Response to Briefing on Northern Ireland Budgetary Outlook 2018-20

Introduction

NI's annual external and export sales figures have shown that despite wider uncertainty, our firms are proving that when the opportunity presents itself, the sector is more than able to grasp it.

The annual Broad Economy Sales and Exports Statistics report for the 2016-17 recorded a total sales increase of £1.8 billion. This was largely driven by increasing sales within NI, up some £829 million with GB sales up £281 million and exports up £686 million, some 7.3%.

Sales to Republic of Ireland have turned positive with an increase of 2.2% and represents just over one third of our export sales. Sales to the rest of the EU increased also by 9.4% over while sales to the rest of the world increased by 10.4%. Sales to GB rose by 2% to £14 billion, some 20.3 % of total sales.

Thanks largely to the sudden devaluation in Sterling after the EU Referendum, our firms have been quick at securing new export markets and fulfilling orders at home and in GB as customers switched to import substitution.

Now should be the perfect time to invest for the future. However, beneath the record annual export numbers hides a story of uncertainty and risk which makes this success insecure, but our firms know well that you can't build a business on the vagaries of the currency exchange, particularly as most have a profit margin of less than 10% with agri-food businesses closer to 2%.

Indeed, provisional results for Q3 2017 from the Department of the Economy's report showed significant headwinds with manufacturing output falling by 3.6% over the quarter and by 6.5% over the year. Four of six manufacturing subsectors saw a decrease in their output, with the Food, Beverages and Tobacco sub sector recording a substantial decline of 18.1%.

And, when we surveyed manufacturers at the beginning of December, **38% said they are planning on shifting production outside of the UK by developing their own facilities, making a purchase of creating new partnerships inside the EU.**

Elsewhere in our survey, 3 out of 4 manufacturers said that Brexit will be negative to their business regardless of a good, bad or no deal outcome. With only 16% saying they thought it would be positive and one in ten believing it will have no impact, it is clear that efforts to convince business that the UK outside of the EU will prosper have, so far, failed.

Broad Position

It is our view is that there needs to be a focus on creating the environment in which private sector jobs are protected and created.

Business is being asked to provide increased employment, both in actual headcount terms and also as a percentage of the overall employment mix to counter the decline in headcount within the Public Sector. In order to do this, business needs a competitive environment. This environment is created by businesses investing in themselves – facilities, production capacity, skills, market development – but also through government action in policy areas, efficient and effective public services, a tax environment and investments.

As we respond to this consultation, our manufacturing sector faces an existential threat. Brexit impacts on broad manufacturing sector more than any other part of the economy with the critical agri-food, exporting and importing firms particularly exposed. No other part of the economy must deal with the uncertainty about borders; customs costs and delays and trade policy; other sectors do not have the same reliance on skilled and semi-skilled migrant workers; and, the manufacturing sector is uniquely subject to a raft of non-tariff barriers which mean their products may or may not have market access from 2019 onwards.

We are deeply concerned that the Department's document contains a series of loaded questions. Threatening to withdrawn services, increase costs (income generation) and emotively asking the reader to make the choice between paying more or funding the health service. This approach is unhelpful. For us, we believe the Department should insist that it's resources are used effectively and efficiently first. Collecting small additional sums will not make a jot of a difference to service provision when there are failures within the system which is wasteful.

Increasing the burden on citizens and business at this time will lead to job losses (when we need job growth), will lead to greater levels of poverty (when we're trying to lift more out of poverty) and will not improve the provision of public services in any way (when you are working to improve these services).

On the basis presented by the Department in this consultation, it appears that protecting households from a series of charges is increasingly unsustainable. However, whilst this may raise some additional revenue, this will make little or no difference to the pressures faced by public services so will in reality only punish the public. Wages are growing at a sensible and sustainable rate, any shock in the system delivered by a sudden rise in domestic charges will undermine the recovery of business at a time when you need it to make a larger contribution to jobs.

Our message is simple – where there is wealth, there is health… healthy people, communities, families and a healthy economy. The work of the Department's must focus on those areas where more work and wealth can be created. This will reduce the burden on other cost areas in the short, medium and long-term.

The challenges faced by Departments can only be eased by delivering reform – the longer you leave it, the deeper the crisis will become. Action needs to start now.

Scenarios

We do not support any of the scenarios presented. In business, you can't simply go back to 'customers' for more money, you win extra work and income and you deliver projects on budget by being efficient. This scenario needs to be delivered before any of the scenarios in your paper are contemplated.

