The BOW GROUP

# The Enterprise Nation?
# Developing Northern Ireland into an Enterprise Zone

**By**

**Ross Carroll**

***with a foreword by Lord Trimble***

**Ross Carroll**

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Ross has researched and written a number of previous papers on healthcare and industry issues - often co-authoring with his brother Stuart - and has a keen interest in matters relating to business and enterprise.

Ross is a frequent visitor to Northern Ireland. His wife is from Northern Ireland and he holds a long-standing interest in matters relating to the province.

**The Rt. Hon. David Trimble, Lord Trimble of Lisnagarvey**

David Trimble was the first First Minister of Northern Ireland (1998 – 2002) and was leader of the Ulster Unionist Party from 1995 - 2005. David served the Upper Bann constituency as MP for fifteen years (1990 – 2005) and was a member of the Northern Ireland Assembly from 1998 to 2007.

In 2006 he was elevated to a peerage, becoming Lord Trimble of Lisnagarvey, where he sat in the House of Lords as a Crossbench peer, and then as a Conservative Peer from 2007 to the present date.

Along with John Hume, David was awarded the Nobel Peace Prize in 1998 following the making of the historic Belfast Agreement on 10 April 1998 (Good Friday Agreement).

# FOREWORD
# By The Rt. Hon. The Lord Trimble

Ross Carroll is to be congratulated on this very interesting overview of the Northern Ireland economy. Its starting point is the regrettable fact that the public sector accounts for over 75% of Northern Ireland's GDP. It is no consolation that the gap with the UK figure may have been reduced somewhat of late as Gordon Brown's enormous increase in spending has brought the public sector share of the UK economy to 52%!

Northern Ireland is not the only UK region to have a high reliance on the public sector and all these regions should have noted from George Osborne that one of the objectives of a Conservative government will be to see the private sector increase in each region. Consequently Owen Paterson, Northern Ireland Shadow Secretary of State, has suggested that all of Northern Ireland should be designated as an enterprise zone, in order to assist the growth of the private sector. At the same time the public sector must be considered. Nearly ten years ago Mark Durkan and I launched the reinvestment and reform initiative as well as needs and effectiveness evaluations of certain services as a way of launching an overhaul of Northern Ireland's public sector which had been by-passed by both Thatcherism and New Labour's attempts at public sector reform. Reading this paper reminded me that since the Northern Ireland Assembly and Executive which we headed was suspended in October 2002 there has been absolutely no progress on these matters.

Ross Carroll focuses on corporation tax, education and skills and transport infrastructure. A lower rate of corporation tax has been the constant call from Northern Ireland business circles for ages and I shall consider it in a moment, but education and skills are as, if not more, important. It is very good to encourage investment, but the businesses created need employees with the requisite skills. In the Republic of Ireland an appropriate focus on skills preceded the rise of the "Celtic Tiger".

Having a rate of corporation tax in Northern Ireland close to the Republic of Ireland's 12.5%, and so much lower than the 28% rate elsewhere in the UK, faces two major hurdles. The first concerns the EU's state aid rules. Ross has a good, balanced discussion of this issue and tends to the conclusion that it would require the reshaping of our relationship with the EU. The recently published *Case for a Reduced Rate of Corporation Tax in Northern Ireland* by the Northern Ireland Economic Reform Group is more sanguine, but it would be a brave commentator that would make a firm prediction of what the European Commission or the European Court of Justice would do.

I would prefer to focus on the second hurdle, namely the perfectly understandable political reaction that would come from other regions in the UK, some of which are less well off than Northern Ireland, and all of whom have lower per capita levels of public expenditure. I do not think any British government could ignore that reaction.

So I would suggest a different route. The Conservatives are proposing consolidating corporation tax on a single rate of 25%. We are coming out of a recession. Recovery will be faster if we can promote higher growth. Taking this tax to below 20% should catch the eye of international investors and the likely higher yield could pay for the cut in short order.  And as has been remarked the tax cut will cost less if done when business is depressed.

**David Trimble**

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## Executive Summary

- At the Conservative Party conference in October 2009 Owen Paterson MP, Conservative Shadow Secretary of State for Northern Ireland, announced that should the Conservative Party win the next general election they would look to develop Northern Ireland into a private sector economic ‘enterprise zone’. This paper looks to examine some of the challenges confronting the Northern Irish economy that have precipitated this policy announcement, whilst considering some aspects of what an ‘enterprise zone’ may look like in practice.

- The reasons for this policy announcement - designed principally to develop the Northern Irish private sector economy - are multi-faceted. The well documented troubles Northern Ireland has experienced over a number of decades has resulted in economic disruption, leading the province to become heavily dependent on subvention from Westminster, whilst public sector spending accounts for as much as 77.6% of the Northern Irish economy. This is unsustainable in the long-term as we enter an era of retrenchment in public spending. It has also been postulated that economic development can play a role in minimising social and sectarian disruption.

- Average salaries in the public sector are higher than in the private sector, with private sector salaries the lowest across the UK. Northern Ireland has high levels of adults without any qualifications, whilst the number of economically inactive adults is critically high. Business start-up rates in the province are modest and levels of young entrepreneurs are lower than the UK or Republic of Ireland average, indicative of an economy not currently primed to promote innovation and entrepreneurship.

- Northern Ireland is afflicted by a ‘brain drain’ of talented A-Level and University undergraduates leaving the province with many never returning to the Northern Irish workplace. In addition to this, enrolments in value added Science, Technology, Engineering and Mathematics (STEM) subjects are declining, with STEM subjects not prioritised in Northern Ireland to the same degree as in the UK or Republic of Ireland. These subjects are vital for attracting Foreign Direct Investment (FDI) in critical business sectors. Northern Ireland should look to develop its levels FDI from the USA whilst also capitalising on opportunities present in emerging markets.

- The UK government has paid attention to some of these issues, principally in the form of two reports published by Sir David Varney in 2007 and 2008 respectively. However, many of the recommendations made, such as reducing regulation where possible and privatising publically owned assets where appropriate have not been enacted. The contentious issue of a lower preferential rate of corporation tax for the province – rejected by Varney in 2007 - to stimulate FDI and wider private sector growth may need to be revisited, not least given the drastically changed economic landscape since 2007/2008. However, European Union legislation and past precedent may continue to pose problems in this area.

- Lessons can be applied to Northern Ireland from the great success of the 'Celtic Tiger' years in The Republic of Ireland, where a flexible, open economy responsible for attracting impressive levels of FDI has been developed through a long-term approach to economic development. Understanding this is critical given that Northern Ireland shares a border with The Irish Republic, and as such will be in competition for investment with its nearest neighbour. However, when developing a Northern Irish 'enterprise zone', policy makers should also be cognisant of the factors involved in the decline of the 'Celtic Tiger'.

- This paper considers three key topics – corporation tax, education and skills, and transport infrastructure - which present either challenges or issues of contention specific to the development of the Northern Irish economy. As part of this, and the wider research of this paper, leading politicians and economists in Northern Ireland were consulted to gain expert insights in these key areas – and others – that an 'enterprise zone' would need to consider for sustainable growth and development to be realised.

- Experts in the financial services, information technology and pharmaceutical sectors – three value-added sectors that any 'enterprise zone' would wish to boast a substantive presence in – were also consulted. The issues confronting small, indigenous business and entrepreneurs – particularly in the growing green technology sector – have been discussed with insights gained from entrepreneurs in this field. Recommendations have been made based on the insights gleaned from politicians, economists, "big business" and smaller scale entrepreneurs, along with a wider analysis of the challenges faced in the Northern Irish economy.

## 1.0 - Introduction

At the Conservative Party conference in October 2009 Owen Paterson MP, Conservative Shadow Secretary of State for Northern Ireland, announced that should the Conservative Party win the next general election they would look to develop Northern Ireland into a private sector economic ‘enterprise zone’. Mr. Paterson stated:

*‘We need a 25-year programme to increase the size of the private sector and steadily bring down dependence on public spending. We are looking at a whole range of measures for turning Northern Ireland into an enterprise zone. There was a study that I saw recently that said the state represents 77.6 per cent of the GDP of Northern Ireland. That is completely unsustainable in the long-term. It would be irresponsible to do nothing.’*[1]

Sir Reg Empey, Leader of The Ulster Unionist Party - the Northern Irish party that has formed an electoral alliance with the Conservative Party - raised this prospect earlier that year, stating in *The Guardian* in February 2009:

*‘What we have agreed is that all of Northern Ireland will be designated as an enterprise zone'* [2]

The desire and rationale for this policy announcement is multi-faceted. The size of the public sector in Northern Ireland is significantly above that of the UK average, whilst as Mr Paterson noted in his conference speech, some reports place this as high as ***77.6%***[3,4]. In an era of public spending cuts, this renders the Northern Irish economy highly vulnerable in future years. To highlight the size of this figure, a report by the Centre for Business and Economic Research estimates that government budget expenditure as a share of GDP in Cuba – an ideologically communist state - is expected to fall to 60% in 2010/2011.[5] In addition to this, wages in the public sector in Northern Ireland are significantly higher than in the private sector, with Northern Ireland private sector wages the lowest across the UK.[6] This has had the effect of making the private sector appear less desirable for skilled workers to enter and has acted as an inhibitor of private sector development. As long ago as 2005, opinion existed publically within the Labour government that Northern Ireland’s economy was unsustainable, with then Secretary of State for Northern Ireland Peter Hain MP quoted as saying that the economy in Northern Ireland was ‘not sustainable in the long term’[7] whilst a *Sunday Times* feature by Alan Ruddock stated that the province was ‘addicted to subvention’[8], detailing the structural deficiencies within this economy.

