)

for banking and capital markets. NI staff are part of globally integrated legal teams and many operate as part of multilingual and 24/7 service models.

14. Similarly, NI has benefited from Foreign Direct Investment (FDI) in the PBS sector Levels of FDI have increased steadily in the last decade, with NI operations now established by firms to include the USA, France, India as well as UK and RoI companies. The nature of these operations has become much more diverse over time too – a focus on contact centres (inbound sales, customer services, outbound sales) has evolved to include higher value added activities e.g. financial service and technical support functions for international firms. Northern Ireland is now a proven location of choice for mobile FDI in shared services.

15. The PBS/shared services NI subsector has a diverse client base, spanning financial services, legal and professional services, IT, Utilities and Energy, Retail, Recruitment, Distribution and Transport. Over time, the range and complexity of services provided has expanded significantly. Whilst a significant proportion of activity is focused on UK customers, many of the firms in NI are dealing with a global client base, including the USA, the EU and elsewhere in the Europe, the Middle East and Africa (EMEA) region. A broad spectrum of activity is export focused, albeit much of this activity is not quantified in an aggregate manner.

<u>Significance of the EU on the sector group</u>

16. The sector's market profile is increasingly international, with substantial revenues being generated outside of Northern Ireland. EU exports make up 6.7% of total sales in NI with RoI accounting for over 60% of these. Markets outside of the EU currently account for a much smaller share of revenues.

17. Parts of the sector, particularly shared services and contact centres, rely heavily on language skills, and the range of languages spoken in the PBS sector in NI is substantial. Whilst a proportion of the sector's language requirements have been met locally, the sector's preference for native speakers has meant a number of firms recruiting directly 'in country'.

<u>Key enablers</u>

18. The sector is already a large employer in NI with roles across the skills spectrum. Key enablers for Northern Ireland to continue to grow the business and professional services sector are set out below:

- **Migrant Labour** – maintaining and expanding movement of necessary skills into Northern Ireland is considered important to fill vacant positions and meet skills needs to drive future success. This will be particularly important to avoid a situation which leads to functions being concentrated or relocated within the EU which can be viewed as highly mobile.

- **FDI** – maintaining market access to the EU will continue to be important as Northern Ireland continues its targeting of FDI.

- **Regulatory system** – to ensure that Northern Ireland is still considered a competitive region in which to do business it will be important to ensure that regulatory or related changes continue to be business friendly.

Northern Ireland's unique position

19. Future prospects for the business services sector in Northern Ireland are generally very positive, with the continuation of re-shoring and other trends potentially beneficial to the sector in the region.

Importance of cross border exports

20. In 2017 60% of the sectors exports went to the EU15, with almost three quarters (74%) of those exports going to ROI, our nearest EU neighbour. It is therefore important to maintain market access arrangements. 40% of exports went to the Rest of the World (ROW).

Importance of FDI

21. A number of professional services firms have established new functions and service delivery models which mean that NI acts as a pan UK/EU hub or centre of excellence. These have been on the basis of a highly skilled and low cost base region. These investments have been secured in the face of stiff competition from other regions and are highly mobile in nature. There is a significant opportunity to secure further growth in the sector via firms opening multiple sites or expanding existing operations to meet client needs.

RESEARCH INTO IMPACTS OF EU EXIT ON NI SERVICES TRADE

22. To date, much of the discussion regarding EU exit and trade has focussed on the impact on trade in goods. This is understandable, particularly in Northern Ireland, as a result of the commitment to avoid a hard border on the island of Ireland. Further, trade in services is different to, and more complicated than,

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[15] Source: NISRA Broad Economy Sales and Exports Statistics (BESES)

trade in goods with the sector's exposure to non-tariff barriers is the primary difference.

23. Research by the OECD and UK Trade Policy Observatory (UKTPO) has shown that the regulatory barriers for a business in a 'third country' selling services into the EU are up to four times greater than selling services within the EU Single Market.

24. The Department for the Economy NI (DfE), commissioned external researchers to produce an analysis of the potential impacts on NI's tradable services sector as a result of the UK's exit from the EU.

25. The analysis was completed using the OECD's Services Trade Restrictiveness Index (STRI) methodology as a basis. DTC were tasked with quantifying the change in services policies under a number of different exit scenarios and to convert these to ad valorem tariff equivalents (AVEs). The OECD define an AVE as "a charge levied on imports, defined in terms of a fixed percentage of value".