Ring Fencing

67% of the resource budget is ring fenced. When savings are required this then means larger reductions for other Departments. This is not sustainable.

If budgets are to remain ring fenced, there needs to be evidence that the investment in these departments are effective and efficient. It also must focus on areas which see a return on this investment by delivering healthy communities. This is best achieved through job creation.

This can be delivered specifically through:

Department for the Economy

Increasing the investment in the workforce, both in capacity and capability terms, providing the skills and leadership to meet the needs of the economy now and in the future including addressing the challenges of Brexit as NI (and the UK) becomes less attractive to workers from the EU.

Supporting investment delivery programs through efficient business development and training agencies, such as Invest NI, the Universities and Colleges and in association with agile local Council Economic Strategies, will help firms prepare for Brexit, growing external and export markets and deliver R&D and skills/leadership development.

Getting telecoms and superfast broadband connections to industrial units will escalate the move to improving productivity through technology.

Department of Infrastructure

Ensuring NI Water is sufficiently resourced to meet the demands of industry and avoid unnecessarily environmental costs and fines.

Swift delivery of key roads infrastructural projects to increase productivity and support our construction sector. Our manufacturers are not in Belfast, they are in provincial towns and townlands – getting product to market through a fit for purpose roads network is essential.

Sufficient funding to maintain the roads network (or single biggest public asset) which is crumbling and adding to departmental costs.

The Importance of Price Competitiveness

Manufacturing NI commissioned Oxford Economics to produce and analysis of the contribution which the sector makes to the NI economy.

It conclusions were important:

> ***"… reduced competitiveness of the sector puts at risk the thousands of jobs and livelihoods that the manufacturing sector supports in communities across the region."***

However, they also made it clear that:

> ***"… when manufacturing grows, the whole economy grows with it."***

*** It should be noted that manufacturing makes up the bulk of the economy in Mid-Ulster, in Armagh, Banbridge and Craigavon and Mid and East Antrim Council areas – these locations are disproportionately impacted if policy decisions make NI less attractive for manufacturing firms.*

To a large extent, competition is all about cost. For any business the key to long-term success is being able to bring a quality product to the market but at a competitive price. Manufacturers in Northern Ireland, like their competitors across the globe, need to control costs, but also invest and create innovative processes and products.

Manufacturing is a high turnover, high cost sector—with large outlays in employment, capital and general materials (that include energy and transport costs). Manufacturers are sensitive to rising costs in any of these areas, which hit profit margins and threaten the long-term viability of the sector.

Investment decisions are usually taken over the long term as firms recycle their profits into capital investment or R&D enabling them to purchase new equipment or create new and innovative processes and products, and with the dual aim of both improving the quality of products but also, by increasing the productivity of the business, helping to keep long-term costs down.

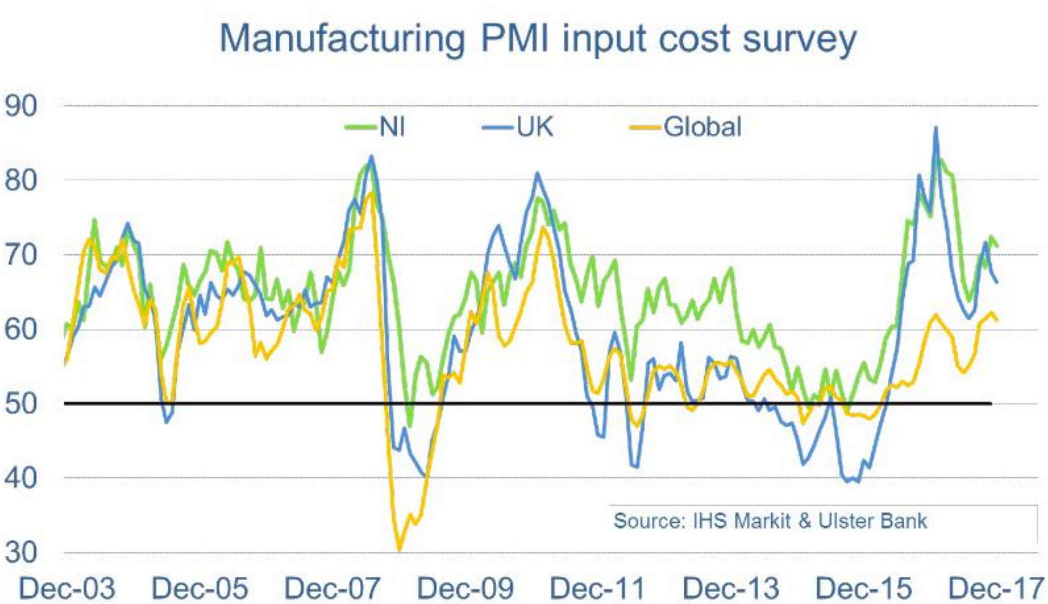
There is an obvious link between existing and expected costs and the capacity of a firm to invest. Any increase in costs will act to squeeze profits, affecting rates of return from long- term investments, and consequently sharp and unexpected cost shocks in one area may mean cutting back on another.