Northern Ireland is not the only part of the UK that would benefit from economic development however, with regions such as the North East of England and Wales also lagging behind the UK national average on various indices of economic performance. So how does Northern Ireland fare relative to these other under-developed regions of the UK? The public sector as a percentage of the economy in Northern Ireland is higher than that of Wales and the North East, whilst average private sector wages in these regions are higher than Northern Ireland. Levels of entrepreneurship – a key indicator of a vibrant and dynamic private sector economy – are low in Northern Ireland, with the province containing proportionately half the number of young entrepreneurs relative to the UK average or The Republic of Ireland (RoI)[8]. The percentage of economically active adults with no qualifications in Northern Ireland is significantly higher than the North East and Wales[6] - presenting issues regarding workforce skills - whilst the levels of economic inactivity are also higher in Northern Ireland than the North East and Wales.[9] Finally, business start-up and development rates in Northern Ireland also lag behind Wales[9] indicating that there is scope for the province to become a more attractive location for private sector businesses.

In addition to the above-mentioned economic factors, unique to Northern Ireland relative to the other UK regions mentioned in comparison is the fact that the province has suffered from decades of well documented troubles, which has held its economy back and prevented the full potential of the economy from being maximised. It has been postulated that social and economic development - yielding jobs, opportunities, prosperity and ultimately hope - can go some way towards minimising the lure of sectarian disruption and paramilitary participation. One such study suggests that – whilst not a cure to eradicate terrorism – social and economic development can weaken local support for terrorist groups and limit recruits to these organisations.[10] The evolution of Northern Ireland into an ‘enterprise zone’ through social and economic development could therefore not only help develop an economy overly reliant on the public sector and subvention from Westminster, but also play its part in the renewal of the peace process and help embed social stability throughout the province. Whilst there is also merit in developing other less prosperous regions of the UK – such as Wales and the North East of England - it is therefore clear that Northern Ireland has a unique combination of social and economic factors that lend logic to Owen Paterson’s ‘enterprise zone’ policy and the attention that the Conservative Party are paying to the province.

It is worth noting at this point that the Labour government has not ignored this issue. In 2007, Gordon Brown commissioned Sir David Vamey to conduct a review of tax policy in Northern Ireland, with a second report – A Review of the Competitiveness of Northern Ireland – published in April 2008. However, much has changed since then, not least a global economic crisis that has seen the UK and The RoI - once famed and envied for its ‘Celtic Tiger’ economy - amongst the worst affected economies in Europe, whilst some have voiced concerns that many of Vamey's conclusions either missed the mark or have not been taken up to an adequate degree.

This paper therefore provides an overview of the Northern Ireland economy in 2010 – the year of a general election - to assess the changes that have occurred since the two Varney Reports were published in 2007 and 2008 respectively. This paper has sought the expert opinion and insight of leading politicians from the island of Ireland, economists, businesses and entrepreneurs. This paper does not intend to be an exhaustive and all-encompassing analysis of the Northern Ireland economy, but aims to offer some insights into the current challenges facing the Northern Ireland economy; to analyse what has occurred since the Varney reports were published over three years ago and two years ago respectively; and to provide some recommendations on how a prospective Conservative government may be able to achieve their aspiration of developing Northern Ireland into an ‘enterprise zone’. Whilst mindful of the current state of public finances and the wider economic backdrop, these recommendations are primarily made with exclusive focus on the action required to achieve an optimal Northern Irish ‘enterprise zone’ moving forward.

This paper will therefore broadly follow three sections:

1) Background and logic for Northern Ireland to develop into an ‘enterprise zone’
2) Expert opinion from politicians, economists and business
3) Analysis of three key issues affecting economic competitiveness

## 2.0 – Logic for an ‘enterprise zone’

### 2.1 - Background and Challenges

Northern Ireland has suffered well-documented historical troubles over a number of decades and this has in turn impacted heavily upon the Northern Irish economy. **Former Taoiseach Bertie Ahern TD** - Ireland's second longest serving Taoiseach, incumbent during The ‘Celtic Tiger’ economy (see section 3.0) and key player in The Northern Irish peace process - told this paper in a telephone interview: *‘During the troubles, Northern Ireland's economy really suffered. Their best graduates left .... lost to the economy. The Troubles really were devastating to economy over years. You have to understand that they lost decades of economic opportunity.* ‘

Reaffirming former Taoiseach Ahern's point, research has shown that foreign business was deterred from investing in Northern Ireland between the 1970's and 1990's, whilst the disruption this caused between 1983 and 2000 is estimated to have cost 27,000 jobs and & £225m in lost economic output.[11,12] Whilst the social disruption and instability caused by the troubles presented too great a risk for foreign owned business to invest *en masse* in Northern Ireland, local business also suffered. Areas of the economy such as tourism have also been hit, with Northern Ireland boasting 40% of all out of state visitors to the island of Ireland before the troubles, a figure that currently stands at just 20%.[6]

It is therefore clear that the troubles were a significant causal factor in preventing the Northern Irish economy from realising its full potential. It is evident from former Taoiseach Ahern's words that any return to the worst levels of the disruption seen in past decades would catastrophically hinder future economic development. However, in recent years, relative peace and stability has been witnessed and with this a degree of growth and progression has been apparent in the economy of the province. Gross Value Added (GVA)[†] - an indicator of wealth creation - has grown more quickly in Northern Ireland

**[†] GVA is a measure in economics of the value of goods and services produced in an area or sector of an economy. GVA is linked as a measurement to Gross Domestic Product (GDP), as both are measures of output. The relationship is defined as: GVA + taxes on products - subsidies on products = GDP**

than the rest of the UK since 1989.[13] The continued economic growth and development in Northern Ireland is perhaps more important than in any other region of the UK, as if jobs, opportunities and prosperity are embedded in the province, there is the hope that people may reject any lure paramilitary organisations or sectarian disruption may hold.

However, despite the impressive GVA figures quoted above, the Northern Irish economy still faces some sizeable and unique challenges. Northern Ireland GVA is still around 20% lower than the UK average, and in recent years the growth in GVA has slowed. Northern Ireland's public sector is over-bearing, with two thirds of Northern Ireland's gross domestic product (GDP) accounted for by the public sector[6]. Indeed, Shadow Secretary of State for Northern Ireland Owen Paterson MP has referred to a figure as high as 77.6%, a figure which includes governmental subsidy from the British government. As mentioned in the introduction of this paper, both figures compare unfavourably to the level of state expenditure as a proportion of GDP not just to the UK average, but also to communist Cuba, and this reality will present Northern Ireland with significant challenges in the future as we face the realisation of an era of constrained public spending. In addition to this, public sector wages have been reported to be around 20% higher than private sector wages, with the public sector employing over one quarter of all workers, compared with one fifth in the rest of the UK.[9] This consequently has the affect of stifling the private sector as disproportionate numbers of graduates enter the public sector. Regarding existing private enterprise, fewer businesses in Northern Ireland employ greater than 500 people in proportional terms relative to the UK average, with 90% of Northern Ireland's private sector firms employing 10 people or less.[6] Additionally, the number of young entrepreneurs in Northern Ireland is proportionately half the number in the RoI or the wider UK, one marker indicative of a private sectors ability to promote innovation.[8]

From an education perspective, a ‘brain drain’ is apparent. A third of A-Level students leave the province to study overseas, with 75% never returning to Northern Ireland[13,14], whilst declining enrolments in science, technology, engineering and mathematics (STEM) subjects are causing concerns over whether the workforce has the necessary skills to drive investment and innovation in value added areas of the economy, with STEM subjects critical in attracting Foreign Direct Investment (FDI) and subsequent private sector growth.[15] A Department of Education Report from September 2009 reaffirms this, and states that STEM subjects have not been as high on the policy agenda as in other parts of the UK or the RoI.[15] Northern Ireland has more people of working age without qualifications than any other UK region. Furthermore, Northern Ireland has the highest proportion of households claiming incapacity benefit with 29% of the working age population not economically active[6] - the highest in the UK - which again raises questions about the skills and flexibility of the labour force.

Geography presents another, unique challenge. Northern Ireland is the only part of the UK not to border another UK region. The border with the RoI presents taxation challenges as the RoI has a corporation tax rate of 12.5%, in contrast to - and in competition with - the main UK corporation tax rate of 28%.

The prevention of sectarian disruption and paramilitary precipitation is a final factor in favour of developing the Northern Irish economy into an ‘enterprise zone’. One study suggests that – whilst not a cure to eradicate terrorism – social and economic development can weaken local support for terrorist groups and limit recruits to these organisations.[10] **Shaun Bailey, Conservative Prospective Parliamentary Candidate for Hammersmith and co-founder of My Generation** - a charity set up to address the social problems that affect young people and their families, including anti-social behaviour, drug use, crime, educational underachievement and unemployment – was consulted by this paper. When asked about the impact economic and social development can have on limiting anti-social behaviour and social disruption, and if this is applicable to the Northern Irish context given the divisive nature of sectarianism over the years, Mr. Bailey said: *‘Whilst there are unique factors to every area, economic and social development is always applicable as it always about people. If you develop the economy you tend to develop people. It provides opportunities and enables people to express themselves. People are then busier and have more options in their lives – they become the master of their own universe. People then tend to have more to lose…they have something to protect and build for their lives in the future. Whether it is Northern Ireland or elsewhere, trouble comes when people have no hope or options.’*

It is therefore clear that despite the economic advancements the peace process has helped to deliver to date, further development and restructuring is required to make Northern Ireland's economy truly competitive on a sustainable basis in a globalised marketplace, and to abate its dependence on public-sector subvention from Westminster. In turn, it is the assertion of this paper that continued advancements in the economic prospects of the province and its people may be able to play at least some role in augmenting the societal developments that have occurred during the peace process.

### 2.2 - Past Attention to the Northern Ireland Economy: The Varney Reports

In 2007, Gordon Brown commissioned Sir David Vamey to conduct a review of tax policy in Northern Ireland. Varney explored how tax policy, including the tax changes announced in the Budget 2007, could support the sustainable growth of businesses and long-term investment in Northern Ireland. A widely discussed and highly contentious issue in this paper was whether a lower rate of corporation tax could be implemented specific to Northern Ireland. A second report by Varney – *Review of the Competitiveness of Northern Ireland* – was then published in April 2008. In this report, Varney explored the range of challenges and opportunities confronting Northern Ireland regarding the competitiveness of the economy. More specific aspects of these reports will be focussed on throughout this paper.