26. The AVEs have been prepared across 17 key sectors as identified in the OECD research. This research has been completed to allow for comparisons of changes in policy to be made between NI's trading relationship (both on an export and import level) with 45 countries covered in the OECD research

27. The researchers investigated the regulatory barriers currently in place for NI exporters and in a number of EU exit scenarios:

    (a) Norway-like agreement between the EU and UK;

    (b) NI in the Single Market but the rest of UK leaves (assumes trade is frictionless between NI and GB);

    (c) A UK/EU agreement akin to the free trade agreement between the EU and Canada (CETA); and

    (d) No deal/WTO terms for services trade.

<u>Headline Results</u>

28. A summary of the results are set out in the table below, expressed in terms of the ad valorem equivalent (AVE) for each sector in the baseline scenario and each modelled scenario.

Northern Ireland's exporting relationship with RoI under all scenarios

Source: Department for the Economy

29. Across all sectors included in the research, the average change in ad valorem/tariff equivalents for services exports to the European Union (compared to the baseline of membership of the EU Single Market) are set out in the table below:

Sector	Baseline	NI SM	Norway	CETA	No Deal
Accounting services	4.42	4.42	4.42	18.44	18.44
Air transport	11.59	11.59	11.59	26.80	34.25
Architecture services	2.19	2.19	2.19	10.33	17.34
Broadcasting	4.16	4.16	4.16	16.04	16.04
Commercial banking	4.81	4.81	4.81	19.08	19.08
Computer services	0.00	0.00	0.00	16.14	24.24
Construction	2.35	2.35	2.35	11.97	14.88
Courier services	10.86	10.86	10.86	29.71	35.44
Distribution services	6.12	6.12	6.12	10.38	14.53
Engineering services	0.00	0.00	0.00	7.61	13.60
Insurance	0.00	0.00	0.00	13.43	14.65
Legal services	7.63	7.63	7.63	13.06	18.56
Logistics customs brokerage	0.00	0.00	0.00	9.95	12.98
Logistics storage and warehouse	2.84	2.84	2.84	10.34	13.81
Maritime transport	2.28	2.28	2.28	16.80	16.80
Road freight transport	1.00	1.00	1.00	10.20	16.70
Telecommunication	4.75	4.75	4.75	8.73	10.24

Scenario	Percentage point change
Norway-like agreement	+0 (no change)
NI in Single Market but rest of UK leaves (assumes trade is frictionless between NI and rUK)	+0 (no change)
CETA-like agreement (the Free Trade Agreement between the EU and Canada)	+10.8
No deal/WTO terms for services trade	+14.5

30. The research shows that the further away NI’s trading relationship with the EU gets the more restrictive and costly trade could potentially get. The research shows that in a no deal scenario, all sectors will be face a significant increase on trade restrictiveness with sectors including computer service, courier services and air transport experiencing the most pronounced increases in tariff equivalents.

Research Update

31. Following the publication of the original research in March 2019, a Memorandum of Understanding (MoU) on the Common Travel Area (CTA) was signed by the governments of the UK and the Republic of Ireland. This allows for a differentiation to be made between the future trading relationships between NI and the Republic of Ireland and NI and the EU.

32. DfE commissioned a technical update of the original report which revised a number of estimates related to expected policy changes in order to fully take account of the MoU on the CTA. The following assumptions are made in the new analysis of the impacts of UK exit:

- The CTA will remain in full force and effect.
- Movement of British and Irish citizens between the UK and the Republic of Ireland to provide services will continue as at present.
- UK and Republic of Ireland citizens will not need permission in order to enjoy the right to work in the other country.
- The parties are committed to allowing for, within their respective jurisdictions, comprehensive measures to continue in place for the recognition of professional qualifications, in accordance with their national laws.

33. The table below sets out average ad valorem/tariff equivalents for services exports to the Republic of Ireland when the CTA is fully accounted for:

UPDATED RESEARCH	
Scenario	**Percentage point change**
Norway-like agreement	+0 (no change)
NI in Single Market but rest of UK leaves (assumes trade is frictionless between NI and rUK)	+0 (no change)
CETA-like agreement (the Free Trade Agreement between the EU and Canada)	+6.4
No deal/WTO terms for services trade	+7.5

34. The removal of any barriers to freedom of movement for UK and Irish citizens has a significant impact on the overall STRI scores and ad valorem equivalents compared to the original research.