Any sustained period of strong cost growth, that is not in line with changes to the cost base of its competitors, risks diminishing the competitiveness of the manufacturing sector in Northern Ireland both by making its goods more expensive, and by reducing the capacity to make investments that are needed to drive innovation and ultimately growth. Given both the size of the manufacturing sector and the ripple- down benefits that it generates in terms of output and jobs all across the economy, the impact of any decline in the sector's competitiveness can be expected to have far-reaching consequences for Northern Ireland's economy.

This will make it harder to win contracts, reduce the ability to compete in both established and new markets, and ultimately, put the jobs and incomes the sector supports at risk.

Factors Affecting Cost in Northern Ireland

Using the monthly purchasing manager's index (PMI) survey of companies in Northern Ireland we can explore the performance of the manufacturing cost base in Northern Ireland relative to its international competitors.



The survey shows that since 2011, reported input costs in manufacturing in Northern Ireland have been increasing more strongly than for manufacturers based in the UK, the Republic of Ireland and across the globe. Prior to 2011 reported input costs were increasing but generally tracked the cost growth elsewhere, including a rapid spike, crash and recovery between late 2007 and early 2011. However, throughout 2011 and 2012, input cost inflation slowed dramatically in the UK, the Republic of Ireland and across the globe, with brief periods of price deflation. In stark contrast, input cost growth in Northern Ireland remained strong, and did not start to converge to the UK, the Republic of Ireland and global pace of growth until late 2013, and then taking a year to fall into line.

The rapid devaluation change in the value of sterling post EU Referendum has presented an opportunity to exporters, but as seen in the above chart has resulted in a huge spike and cost differential between businesses here and across the word. This has had a dramatic impact on all manufacturers (every one imports).

The following sections explore the main costs facing Northern Ireland's manufacturers—in particular labour costs and production costs, including energy and transport—and examines how these costs have changed by comparison to the picture for its major competitors.

Labour costs

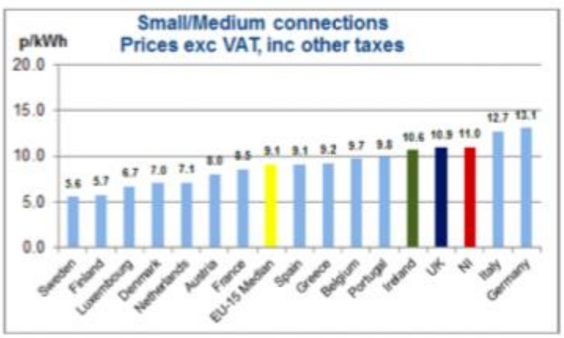
Like most other industries, manufacturing wages in Northern Ireland are below the UK average. In 2015 the median weekly gross pay for a full-time manufacturing employee was £479, 12 percent below the UK equivalent. The picture of wage patterns is, however, changing. In 2014 annual wage growth was 6.6

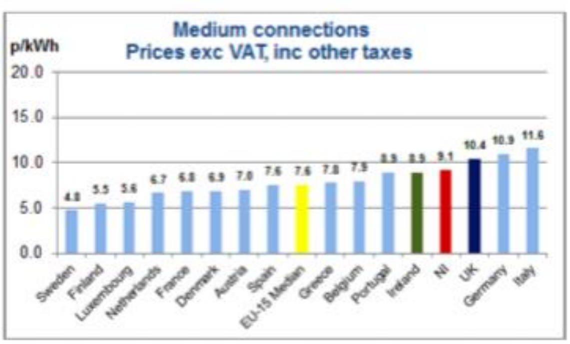
percent in Northern Ireland, substantially higher than the UK average pace of growth, at just 1.6 percent on 2014. In fact, the competitive gap on wages between Northern Ireland and the UK as a whole has been reducing for some time. Since 2008, wages for full-time employees have risen by 16 percent in Northern Ireland, significantly faster than the UK average of 12 percent.