Whilst it was clear that some policies called for by certain groups that submitted to the Varney processes were ruled out – such as a preferential rate of corporation tax (see section 6.1) – this paper asked senior economists[‡] whether the affirmative recommendations from the Varney reports have been taken up since their publication. One economist commented that: *‘Varney made many sensible recommendations – such*

[‡] A number of the economists consulted could not be officially quoted given the nature of their position of employment.

*as privatising vehicle testing, transferring public transport to private sector and action on the massive social housing programme which is displacing private provision - but very few have been enacted, mainly for political reasons. There doesn't seem to be a political will to follow these issues up.'*

Another senior economist questioned some of the actual conclusions themselves, particularly from the 2007 report, querying their ability to emulate the type of economic growth enjoyed in the RoI during The 'Celtic Tiger' years: *'Sir David Varney stated at the time the (initial) report was originally released in 2007 that he thought Northern Ireland could potentially emulate the economic success of the Republic. However in the absence of high profile initiatives similar to those adopted in the RoI it is quite difficult to see how this may be realised. A step change in economic development with a fundamental change in the operating environment, such as much wider enterprise initiatives or tax incentives would need to be actioned to realise this vision.'* A final economist suggested that Gordon Brown as Chancellor had a closed mind to a different rate of corporation tax from the outset, and that the first Varney Report was written from this closed premise.

It seems clear from these insights from leading economists in Northern Ireland that there would be scope for a prospective Conservative administration to work in partnership with the Northern Irish Executive to further implement the appropriate recommendations made by Sir David Varney, whilst revisiting some of the more contentious conclusions, particularly given the economic landscape has drastically changed since 2007.

**2.3 – Scope for Privatisation**

As already highlighted, privatisation was one issue raised at the time of the Varney reports. The second report – in April 2008 – recommended that the Northern Ireland Executive should seriously consider privatising its larger public corporations, such as bus, railways and water, along with other areas such as public car parks, the Driver and Vehicle Agency, ownership of the housing stock and Belfast Port.[9] It is clear from the insights gained by this paper that few of these recommendations have actually been enacted.

It would seem clear that in an economy with a public sector magnitude that 'crowds out' the private sector, those operations that could reasonably be transferred to the private sector should take place as a matter of priority. This is of importance to Northern Ireland for two reasons: Firstly, areas such as the water and sewerage system that are retained in public sector have implications for the Barnett formula funding arrangements, public finance which could otherwise be spent elsewhere in the economy. Secondly, The Office of National Statistics (ONS) has reported that the average UK public-sector worker's productivity has dropped over the last decade, with output in 2007 3.2% lower than in 1998. In contrast, the private sector productivity rose 22.8% over the same period.[16] This difference in productivity between the two sectors is striking. Given the preponderance of the public sector, Northern Ireland may face a 'perfect storm' of chronically decreasing productivity in an era of constrained public spending if action is not taken.

**Northern Irish Finance Minister Sammy Wilson MP MLA** told us that: *'You have to look at what is in the public sector that could be done adequately and appropriately in private sector. This would increase private sector jobs plus productivity. There is lots of entrepreneurial spirit in Northern Ireland, so this would help those entrepreneurs.'*

### 2.4 – Regulation

Regulation is a key area that can help or hinder economic development. This is very much dependent upon whether the correct levels of regulation are in place. **Bertie Ahern TD** told us that: *'In general as little regulation as appropriate must be beneficial, as anything that helps make business function is a good thing.'*

In the 2008 Varney Report, it was recommended that the Northern Ireland Executive keep the regulatory burdens on Northern Ireland businesses to a minimum, working where appropriate with the UK Government.[9] This appears to be a sensible argument designed to enable business to function as smoothly as possible. However, **Sammy Wilson MP MLA** told us that there is still scope for improving the burden of Northern Ireland controlled 'red tape' and that there is perhaps a culture of interpreting the regulations too stringently: *'There is plenty of scope in Northern Ireland regarding Red Tape reduction. Look at the planning laws for example. There is probably scope for the Northern Ireland environmental agency to speed up processes. There may also need to be a change in culture regarding interpretation and working to – but more flexibly within - certain regulations.'*

Entrepreneur **Irene McGee, Managing Director of Arttoo,** a green technology company (see section 4.5) also told this paper that the Department of Enterprise, Trade and Investment (DETI) have a consultation paper proposing 40% renewable energy by 2020, but that the planning regulations can sometimes slow down necessary processes: *'The DETI have a consultation released which proposes 40% renewable energy by 2020. This is more than enough and Northern Ireland can reach these targets if the planning service increases its speed in dealing with applications. Perhaps there should be policies which deal with the speed of the planning service. This would allow the green jobs to come faster and thicker.'*

**Conall McDevitt MLA –** the Social Democratic and Labour Party (SDLP) Northern Ireland Assembly member for Belfast South – suggested that there is a role for regulation to be reduced, but as part of a simultaneous corporation tax reduction, telling this paper: '*The key perceived barrier to inward investment is the differential tax rate. Regulation should be reviewed alongside a lower rate but not as an alternative to one.'*

### 2.5 - Post-Varney Developments

The major point of difference between when Varney was involved in taking submissions, holding consultations and ultimately presenting his recommendations is the global economic downturn, or 'Credit Crunch'. Indeed, **Victor Hewitt, Head of The Economic Research Institute of Northern Ireland (ERINI)** told this paper: *'The recession is the big thing that has come about since the Varney reports. This will have public expenditure fallout. The UK national debt is currently unsustainable. Tackling this will likely have* *repercussions through the Barnett formula. There is also an opportunity however, as it provides a chance to look at how we go about our business.'*

The hugely changed economic landscape is of major importance for a multitude reasons, although one specific point of focus relates to an issue made on page 29 of Varney's report on tax competition. In this report, Varney stated the following;

*'.....Thirdly, the marketplace in global Foreign Direct Investment (FDI) is not shrinking. If it were, this could imply greater merit in tax-cutting strategy to attract taxable income from other countries. Rather, forecasts indicate that between 2007 and 2010 global FDI flows are projected to grow at an average annual rate of around 4.8 per cent.* '

In other words, Varney was making FDI projections at a time of economic growth and before the global economy unravelled. His words suggest that there may be merit in a tax cutting strategy where FDI is contracting in order to help attract investment in a more competitive environment. This paper asked **Mr. Stephen Endacott, Investment Analyst at City Hedge Fund Centaurus Capital** for figures on FDI in 2009. Mr. Endacott said: *'FDI is predicted to fall by as much as 47% this year according to figures from The United Nations. Corporate profits have fallen and share prices have dipped in the credit crunch. Equally, because of the economic landscape, there is a diminished appetite - and ability to pay - for goods and services, which further causes companies to scale back their investment plans.'* The UN report cited by Mr. Endacott puts the figure for FDI in 2009 at $900 billion, down from $1.7 trillion in 2008.[17]

It could therefore be argued that with the "credit crunch" – and the reduced levels of FDI - a corporation tax cut for Northern Ireland should undergo fresh review. As mentioned in section 2.1, Northern Ireland faces a geographical challenge with regards to corporation tax given its border with the RoI, which has a corporation tax rate of 12.5%. This is discussed further in section 6.1. **Victor Hewitt** told this paper *'Forgetting for a moment the EU complexities of implementing a rate of corporation tax specific to Northern Ireland (see section 6.4), if you want to do something on corporation tax, now is the time to do it as due to the recession tax receipts are relatively low anyway, and so the disruption would be, in relative terms, minimal.* '

## Summary and Recommendations

- The logic for developing the Northern Irish economy as an 'enterprise zone' is a sound one, based on a multitude of considerations. An over-reliance on Westminster subvention and public sector spending is apparent in the economy, with average wages lower in the private sector relative to the public sector. Northern Ireland has problems with workforce skills and inactivity whilst declining enrolments in value added STEM subjects is cause for concern. It has also been postulated that if economic and social development can be embedded in the province, societal stability may be enhanced.

- Varney seems to have made numerous sensible suggestions regarding privatisation. The recommendations outlined in his 2008 report should be revisited and acted upon in earnest where not already implemented.
- The Northern Irish Executive should review operations that currently reside in the public sector, assess those which could reasonably be performed in the private sector and commit to a phased transfer of activity. Conversely, private or independent sector organisations should be invited to pitch to deliver public services in a drive to increase competition and resultant productivity.
- The Northern Ireland Executive should also look to minimise regulation where possible, and should work in partnership with the UK government to identify reserved powers that, if modified, could produce marked improvements in the functioning of the Northern Irish private sector.
- Corporation Tax is discussed further in section 6.1.

## 3.0 – Lessons from the 'Celtic Tiger' years

It is important at this stage to have a brief look at the economy of the RoI. The reasons for this are twofold. Firstly, Northern Ireland shares a border with the RoI, and thus it is important to have some understanding of how the economy south of the border has developed, and what competitive advantages it may hold. Secondly, whilst the RoI economy has recently faced a severe downturn, and come in for criticism from some quarters, it is important to understand the factors that triggered the impressive levels of growth and private sector investment and development recorded during the 'Celtic Tiger' period. Indeed, in his 2007 report, Varney stated:

***'There is much that the UK Government and the Northern Ireland Executive can learn from the success of the "Celtic Tiger" economy.'***[6]

In addition to the positive aspects of this period in the RoI economy, some of the key factors involved in the decline of the 'Celtic Tiger' will also be discussed.

### 3.1 - The Tiger "at a glance"

'The Celtic Tiger' is a term used to describe the rapid period of economic growth in the RoI between 1995 and 2007. As mentioned, whilst recently – along with other major economies globally - the RoI economy has faced a severe downturn, during the period of 1995-2007 the economy of the RoI was marvelled at internationally, and analysed extensively by economists and policy-makers alike because of its sustained and high levels of growth.