35. The average percentage point increase under a CETA-like agreement drops by around a third (from a 10.8 percentage point increase to a 6.4 percentage point increase) and almost halves the impact of services trade with the Republic of Ireland on WTO terms (falling from an average 14.5 percentage point increase to a 7.5 percentage point increase).

36. It should be noted, however, that the ad valorem/tariff equivalent increases of 6.4 percentage points and 7.5 percentage points, for the CETA-like agreement and no deal/WTO terms scenarios respectively, are far from trivial and represent significant increased costs, and a resulting reduction in competitiveness, for NI businesses trading services into the Republic of Ireland.

37. The original research, along with a DfE Executive Summary and an explanation of the methodology and approach, along with the technical update, can be found and reviewed at the following link - https://www.economy-ni.gov.uk/publications/eu-exit-and-impacts-northern-irelands-services-trade

MRPQ

38. At the moment, during the transition period, the UK remains within scope of the EU's MRPQ regime and the MRPQ directive. This provides a multi-route system allowing for individuals operating in close to 300 professions to have their qualification recognised throughout the EU/EEA.

39. Outside of the scope and coverage of the EU's system, UK nationals will be treated as 'third country' nationals when seeking to have their qualification recognised and may face increased barriers in each Member State. These requirements could include a need to re-train/undertake additional training or take additional exams.

40. Although it should also be noted that the UK and EU have agreed that any individuals who have had their qualifications recognised in the other jurisdiction prior to the end of the transition period will not have to reapply in future.

41. We welcome the fact that the UK government has, in negotiations with the EU, set out an ambitious ask in terms of future arrangements for MRPQ. However, at the moment the EU is rejecting this position and has cited the UK proposal on MRPQ as an example of 'cherry picking' single market benefits despite leaving the EU.

42. Given the importance to NI of maintaining competitiveness in the RoI market for our services exports the fact that the UK and Irish governments have recognised the importance of MRPQ in the CTA Memorandum of Understanding (published May 2019) is a positive development.

Data Adequacy

43. Rules governing the collection and use of personal data are currently set at an EU-level by the General Data Protection Regulation (GDPR). In the UK, the Data Protection Act 2018 and the GDPR provide a comprehensive data protection framework.

44. Under GDPR rules, organisations are only permitted to transfer personal data outside the EU if there is a legal basis for doing so. Transfers of personal data within the EU are not restricted.

45. During the transition period, data transfer continues to operate as it did when the UK was a Member State. The UK is seeking an adequacy decision from the EU to allow the continued free flow of personal data once the transition period has expired. An adequacy decision occurs when the European Commission assesses the levels of personal data protection in a third country and deems it to be of an equivalent level to that of the EU.

46. However, there are concerns around the EU Commission reaching an adequacy decision for the UK. The main issue revolves around timescales. The adequacy decision process normally takes two years but only formally began following the UK's exit from the EU on 31st January 2020 and has to be completed by the end of transition (31 December 2020). UKG expects that this process can be expedited given the close alignment of data protection systems at the point of exit but it is not guaranteed that it could be achieved within the required timelines.

47. Before the Withdrawal Agreement was agreed by the UK and the EU, the UK government produced and published a technical notice on data transfer in the event of a no deal exit. The technical notice signposted businesses to advice and guidance produced by the Information Commissioner's Office. That advice relied heavily on standard contractual clauses (SCCs) and binding corporate rules (BCRs) as the most effective mechanisms for continuing data flows in the event a data adequacy decision was not in place.

48. However, these alternative transfer mechanisms do not appear to be appropriate for the majority of the NI business community as experts have questioned the relevance and utility for SMEs. Further, the technical notice has not been updated during the transition period.

49. This presents particular concerns in Northern Ireland as the continued free flow of personal data from the EU is of particular importance to our businesses. A survey of local businesses, conducted by the Department for the Economy in Northern Ireland, found that 70% of respondents identified data from the EU as important for business function.

50. Further, the survey indicated that just 6 per cent of respondents had undertaken all actions to prepare for the lack of a data adequacy decision, with a further 20 per cent have undertaken some action. Almost three quarters of respondents had no plan in place for the continuing free flow of data in the event an adequacy decision is not achieved.

July 2020