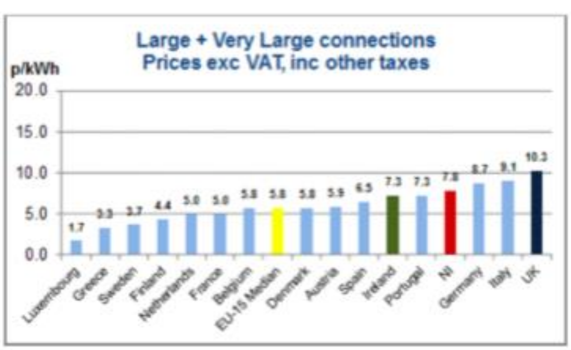
This is reflected when examining the average cost of employment in Northern Ireland against other countries in the UK. Average employment costs in manufacturing in Northern Ireland have increased by 27 percent since 2008, significantly faster than the UK average of 17 percent and the second highest in the UK behind Scotland.

Having lower labour costs in absolute terms is an advantage in relation to competitors in other developed economies in the UK, the US, France, Germany and Italy. But this advantage becomes less relevant as global competition in manufacturing increases where emerging economies have a significant advantage due to low wage levels compared to developed economies. This is particularly relevant in labour intensive areas of manufacturing.

National Living Wage, pensions, Apprenticeship Levy are all pressures which are adding significantly to wages costs and reducing international competitiveness.







Input costs: energy and transport

Echoing the relatively strong growth in labour costs that we have outline above, an examination of Annual Business Survey (ABS) produced by the ONS confirms that Northern Ireland has also experienced stronger growth in input costs in manufacturing relative to the UK average.

Our electricity prices are amongst the most expensive in the EU.

The price of gas is also an important factor in determining energy costs in Northern Ireland, not least because it is an important input into the generation of electricity. Therefore, higher wholesale gas prices push up the price of electricity that businesses face, as well as the retail cost for I&C customers that use gas for general industrial purposes.

Gas prices in Northern Ireland have been higher than the UK as a whole due to a lack of competition and the fact that the gas supply largely comes from Great Britain. **We estimate that the average unit cost of Gas for a typical industrial and commercial user is the second highest in the EU, 35 percent higher than the equivalent cost in the UK and 47 percent higher than the cost in Ireland.**

Transport and logistic costs are also significant for most manufacturers but the peripheral location from the other countries in the UK means manufacturers based there face additional haulage costs in moving raw materials and finished products to and from ports in Great Britain, as well as the freight costs in transporting supplies and products across the Irish sea.

This means firms in Northern Ireland face a set of additional costs when dealing with the domestic market. In fact, some face a double hit if both their supply chain and final market is based in GB. These are costs that competitors based in Great Britain to not have to incur, and therefore place firms in Northern Ireland at a distinct disadvantage in this area.

After labour and materials, purchase of road haulage is the highest expense for manufactures in Northern Ireland, with total expenditure reaching £252m in 2013.

The Costs of Brexit

The cost of Brexit will fall most severely on the manufacturing sector.

The UK need a new trade and customs deal with the EU. If none is achieved, there will be a huge cost burden on local manufacturing firms. If the UK achieves a new deal, it will still come with additional costs for NI manufacturing firms.

As an example, ADS (the representative body for the Aerospace sector) estimates that up to 10% (£1.5bn) of additional customs administration costs will be required. The equivalent costs therefor for NI manufacturing firms (including aerospace) could be £570m.

InterTradeIreland forecast that NI firms would be most impacted by a Brexit deal with sees both tariff and non-tariff barriers resulting in -19% in trade between NI and Ireland. This, they estimate, is a €200m reduction in trade from North to South.

MNI's analysis of the administration cost of just customs documentations shows that an additional £478 per shipment would be required – this is the cost from a Chamber of Commerce for the Certificate of Origin, copies, transport and time.

Business rates and industrial de-rating

A whole range of other factors, of course, also affect costs for manufacturers: including taxes that are levied, and that can vary markedly across different countries, impacting on the cost base and therefore competitiveness.

Business rates are a tax on commercial property and are regarded as a tax on production in the national accounts. They are set independently of the value of the goods or services produced by the business and are levied on businesses whether or not they are profitable.

Whilst industrial derating policy exists, what is often misunderstood is that despite this policy, **manufacturing firms pay more per business** than all other parts of the economy (excluding energy) – the figures opposite are MNI's based on 2015's bills and numbers of firms.