**Mr. Michael Carroll, a senior pharmaceutical industry consultant** with over 35 years of experience with numerous global pharmaceutical companies, told us the following about the RoI success story: *'In short, Ireland had a coherent business plan or road map, which joined up ministries and linked together areas such as education, transport, infrastructure and so on as part of the same vision. Financially, their tax system is competitive, with a 12.5% corporation tax rate conducive to FDI, whilst attractive R&D tax credits and employment and capital grants on entry to Ireland are available. Training* *incentives and productivity improvement initiatives are also visible to aid development whilst the education system is closely aligned to industry needs. Ireland is nearly 10% above the EU average for science graduates. One final comment I would make is that the Industrial Development Agency (IDA - see below) markets the benefits of locating in Ireland extremely well, whilst there is a culture of flexibility that assesses businesses on a case-by-case basis in order to attract or retain business accordingly.'*

Additionally, Mr. Carroll highlighted parallels with Singapore (see section 7.2), another country with a small population that has developed an impressive economy based upon the investment in skills, infrastructure, long-term planning and action in the tax system designed to attract investment.

It is beyond the scope of this paper to conduct an in-depth analysis of the Singaporean economy or the factors that contributed to the RoI experiencing such impressive levels of growth during the 'Celtic Tiger' years. It is nevertheless worth briefly summarising some of the key positive factors that were involved in the 'Celtic Tiger' in order to examine whether there are any lessons to be gleaned for Northern Ireland as a prospective 'enterprise zone'.

- **Long-Term Planning**
  Before analysing sub-sections of the RoI economy, it is important to state that the levels of growth achieved during the 'Celtic Tiger' years were not just stumbled upon during the life cycle of one or two parliaments. A large number of decisions and policies were taken over a period of decades that culminated with the 'Celtic Tiger' in 1995. Serendipity also played its part, as a number of factors combined – not necessarily all through judgement – to help create conditions ripe for rapid and sustained growth. However, one example from **Mr. Michael Carroll** effectively highlights this point. *'RoI has 6 strategically located biopharmaceutical sites all ready with outline planning permission, consents and ready water supplies. This negates issues with environmental planning and thereby expedites site occupancy.'* This long range approach could circumnavigate the issues **Mr. Sammy Wilson MP MLA** raised about the slow approach of the Northern Ireland Environmental Agency in section 2.4. Long-term planning is something Mr. Paterson has been at pains to stress regarding the timescales of economic development in Northern Ireland.

- **Deregulation**
  Deregulation is a good example of long-term planning in the RoI. One such example can be drawn from as far back as the 1950s. Before the middle of the 1950s, the Irish Free State – the precursor to the RoI – followed policies than were inward looking, with a ban on majority foreign ownership in the industrial sector. This led to a situation of economic stagnation. From the mid-1950s, things began to change, with restrictions on foreign ownership phased out and export-derived profits made tax-free for a 15-year period .[18] These policies were designed to attract FDI into Ireland by making the landscape as attractive as possible for business. Similar policies were pursued to attract investment over the subsequent decades.

- **Corporation Tax**

The corporation tax rate of 12.5% in the RoI is particularly low relative to many other developed nations, and is often credited as being one of the main drivers behind the 'Celtic Tiger' phenomenon. This paper will later discuss the RoI's ability to attract US FDI through its low corporation tax rate and its importance - in the view of Finance Minister Brian Lenihan TD - to the RoI's growth throughout the 'Celtic Tiger' boom (see section 6.2). Indeed, despite the RoI's current economic difficulties, which has seen Lenihan deliver one of the most austere Irish budgets seen in recent memory in December 2009, the corporation tax rate has remained at 12.5%. As with the deregulation policies, it is important to note that this low corporation tax rate was part of a long-term strategy.

- **Grants and Tax Credits**

The RoI - often through the IDA (see below) – offered investors generous grants and tax credits. For example, the Irish and US governments agreed to allow US companies to gain credits on higher taxes paid elsewhere and then use this to offset charges that could be made against the lower RoI tax rate.[19] This policy offered an attractive basis for exports, and subsequently large levels of US capital was attracted. These policies not only offered lower taxes on activity within Ireland, but allowed profit 'shifting' into Ireland via transfer pricing, allowing multinationals to reduce their global tax liabilities.[20]

- **The Industrial Development Authority (IDA)**

The IDA was established in the 1950s with the aim of attracting and developing foreign investment, including R&D. The IDA often provided subsidies for companies, including capital grants and training. In addition to its core roles, the IDA has also played an important role when considering education and skills, advising Regional Technical Colleagues (RTCs - see below) to focus on investing in the subjects large multinationals required from its workforce.[18] This subsequently helped the IDA and the RoI as a whole to fulfil its promises on delivery to foreign investors.

- **EU Funds**

Given the need to develop large sectors of the economy and thereby qualifying for significant EU structural funds, there is little question the RoI has benefitted from EU membership. However, the RoI used these funds well and invested in infrastructure that enabled productivity to increase, and with this, the overall attractiveness of the RoI to overseas businesses. From the spending programme of 1994 to 1999, roughly 10% was spent on income support, 25% on the private sector in the form of investment aid, 30% on skills, and 35% to physical infrastructure. The latter was designed to offset the significant adverse effects that high transport costs have on the competitiveness of Irish business.

- **Technology Infrastructure**

The Irish telecommunications system was once a highly unreliable, inefficient, government run department that triggered complaints *en masse* from foreign investors. This was modified into Telecom Eireann in the 1980's and run by a leading businessman before being eventually privatised. These factors improved business practice led the Irish telecoms system from being one of Europe's worst to one of its best. The IDA (see above) played a key role in informing and convincing government of the need to upgrade the telecommunication system in order to retain businesses that had invested in Ireland, and to attract new FDI.[18]

- **Education and Skills**

Throughout the 1980's, increased resource went towards developing Regional Technical Colleagues (RTCs) and universities, with an emphasis on STEM subjects required by foreign companies investing in Ireland. By the early 1990's the Irish labour force had high levels of young, educated graduates in technical disciplines desired by foreign multinationals. It has a broad science strategy for 2006 – 2013 addressing STEM subjects as the artery of this and in 2003 launched a National Integrated Awareness Programme with a €5m budget and dedicated team of 8 people to drive an awareness campaign to increase the number of STEM graduates.[15]

- **Labour**

As the Irish economy had remained under-developed for numerous decades, the Irish had a large pool of low wage workers, with wages often amongst the lowest in Europe.[19] In addition, high birth rates meant that the age of the working population was relatively youthful. Investment in education and the aforementioned focus on technical skills such as IT meant that the RoI had a young, low wage, technically skilled workforce to present to businesses looking to invest in Ireland.

- **'Backing a Winner'**

In a nation known for its love of horse racing, the concept of backing a winner is well known. That is exactly what the RoI did when the government extended the 10% corporation tax rate, which helped the establishment of The International Financial Services Centre in Dublin. Whilst major problems have since materialised in the global financial sector, with numerous lessons to be learned from this, at the time this created a thriving sector and a critical mass of jobs.

- **Spending**

Perhaps pertinent to the present day UK and RoI, throughout the 1980s the government struggled with large budget deficits, high unemployment, increasing migration and international concerns over its creditworthiness. The 1987 minority government delivered substantial spending cuts. This helped improve the nation's finances, enabling the RoI to project an image of stability and restore investor confidence overseas.[18]

- **The Peace Process**

Highly and intrinsically relevant to Northern Ireland, the peace process that was started by Sir John Major and Albert Reynolds and then further developed by Tony Blair, Bertie Ahern, Lord David Trimble and John Hume – culminating in the momentous Good Friday Agreement – led to a mood of relative optimism on the island of Ireland, and enabled the RoI to project an image of stability. This in turn reassured overseas business and investors. It is critical therefore that the peace process continues to supplant violence and with greater economic prospects, a positive cycle of stability can develop.

**3.2 – 'Celtic Tiger' decline**

Whilst it is vital for Northern Ireland to understand the key factors responsible for growth in the RoI during this period, it is worth noting some of the issues that contributed to the downfall of the 'Celtic Tiger':

- The RoI experienced a major property bubble that eventually burst in 2008, leading to large price drops.
- In addition to this, the RoI had what Ernst & Young have described as a "massive reliance" on the construction industry, with 1 in 7 people working in this sector at the height of the economic boom compared with 1 in 15 in the UK.[21]
- Rising wages, inflation and increased public spending with concurrent income tax cuts - said to be excessive and imprudent by some - also dampened the competitiveness of the Irish economy. These internal economic imbalances have subsequently unravelled[22, 23.]
- Whilst FDI specifically from the USA (see section 6.2) has greatly benefitted the RoI economy, a relative over-reliance on this - as opposed to a more diverse global FDI portfolio - predicates that the RoI recovery will to some degree be intertwined with economic fortunes in America.

However, whilst the RoI is currently experiencing severe economic hardship, Ernst & Young have predicted that its relatively small, open economy could enable a more impressive recovery than Northern Ireland or the wider UK in the medium term. Ernst & Young's *Economic Eye* report from May 2009 suggested that export deterioration in the RoI appears modest relative to domestic consumer and investment contraction and that firms located in the RoI still benefit from the same tax advantages now as they did during the 'Celtic Tiger' boom years, alongside a strong education system and much improved infrastructure.[21]This forecast also confirmed that whilst the RoI's low corporation tax regime and strength of reputation in the export services sector will be critical to successful economic recovery, tempering recent cost pressures and negotiating more realistic wage agreements will be also key to restoring lost competitiveness.[21]

**3.3 – Celtic Tiger: Summary**

In summary, it is clear that there are wide ranging lessons that Northern Ireland can learn from the Celtic Tiger years, which could be applied to the development of its private sector economy:

- The RoI employed a strong macroeconomic policy and prudent fiscal policy over several years prior to it the eventual demise of the 'Celtic Tiger'.
- A strong and successful economic and industrial strategy was at the heart of this approach - a low level of corporation tax and favourable incentives were vital to attracting FDI, aided by a capable inward investment agency.

- Public spending policy was geared to reinforce economic objectives that would aid FDI and development, particularly in education, skills and innovation policy. Yet when necessary public spending was severely restrained to stabilise the economy. Indeed, this has occurred again recently in the 2009 Irish budget, where Brian Lenihan TD announced major cuts in capital expenditure, benefits and public sector pay in a bid to stabilise the economy.
- The favourable impact of the peace process across the island of Ireland helped deliver real and perceived stability, which in turn the enabled the RoI to maximise FDI and the use of EU funds..
- During the sharp decline of the 'Celtic Tiger', the RoI struggled with a housing boom, rising wages, inflation, increased public spending levels relative to tax take and huge levels of employment in one industry – construction. Conservative and Northern Irish policy-makers should be as cognisant of the issues that have exacerbated the recession in the RoI as the factors that triggered the initial 'Celtic Tiger' growth when developing practical policies for Northern Irish economic development.
- Whilst FDI from the USA has stimulated the RoI economy over the years, the relative lack of diversity of this FDI links the RoI recovery to fortunes in America.

There are many factors that can be drawn from this analysis that could be implemented by the Stormont Executive to aid the development of the Northern Irish economy:

- Long-term planning and a clear strategic vision should be in evidence, and is something that can be initiated by Stormont. Northern Ireland should look at the benefits yielded by the RoI throughout the 'Celtic Tiger' years in taking this approach.
- Appropriate deregulation, education & skills, infrastructure and further enhancing the functional abilities of development agencies such as Invest Northern Ireland (Invest NI) are also all areas that the devolved Northern Irish assembly have the powers and remit to act over.
- It would be for a prospective Conservative government in Westminster however to consider the wider ramifications of preferential action for Northern Ireland within the corporation tax system (see section 6).
- It would also be for a Conservative government to consider a UK-wide reduction in corporation tax. Whilst this wouldn't specifically and preferentially aid Northern Ireland, it would nevertheless improve the current attractiveness of the province as a place for business to invest in.

## 4.0 – Expert Opinion: Political; Economic; and Business

### 4.1 - The Political Opinion

When canvassing political opinion in Northern Ireland about the merits of an 'enterprise zone', this paper looked to focus on the opinion of prominent members of the major political parties in the current Stormont power sharing executive. The Ulster Unionist Party (UUP) was not consulted given their electoral alliance with the Conservative Party, who this paper is primarily designed to inform. A number of members of The Democratic Unionist Party (DUP) provided input into this paper as did **SDLP MLA Conall McDevitt**. Sinn Fein were unable to respond, perhaps due to the understandable prioritisation of their engagement in the extensive talks over devolution of policing and justice powers which occurred during this papers ‘consultative period’. Opinion was also received from **former Taoiseach Bertie Ahern TD** given Mr. Ahern's rich experience from the peace process and the economic success the RoI enjoyed during The ‘Celtic Tiger’ Years.

**A Special Advisor to First Minister Peter Robinson MP MLA,** told this paper that the DUP - the largest party in the Stormont power sharing executive - broadly welcomed the Conservative Party proposal to develop Northern Ireland into an enterprise zone, stating: *‘The* DUP *says yes to the announcement and is supportive of it, but there is of course some concern about the precise details of this proposal at this stage. We need to see more detail before we can fully comment on this. ‘*

**Jeffrey Donaldson MP MLA** of the **DUP** reaffirmed the view of the Special Advisor to Mr. Robinson, stating: *‘Whilst I believe that this proposal has much merit, I have yet to see specific details emerging in relation to how a Conservative Government would hope to implement the idea of Northern Ireland becoming an enterprise zone. As such, it is difficult to be specific in making comments in relation to this proposal. I do feel though that such an initiative must include special tax or grant funding incentives for businesses that would hope to locate in Northern Ireland. This would help us to compete with our neighbours in the Irish Republic and would make Northern Ireland a very attractive location for investment. ‘*

**Conall McDevitt MLA** echoed Mr. Donaldson’s comments about favourable rates of taxation for businesses looking to invest in Northern Ireland, whilst also mentioning that tax incentives should be considered in other areas such as tourism, a sector ravaged by the troubles (see section 2.1). Mr. McDevitt stated: ‘*The key perceived barrier to inward investment is the differential tax rate…it should be harmonized with the Republic of Ireland. Other tax incentives for capital investment should be considered, particularly in the tourism sector.”*

### Summary and Recommendations

- It would appear from the insights received from Northern Irish politicians that there is merit in the idea of developing the Northern Irish economy into an ‘enterprise zone’. However, this was tapered with caution regarding what the precise details of an ‘enterprise zone’ would look like in practice.
- Should a Conservative government be elected after the 2010 General Election, they should look to engage with all parties in the Northern Irish Executive – including those unable to provide insights during the consultative phase of this paper – to detail the key aspects involved in implementing an ‘enterprise zone’ policy in order to build consensus and foster partnership.

**4.2 - The Economic Opinion**

In addition to consulting leading politicians for their views on the Conservatives 'enterprise zone' aspiration, we also consulted a number of senior economists that work in various positions throughout Northern Ireland (also see section 2.2)

**4.2.1 - Challenges**

As mentioned above in section 3.1, corporation tax (discussed further in section 6.1) is something that was integral to the 'Celtic Tiger' growth in the RoI, and something several politicians have called for in Northern Ireland in order to improve competitiveness. However, it seemed clear from all the economists we consulted that it would be difficult to offer corporation tax breaks specific to Northern Ireland under EU competition rules (see section 6.4) without the cost of this being borne by the province. Furthermore, concerns were raised about the financial cost to The Treasury through lower corporation tax receipts received in Northern Ireland. It is also possible to see a "political cost" resulting, with other UK regions in need of investment 'crying foul' at Northern Ireland's preferential attention in economic development policy. It was also highlighted that inefficiencies can occur as a result of 'enterprise zones' through displacement of activity and deadweight costs. It was the view of one senior economist that constructing an attractive FDI package would be best focussed on offering state-of-the-art infrastructure (transport, telecoms, energy, etc) and a well qualified skills package at low cost.

It was further acknowledged that should a preferential corporation tax rate be implemented for Northern Ireland, companies may seek to relocate activities to Northern Ireland in order to 'wash through' profits at a lower rate of tax than elsewhere in the UK. The transfer pricing mechanisms put in place would likely seek to maximize profits in Northern Ireland, and whilst this may lead to an increase in tax revenue generated in Northern Ireland, there would be a net loss to The Treasury overall, which may discourage Westminster based political parties from this policy, particularly in times of severely constrained public finances. Equally, even if new companies did relocate to Northern Ireland, there is the potential risk that they may simply to do so to 'repatriate profits'. The transfer pricing regime would likely not benefit Northern Ireland to the same extent as occurred in the RoI as many of the other taxes that are generated will accrue to The Treasury (for example, PAYE and VAT) rather than stay within Northern Ireland. The final point here would be that whilst companies look to move profits to Northern Ireland to exploit the lower corporation tax burden, there may not be an actual or substantive employment spin-off to accompany this. It is from this perspective that Northern Ireland based political parties may be more sceptical of the benefits of such a taxation policy.

Another challenge highlighted was EU structural funding. Northern Ireland *did* qualify for EU Objective One status – those regions most in need of EU structural funding. However, Northern Ireland no longer qualifies for this assistance with other laggard areas of the EU deemed more in need of such funds. More pressingly, Selective Financial Assistance (SFA) is the most significant programme Invest NI uses to support businesses, yet changes to EU regional aid rules means that from as early as January 2011 Northern

Ireland will have considerably less scope to support firms using SFA, with aid ceilings expected to reduce further, potentially to zero, post 2013.[24] To make matters more complex, even within Northern Ireland there are rates that apply to the Belfast area and rates that apply elsewhere in the province.

A final issue relates to tax credits. Whilst there were some differences of opinion on their usefulness amongst the economists consulted in the research of this paper, there seemed to be agreement that there is a lack of awareness of existing UK wide schemes, with companies perhaps having a preference for grants. **Victor Hewitt, Head of ERINI** , told us that: *'Tax credits are good for inducing behavioural changes and help to achieve more of something, for example R&D. But it does take time for effects to be fully seen too. They are not great in themselves at influencing location decisions however.'* It is also worth highlighting **Bertie Ahern's** view, given his experience of this in the RoI economy. He told this paper: *'There is an argument for tax credits. I brought one in five years ago for investment assistance and infrastructure and it proved to be beneficial for R&D. It attracted inward investment, particularly with multinationals, and was liked by American companies.'* However, **Mr. Conall McDevitt MLA** struck a note of caution, intimating that the success of tax credits can be variable: '*Tax credits have a chequered record and have to date been of limited positive effect. A drop in the headline rate has proven much more effective and strengthens the entire business chain.'* (see section 6.1 for corporation tax)

It would appear as though tax credits do have some role in attracting overseas inwards investment. By nature, inward investment projects involve internationally mobile capital that tends to go where the best return can be made. Often, FDI projects are what were described to this paper as 'modular in nature'. For example, this essentially means that a region may secure a small project that delivers 50 employment opportunities, but if this then proves to be successful, it may be possible to attract follow on investment of several hundred heads. Attracting these projects by way of grant incentives helps capture the initial investments,  but in order to retain them some form of follow on assistance – for example R&D tax credits - is necessary to enable the development of key skills and capacity. Once these key skills have been embedded, there is a greater chance that investments will be maintained without further support. This is what was described as the 'sustainability argument', and the economists we spoke with had many examples whereby further significant investment has been secured in this way.

### 4.2.2 - Opportunities:

Despite the abovementioned potential difficulties an 'enterprise zone' may face in areas of taxation described, it was made clear to this paper that there are a number of opportunities available to Northern Ireland. It was even suggested by a number of economists that if there was any inclination to implement a preferential corporation tax rate for Northern Ireland, now would be the time to do so given the deterioration of the national fiscal position and the lower levels of revenue raised via corporation tax in this climate, as the effects would be less acutely felt.

Whilst there was some difference in opinion about the importance of tax credits, it seems clear that there is an opportunity to promote the range of tax credits, grants and allowances available to companies more prominently.

All of the economists we spoke with believed that there was scope for 'Northern Ireland - determined' regulation (as opposed to preferential changes in UK regulation) to be eased, mirroring comments made by **Finance Minister Sammy Wilson MP MLA** (see section 2.4). This could include easing planning approvals, making Invest NI assistance approvals easier, and setting aside equality / environment / locational preconditions and assessments.