We have been able to run a very high-level analysis of potential impact using the published regional national accounts for Northern Ireland.

This analysis assumes that any changes to de-rating will affect profit levels in manufacturing firms, and that this will, in turn, impact of the extent of their investment, innovation, and competitiveness.

It is important to stress that the additional tax liability will vary by firm size, with manufacturers operating in larger premises likely to face an increased tax liability in the magnitude of hundreds of thousands of pounds. Therefore, if the additional costs were to put excessive pressure on margins it could pose a significant risk to employment within large firms and the amount of money they put through the supply chain; damaging the sector as a whole. While smaller firms will face a smaller liability in absolute terms, the impact would also be significant, especially given the important role these firms in supporting the small towns and rural communities.

Northern Ireland already has the fastest growing business rates in the UK, and has seen an increase of 13 percent since 2008/09, compared to average growth of just 3 percent across the other countries in the UK.

Figure 36 shows the high-level sectoral impact of de-rating on profits. Overall, the manufacturing sector would see profits fall by £58 million, or just under 3 percent. This will increase the share of profits that is accounted for by taxes on production to just under 7 percent. The largest proportional fall in profits would be felt by the other manufacturing and repair, basic metals and metal products industries.

Industry	Profit (£m)	Change	Tax as a % of profit
Food products, beverages & tobacco	744	-0.9%	2.1%
Transport equipment	193	-1.3%	4.4%
Rubber and plastic products	176	-1.9%	7.6%
Computer, electronic and optical products	156	-0.8%	2.8%
Basic pharmaceutical products	133	-0.2%	1.0%
Basic metals and metal products	89	-12.4%	27.7%
Machinery and equipment	87	-4.6%	14.0%
Other manufacturing and repair	81	-15.3%	25.5%
Chemicals and chemical products	81	-1.1%	7.2%
Textiles, wearing apparel and leather	70	-3.7%	6.6%
Electrical equipment	65	-1.7%	4.9%
Wood and paper products and printing	63	-10.7%	23.1%
Coke and refined petroleum products	1	-11.5%	238.9%
Manufacturing	1,938	-2.9%	6.9%

Source: ONS

Whatever the outcome, the potential impact of industrial de-rating would be likely to affect the competiveness of Northern

Ireland's manufacturing sector by increasing by reducing capacity to make the kinds of investments needed to keep pace. It would be likely to negatively impact on the investment decisions of firms currently operating in Northern Ireland, as well as on incentives for potential investors from abroad.

As we have seen, this is in a context where the overall cost base in manufacturing in Northern Ireland is already rising faster than manufacturers in the UK and across the globe—driven by rising employment costs, Brexit and in a situation where the cost of purchasing intermediate goods, services and materials is rising at twice the pace as the UK as a whole.

Unless firms find other avenues to absorb the cost, this will reduce the productive capacity and competitiveness of the sector. Indeed, the decision by Michelin to close its plant in Ballymena specifically cited high energy costs as a factor, while Bombardier stated that it's looking to optimise its cost base by going to lower cost countries.

In such a context any further uncertainty or threats to the cost base—including those stemming from public policy decisions—would seem likely to delay or discourage the major investment required to replace depreciating stock and the purchase of new technology that is necessary to retain sector's international position and its scope to support wider economic output. Ultimately, reduced competitiveness of the sector puts at risk the thousands of jobs and livelihoods that the manufacturing sector supports in communities across the region.

Summary

- The cost of doing business in NI is growing faster than the rest of the UK, Ireland and globally.
- The cost of Brexit will disproportionately fall on local manufacturing firms – up to 10%, over £500m.
- 38% of firms surveyed said they were shifting production out of NI and the UK – this is not the time to give them additional reasons to move jobs.
- Business rates are growing 3x faster than the rest of the UK without some of the policy benefits available elsewhere in the UK.
- No revenue raising options will make any significant difference to the budgetary challenges being faced.
- Only public-sector reform – delivering effective and efficient services – can have a positive impact.
- With profit margins usual ranging from 1% in agri-food to 10%, any increase to rates costs would jeopardise the sustainability of some firms.

MNI believe that it is important that given Brexit, our cost competitiveness challenge and the decline in jobs from the public sector that policies and investments in the budget are focussed on creating the conditions which secure jobs and allow firms to grow.

We are happy for this response to be published.

Manufacturing NI
26 January 2018