It was also agreed that action on STEM subjects in the education system was possible, and indeed logical, in order to enhance the prospects of a labour force equipped with the skills required by innovative private sector companies (see section 7.0). In addition, the scope for privatisation of certain services was also mentioned as something that could be achieved within reason.

From the insight gained from the economists this paper consulted with, it seems that if the Northern Irish economy is to develop into a vibrant, knowledge based economy built upon strong skill sets, then the economy and wider environment has to be business friendly and must be conducive to encouraging external inward investment, whilst promoting entrepreneurship from indigenous companies. This can be developed through offering the right type of grants, tax credits and investment incentives to enable companies to initially invest, and then grow that investment in the future. As part of this, a skilled work force tailored to the company's requirements is essential.

### Summary and Recommendations

- The economists who were consulted in this process highlighted corporation tax as a key issue, but one that is highly contentious. This is further discussed in section 6.1. However, a number of contributors did suggest that should a favourable rate of corporation tax for Northern Ireland be considered, the current economic backdrop would present as good a time as any to enact this.
- Promotion of tax credits and grant incentives available in Northern Ireland should be optimised so that businesses and investors are fully aware of the range of benefits available. A Conservative government, in partnership with the Northern Irish Executive, could review the current effectiveness of the benefits currently available to ensure Northern Ireland is able to present as effective a value proposition as possible to prospective investors.
- Reducing regulation where appropriate is something that the Northern Irish Executive should look to adopt in earnest where applicable.
- Education & Skills are discussed in section 7.0.

### 4.3 - The Business View

Although it is important to glean the invaluable insight of politicians and economists on the types of policies required to develop the Northern Ireland into a true 'enterprise zone', it is also vital that those businesses that are in a position to invest in a certain location have their investment criteria properly understood. This paper therefore received insight from individuals working for leading companies and organisations in three innovative industries that any 'enterprise zone' would wish to have a significant presence in:

- Finance Services
- Information Technology
- Pharmaceuticals

#### 4.3.1 - The Financial Services Sector

Despite receiving almost universal bad press in recent times due to the fall out from the 'credit crunch', the financial services sector remains an important part of the UK economy. An Ernst & Young report from May 2009 suggests that financial services account for 10% of the UK economy[25] – a proportionally larger figure than the US or larger Eurozone countries – whilst average pay for workers in this sector is above the national average.[26] It has also been estimated that the UK financial services sector employs 1.3 million people and generates 15% of the corporation tax collected by the government.[27] Indeed, Northern Ireland already has a presence in the financial services sector. Global banks and insurance firms including Citi, Liberty Mutual, and The Allstate Corporation have Northern Irish operations, whilst NYSE Euronext (NYX) recently announced plans to expand the business operations of its NYSE Technologies division in Belfast, creating up to 400 new jobs.[28]

However, in his recent pre-budget report, the Chancellor of the Exchequer announced a special tax on 'bankers' bonuses' whilst reaffirming his commitment to a 50% upper rate of income tax. This has led to numerous people in the financial services industry suggesting they may now quit the UK due to prohibitive levels of taxation and regulation.[29] Indeed, one hedge fund and one City trading firm told this paper that they are actively considering relocating to Switzerland because of these policies, with the latter likely to relocate in the winter of 2010. Whilst it may be true that the 50% upper rate of income tax would affect less people in Northern Ireland than the UK as a whole in relative terms – especially the south east of England – if Northern Ireland has serious aspirations of attracting large scale jobs in financial services to the province, this rate of tax could become prohibitive, as it seemingly already has in London.

The UK government therefore has a role to play here in protecting the future competitiveness of what is clearly a key sector of the UK economy. Whilst the public are still incensed at the actions of certain banks, and public finances remain in a parlous state, Shadow Chancellor George Osborne MP should consider the wisdom of increasing the tax burden in this sector, and in the wider UK economy, in order to avoid a mass exodus of financial services sector jobs overseas.

This paper spoke with **The Head of Northern Ireland for a global commercial bank,** to get a perspective on the financial services sector in Northern Ireland specifically. Some of the positive attributes that Northern Ireland can offer the financial services sector were mentioned including the relatively low rate of office rents, the high quality of IT and communications infrastructure, whilst the proximity to the larger financial centres of London, Dublin and Edinburgh was highlighted as an opportunity that currently exists for Belfast. On taxation policy, we were told: *'To attract the high value activities as opposed to the back office staff and call centre jobs that in part already exist here, you need tax relief and lower tax rates in general. Dublin did this. You may need to ring fence an area such as financial services and provide incentives to attract investment in this particular area. Perhaps the single biggest thing you could do to stimulate investment is action on corporation tax rate.'*

Also raised was the state of education and skills in this sector: *'There are not high levels of financial services graduates. However, the Dublin market is saturated so there are perhaps less opportunities for people there than before, and if jobs were created in Northern Ireland you could perhaps recruit people from there. I am also sure you could recruit a proportion of people originally from Northern Ireland who are in London or elsewhere that would wish to return if the right level of job was available for them. There are also low numbers of IT graduates too which is concerning, and the Government should innovate around STEM subjects to develop this situation.'*

This same expert also provided his thoughts on the transport infrastructure. He suggested that the trains from Belfast to Dublin could perhaps run quicker than is currently the case and highlighted the fact that there is no direct flight path from Belfast to London City airport, which would markedly increase the efficiency of staff from Northern Ireland reaching Canary Wharf or City headquarters (section 8.0)

### 4.3.2 - Information Technology

The second industry this paper gained insight from was information technology. This paper approached **Google** for insights, given their huge level of global users and brand recognition, and the innovative nature of the business they run. **Sarah Hunter, Head of UK Public Policy,** told us how Google actually have their European headquarters based in Dublin - as many other global companies do - and described how corporation tax and accessibility are issues of prime importance to Google when looking to locate an operation somewhere. Ms. Hunter mentioned that a significant number of Google staff work a number of weeks or months of the year in offices outside of their affiliate headquarters, meaning that transport links are essential, particularly to the US. Equally, telecommunications infrastructure is vital, especially for a company such as Google.

Northern Ireland is able to compete favourably on this latter point, being the first region in Europe to have 100% access to broadband internet.[6]

Another area of importance for Google is education and skills, especially in the engineering and technology disciplines. Ms. Hunter stated: *'Clearly Stanford University is historically and emotionally important to Google (the university where Sergey Brin and Larry Page studied) and many of our best engineers still come from here. However, there is not a 'UK Stanford university' and so perhaps there is an opportunity for Northern Ireland and its universities to study best practice from here and develop their existing universities along these lines.'* It is clear that if – in the opinion of a market leader such as Google – no UK University meets the standards or qualities of Stanford University, there is an opportunity to evolve universities to ensure a steady supply of highly skilled engineers and technology graduates with 'Google required' traits. This would then increase the likelihood that technology companies may consider Northern Ireland as an increasingly attractive place to invest.

A secondary point that was made relates to how the UK lags behind the US in relation to venture capital available for small start up technology firms. Whilst a Northern Irish enterprise zone would want to attract investment from highly successful and innovation companies such as Google, it should also seek to create a climate whereby the 'next Google' could be conceived. Ms. Hunter told this paper how technology start ups depend upon venture capital, and referred to the Governments UK Innovation Investment Fund (UKIIF). Here, the Department for Business, Innovation & Skills (BIS) have committed funds of £150m to increase the supply of venture capital in areas such as digital technology. Whilst this is a UK wide scheme, Northern Ireland should look to advance the implications of this scheme to its indigenous population of entrepreneurs, as well as the wider cost effectiveness arguments for locating in Northern Ireland.

A final point of importance to companies such as Google is the investment location from a social point of view. Ms. Hunter stated: *'Employees obviously work for us but have social lives too. Many people at Google are under thirty, with many of them wanting to live in a place that is vibrant and has plenty to offer them socially. London is a 'trendy' city with plenty to do for example, so good employees are happy to locate themselves there. You also need to consider the quality of housing, transport system for their commute, flexibility of employment conditions when considering visa's and so forth.'* This final point is interesting, as most of the arguments gathered by this paper have been technically based. However, if high calibre workers with skills required by major companies are unlikely to remain in a location long-term due to its inability to meet the requirements of their social lives, a large turnover of staff to competitor companies in more opportune locations is likely (see section 5.0)

### 4.3.3 - The Pharmaceutical Industry

The third industry this paper gained insight from was the pharmaceutical industry. In particular, the **Association of British Pharmaceutical Industry (ABPI)** was initially consulted**.** The pharmaceutical and life sciences industry is a multi-billion dollar global industry that is devoted to the research, development and marketing of innovative new medications and vaccines that help improve patient healthcare in a number of medical conditions and disease states. In the UK, the pharmaceutical sector is a high value added sector, responsible in 2007 for a balance of trade surplus of over £4bn and employment of 73,000 people directly.[30] The 2007 Varney Report acknowledged that pharmaceutical investment in the RoI had proven to be an outstanding success.[6] Indeed, many of the worlds top pharmaceutical companies now have some form of presence in the RoI. The industry in Ireland now employs 50,000 people and exports over €42 billion - making Ireland the largest net exporter of pharmaceuticals in the world – with 18 of the world's top 20 companies having a substantial presence in Ireland.[31]

There are a number of reasons why the RoI has developed to become an attractive place for pharmaceutical companies to invest in (see section 3.1). A 2007 report by KPMG placed the RoI as one of the most attractive locations in Europe for business from a corporate tax perspective, with a low corporation tax rate, ease of interpretation of tax legislation and a reluctance to constantly change tax legislation and directives all cited as important aspects that make the RoI attractive for investment.[32] Favourable R&D tax credits have also been made available to companies, whilst a remission in corporation tax and Capital Gains Tax for companies in their first three years of operation with certain limits have also been made available to investors over the years. Tax agreements to mitigate 'double taxation' with other countries have also helped encourage inward investment and business presence. In addition, the RoI can boast a world-class research base, a highly evolved technology transfer and clinical infrastructure, a buoyant venture capital community, and an internationally renowned regulatory environment.

This paper spoke with **Dr. Richard Barker, Director-General of the ABPI,** to gain expert insight into what are the factors that drive investment decisions for pharmaceutical companies. Dr. Barker referred to a major report commissioned in 2007 which had input from a multitude of senior leaders within the pharmaceutical industry. The key drivers that determined investment decisions were[33]:

- **History:** New investments need to have synergy with existing assets and operations
- **Stability:** Political, tax, bureaucracy, regulation & flexible labour stability all key
- **Education & Skills:** For R&D, a good supply of scientists - and access to world leading scientists - is vital, requiring an education system geared towards science
- **Labour cost:** Cost and labour flexibility especially important for manufacturing
- **Infrastructure:** For regional offices, attractive locations with good transport links
- **Tax:** Once quality as above established, costs will dominate, especially in areas such as manufacturing

This paper also consulted **Dr Rick Greville, Director of ABPI Wales & Northern Ireland** and **Chris Brinsmead, Chairman of AstraZeneca Pharmaceuticals UK and**

**Chair of UKTI Life Science Marketing Board.** Both individuals referred to the recent Office of Life Science (OLS) Blueprint, launched by the government in July 2009. **Dr. Greville** stated: *'I don't think the asks from industry would be any different in Northern Ireland from those issues raised within the OLS Blueprint. Northern Ireland may develop advantages if they can deliver any of the solutions faster or to an improved level compared to the rest of the UK. When we met with Invest NI recently we charged them to highlight specific centres of excellence in Northern Ireland in relation to the issues raised within the OLS Blueprint.'* **Mr. Brinsmead** concurred: *'The OLS blueprint describes a range of measures designed to make the UK attractive. These are not specific to England and equally apply to Northern Ireland.'*

The measures in the OLS blueprint include proposals on education and collaborative working across sectors in order to improve the quality and skills of science graduates, and to boost the profile of life sciences in the UK. The blueprint also reaffirms the availability of funds – through the governments UK Investment Innovation Fund (see section 4.3.2 – Google) – to life sciences organisations, and has laid the foundations for the government's 'patent box' announcement in the pre-budget report 2009 that will enable profits derived from UK patents to be taxed at 10%.[34]

In addition to the OLS blueprint, Northern Ireland has its own specific science industry panel called MATRIX. In 2008 MATRIX released their first report[§] that mirrors many of the key points raised in the OLS blueprint and the abovementioned NERA report Dr. Barker referred this paper to. These key issues included the need to capitalise on global opportunities, join up business, academia and government, optimise regulation to promote innovation and to develop STEM subjects, recognised by MATRIX as being of huge importance to the economy (see section 7.0).

**Mr. Brinsmead** was positive that Northern Ireland could develop into an enterprise zone, but warned that work and leadership would be required: *'I was in Belfast this week and think that Northern Ireland has some very real opportunities given the size of population, the low movement and some real centres of excellence. Northern Ireland could become an enterprise zone but it would need clear leadership and government support.'*

## Summary & Recommendations

- From the business sectors consulted, the areas of tax, infrastructure and education & skills were raised as issues of importance.
- Whilst action in areas such as labour costs is difficult in an era of global competition with lower cost economies, Northern Ireland can develop policies in areas such as education & skills (see section 7.0 for recommendations) and infrastructure, whilst promoting tax incentives available in Northern Ireland in order to further publicise its attractiveness as a location for companies to invest in.

[§] www.matrix-ni.org

- Further analysis and subsequent recommendations on these three areas will follow in the latter half of this paper. It would seem however that if the development of the economy in Northern Ireland can play its part in renewing the peace process, as postulated by some, then further stability will also follow. This will provide potential investors with the long-term confidence required to develop a lasting presence in the province.
- From the perspective of the UK government, the Conservative Party should be mindful of the impact that high levels of tax and regulation can have on investment decisions. Two financial services companies told this paper that they are actively considering relocating from the UK due to prohibitive levels of taxation, and they are unlikely to be in isolation.
- This paper would support the recommendation from the 2008 Varney Report around the need for agencies and trade bodies in the UK and Ireland to work together in a coherent manner to attract FDI. Invest NI, UK Trade & Investment (UKTI) and, where appropriate, the IDA would fall into this category, and this paper would support closer working ties between these agencies.
- After the general election, the UK government should also work with the Northern Irish Executive to review whether current levels of venture capital for start-up companies are adequate relative to competitor nations, and how Northern Ireland can optimise the promotion of venture capital available in the province.

The three examples above focus on large, multi-national, multi-billion dollar industries that account for significant parts of a developed economy. However, it is also important to recognise that in any economy – but particularly an enterprise zone – small and medium enterprises (SMEs) must also be allowed to start, develop and grow. This is particularly important in Northern Ireland given that 90% of firms employ 10 people or fewer and two-thirds of businesses are family-owned.[6] In addition to SMEs, entrepreneurs must also be provided with the climate to thrive in an enterprise zone. This paper therefore pays attention to these two areas in the next sections.

### 4.4 - Indigenous Business

A large proportion of businesses in Northern Ireland are small and medium-sized enterprises (SMEs) and Northern Ireland has proportionally more of these relative to the wider UK.[6, 35] The recent Barnett Report (Independent Review of Economic Policy) highlights the importance of integrating local SMEs into the supply chain of multinationals, which appears to be a sensible and clear suggestion. However, SMEs must have the ability to be able to develop their business in a manner that will enable a more efficient integration into larger companies' supply chains. It therefore seems logical to support the recommendations from the Barnett Report that calls for a small business unit within Invest NI to be created, with responsibility for the development and co-ordination of relevant support to SMEs throughout Northern Ireland.[35] This information should be as clear as possible so small businesses understand what help is available to them, with attention paid to the awareness companies have of this.

**Finance Minster Sammy Wilson MP MLA** highlighted the importance of indigenous business in addition to the need to attract FDI, and stated that it is important that these businesses should be able to grow should they wish. He stated: '*It is not just about attracting FDI. You need to develop local business too. There could be a case for bringing in equity finance to aid this. Many businesses are family run and some are reluctant to embrace this as they would lose some control, but it could potentially help open greater markets for them. Invest NI could have greater role in helping them with export markets.'*

A good example of where the UK government could work in partnership with The Northern Irish Executive to aid the development of a slightly larger local business is The Port of Belfast. **Tony Lodge, Chair of The Bow Group Energy & Transport Committee**, told this paper: *'The UK government are looking to fund the development of 3 'Super-ports' within the UK. The Port Of Belfast was rarely considered despite having some great advantages, such as volume of development land available on the foreshore, a wide range of indigenous heavy engineering companies in the port, good Universities and educated labour pool, good port access and good air travel access. The big disadvantage as perceived by both those lobbying and making the decisions is the location (Irish Sea rather than North Sea facing the continent) and political support. It seems that the Government is intent on backing all of the new super-ports being on the UK's East/North Sea coast with possibly one on the south coast. This would be foolish as it would mean none of them would be on or close to the Atlantic so unable to capitalise on rest of the world and Atlantic maritime trade.'*

### Summary and Recommendations

- Barnett's recommendation regarding the creation of a small business unit within Invest NI to coordinate support for SMEs appears sensible and should be enacted with celerity.
- Given the high number of SMEs in Northern Ireland, a Conservative government should aspire to cut the corporation tax rate for small companies, and execute its pledge to reduce the main rate of corporation tax from 28% to 25% across the UK. This should help the wider UK competitiveness, but enable Northern Ireland in particular to strengthen and grow its large pool of SMEs that could then more effectively fit into the supply chain of larger companies.
- The UK government should look to support and promote local business and enterprise in Northern Ireland where it has the capacity to compete for contracts and investment. This would bring private sector opportunities and ultimately play a role in developing the Northern Irish economy.

### 4.5 - The Entrepreneur's View

In addition to the views from individuals from major industries in the private sector, this paper also sought opinion from entrepreneurs. Any fully functioning and sustainable enterprise zone clearly has to provide conditions that enable entrepreneurs and innovation to thrive. However, it has been muted that years of state dependency in the economy has stultified Northern Irish entrepreneurialism, with it lagging far behind the RoI and the UK. This is exemplified by the fact that Northern Ireland has proportionately half the number of young entrepreneurs.[8] This paper received insight from two entrepreneurs based in Northern Ireland and London respectively.

Insight in relation to the issues affecting entrepreneurs in Northern Ireland was sought from **Irene McGee, entrepreneur and Managing Director of Arttoo**, a green technology company specialising in low energy design, and one that has received numerous awards and accolades in the province. Regarding help currently available to entrepreneurs in Northern Ireland, Ms. McGee stated: *"There are already lots of different awards or entrepreneurial schemes in place to help new technology-based business to start. These are mainly through Invest NI. However, they are difficult to win and are quite restrictive in their 'claims' make-up i.e. it takes several months to claim the money. Also, 'match-funding' is required for a seed-corn business generally, therefore if an entrepreneur does not have their own match funding, they need to partner with the right investor to receive the funding. For example, I won an Invest NI SMART Award for £40,000 to research a new technology idea. However, I had to source another £15,000 in order to receive the funding. I didn't have this money, therefore I had to go out and find an investor. Luckily I found a great investor/mentor. I also think that there need to be a more joined up thinking for entrepreneurs. There are different schemes in different places; it's quite sporadic"*

It seemed clear from this discussion that there would be value in some form of 'mentor forum', where entrepreneurs can turn to existing and experienced business leaders for dedicated one-to-one support. Ms. McGee suggested that a 'mentor sponsorship' type of organisation, where entrepreneurs could be matched up to their ideal mentor, could provide value to budding innovators. Whilst currently there is a 'Halo' network of investors run by the Innovation Centre, the effectiveness of this was questioned, as was help for areas outside of technology such - as architects - wishing to set up their own business, or entrepreneurs in the retail sector.

Regarding taxation policy, Ms. McGee commented on corporation tax based on her first hand experience. Ms. McGee stated: *"In my view, corporation tax definitely needs to be reduced to attract more external companies to Northern Ireland. The RoI is only 12.5%. Why would a multi-national invest in Northern Ireland rather than the RoI when the corporation tax is so much less there? All other areas are well developed in Northern Ireland in terms of education, skill and infrastructure. I am in the middle of setting up a new Wind Energy Finance Company. Currently it is registered in Northern Ireland. However, once developed, our intention is to move the company out of Northern Ireland to the RoI, purely for corporation tax reasons."*

This paper also received insights from **Mr. Paul Lewis, CEO of Self Energy UK** - a London based company specialising in the implementation of energy efficiency technologies and decentralised energy generation - to understand what factors would be of interest of an organisation currently located outside of Northern Ireland. Mr. Lewis said that whilst market strength is of primary importance for his organisation, an attractive tax regime is something that could persuade companies – particularly technology based companies – to consider relocating. Mr. Lewis also mentioned the importance of a good supply of skills, highlighting that his organisation is strategically located in close proximity to Southbank University given their expertise in the skills of importance to Self Energy UK. As part of this, Self Energy UK utilises a Knowledge Transfer Partnership (KTP) with London Southbank University. A KTP is a UK-wide programme enabling businesses to improve their competitiveness, productivity and performance through mutually beneficial relationships with leading Universities that have expertise and skills in the areas of interest to a given business. KTPs are part-funded by a Government grant, and can involve projects undertaken by a recently qualified person (called an Associate), recruited to specifically work on a given project. KTPs can vary in length up to 3 years depending on the requirements of the business. Mr. Lewis extolled the value KTPs can provide to businesses and suggested that if Northern Ireland had the best skills in green technology, companies may be more inclined to locate there.

**4.6 - Green Technology**

The area of green technology is a growth market, not least given the current political attention being paid to the issue of climate change. This is potentially another area where Northern Ireland could look to capitalise on entrepreneurial activity through a policy of promoting green technology courses in the education system through preferential tuition fees. Invest NI could also offer dedicated "green grants" to attract credible green start-up companies to Northern Ireland. Northern Ireland should also ensure it is in a position to maximise KTPs as mentioned by Mr. Lewis in section 4.5.

Whilst Northern Ireland should look to capitalise on 'green entrepreneurship' throughout the education system, it should also look to promote existing businesses that offer services in this area. A good example of this involves one of Northern Ireland's most famous and historic companies, Harland and Wolff. Most famous for building the Titanic and HMS Belfast, Harland and Wolff has evolved over the years and in recent times has developed a considerable track record in the build and construction of both wind turbines and marine tidal renewable devices. This is important as a number of wind farms exist in the north Irish Sea and North Channel within Scottish Territorial Waters (12 miles limit), and because of their expertise and location, Harland and Wolff are perfectly placed to support these wind-farms with logistical support and manufacturing.

However, **Tony Lodge - Chair of The Bow Group Energy & Transport Committee** told this paper of an example where the expertise of Harland and Wolff could be utilised to great effect in Scotland, but is currently not being pursued. Mr. Lodge said: *'The devolved Scottish government are contemplating using taxpayer's money to subsidise and develop near redundant ports on the west coast of Scotland to handle these wind-farms in terms of logistics and possibly manufacturing. This is not an effective use of their money as Harland and Wolff can satisfy these demands and lies a mere 45 miles away. A successful, privately run, Northern Irish company with considerable expertise in green technology should be supported and promoted by the UK Government if it is to meet its ambitious carbon reduction and renewable energy targets, whilst utilising the talents of companies across Britain.'*

Regarding Mr. Lodge's point about renewable energy targets, Ms. Irene McGee also told this paper that the DETI have a consultation paper proposing 40% renewable energy by 2020, but that the planning regulations can sometimes slow down necessary processes, which in turn slows down the development of green jobs. As mentioned in section 2.4, regulation is therefore a further issue that The Northern Irish Executive should look to minimise where possible.

**Summary and Recommendations**

- Northern Irish universities should look to encourage a culture of entrepreneurship, particularly with students studying appropriate courses.
- The Northern Irish Executive could encourage a network of "consultants" from the business community to enter universities and at this early stage of a student's development, provide mentorship for budding entrepreneurs in Northern Ireland.
- A robust mentorship network should also be established outside of universities so budding entrepreneurs can receive guidance from seasoned and established professionals in this field.
- The Northern Irish Executive should review whether there is a joined up approach to policy for entrepreneurs in Northern Ireland, and conduct an assessment of whether KTPs are currently optimised.
- An arm of Invest NI could be established to send a quarterly bulletin on what schemes are available to help entrepreneurs in Northern Ireland to all universities, job centre's and appropriate businesses.
- The UK Government, in partnership with the Northern Ireland Executive, should look to more effectively promote and support existing green technology companies and other entrepreneurial organisations in Northern Ireland to improve their ability to compete for business in a global economy. This would help companies to expand, and ultimately aid private sector growth and development.
- The feasibility of offering competitive green grants that would help Northern Ireland establish itself as a location of preference for green technology should be explored. Planning processes and wider regulation should be eased to facilitate business development in green technology.

## 5.0 - Culture and Social Life

As Sarah Hunter of Google highlighted in section 4.3.2, it is important to note that even if investment is attracted to a location through economic and policy levers, high quality staff may still not be attracted or retained if that location's cultural and social activities are under-developed. This is particularly the case in industries that tend to attract young, highly skilled graduates.

Global cities such as London, Paris, New York and Tokyo will attract workers due to the sheer range of opportunities to be found in these metropolises, but other smaller cities of similar size to Belfast can be highlighted as having highly attractive cultural and social features. Whilst unscientific and anecdotal in nature, the Channel 4 'Best and Worst

Places to Live' poll has named Edinburgh as a past winner, as has the www.housetohome.co.uk '10 best places to live in the UK'. Both polls noted its architectural beauty, whilst its culture, restaurants, bars, history and a thriving arts centre were also highlighted as positive features. Another example includes Cardiff. A vibrant nightlife, reasonable house prices and massive redevelopment have transformed Cardiff, with high standard hotels, bars, restaurants and apartments co-existing with arts and crafts galleries, comedy clubs, children's attractions and striking architecture.[36]

We asked **Áine McVerry, Director of Marketing and Development of the Old Museum Arts Centre** in Belfast about Arts and Culture funding in Northern Ireland. Ms. McVerry told this paper: *'The main issue for arts organizations is revenue funding. Northern Ireland needs an additional £26million to place the arts revenue funding here on a par with the rest of the UK and Ireland. Government funding for the arts in Northern Ireland is the lowest in the British Isles at only £6.13 per head. (Scotland £11.93, the RoI £12.61). Years of under investment mean that the Northern Ireland arts sector still faces an uncertain future and will struggle to realise its full potential. We need to move to a situation where the arts have sufficient resources to prosper so Northern Ireland can fully reap the benefits of a strong and confident arts and cultural sector.'*

If Northern Ireland can build upon its unique cultural history with investment in modern social, cultural and artistic projects, it could help improve the overall value proposition presented to prospective overseas investors.

### Summary and Recommendations

- Whilst investment in the arts and culture may not be a major priority of any government given the parlous state of public finances across the UK, the Northern Irish Executive should be mindful that a vibrant social life and cultural component to a city can be important in attracting and retaining highly skilled workers.
- The Northern Ireland Executive should ensure that regulation is eased to create favourable condition for local business people looking to develop social or cultural ventures, with the promotion of equity capital where needed to help these businesses grow and expand.
- The Conservative Party could work with the Northern Ireland Executive and Invest NI to consider innovative solutions that may increase investment in the social and cultural heart of Northern Ireland. Tax benefits for the private sector could be considered if companies engaged in sponsorship of appropriate cultural projects.

## 6.0 - Issue Focus: Corporation Tax; Education & Skills; and Transport Infrastructure

Whilst it is beyond the scope of this paper to scrutinise all aspects of the Northern Ireland economy at the end of 2009 and early 2010, it is clear that the economic climate in this period is markedly different from when Varney released his reports in 2007 and 2008 respectively. After receiving political, economic and business input, this paper scrutinises in further detail the issues of corporation tax, education & skills and transport infrastructure. This paper has focused on these areas given they all presented challenges or raised issues throughout the Varney reports, whilst being raised by the political, economic and business contributors to this paper. As such, they provide areas where progress can be assessed since conclusions outlined by the Varney's reports, and are equally areas of huge importance and prominence for any business when considering investment decision criteria.

**6.1 - Corporation Tax**

One of the major points of contention throughout the Vamey submissions was corporation tax. Varney acknowledged in his 2007 report that he had received numerous submissions urging a reduction in the rate of corporation tax for Northern Ireland, based on the rationale that an equivalent rate of corporation tax would enable Northern Ireland to better compete with the RoI and present an opportunity to mirror their 'Celtic Tiger' success story. Indeed, much of the reports foreword was dedicated to the subject of corporation tax. Vamey acknowledged the work done by ERINI that highlighted the potential benefits of a reduced corporation tax, but countered by questioning whether the academic literature supported the ERINI conclusions. Varney concluded himself by stating *'On the assessment of costs and benefits to The UK, there is not a case for a lower corporation tax rate in Northern Ireland'*[6]

**6.2 - Why is Corporation Tax important?**

Whilst Vamey correctly highlights that corporation tax isn't the sole contributory factor in determining investment decisions, with easy market access, low costs, skills, infrastructure and telecommunications all important, research by Devereux and Lockwood in 2006 found that taxation has an impact on the investment behaviour of US multi-nationals. Specifically, this research suggested that a 10% fall in the effective average corporation tax rate in a host country seeking FDI could increase inward investment by US multinationals by 60% in the short-term.[6]

This is vitally important given that the US currently accounts for about half of all FDI into Northern Ireland.[6] If US corporations were to suddenly deem Northern Ireland - or the UK tax system in general - uncompetitive, huge levels of proportional investment in Northern Ireland would be vulnerable. Furthermore, the RoI also has half of its FDI derived from US investment, but on a much larger scale, as the RoI accounts for around a quarter of all US FDI in The EU.[6, 37] Indeed, during his 2009 budget speech, **Irish Minister for Finance Brian Lenihan TD** told the Dail Eireann:

*'The 12.5% rate of Corporation Tax is an important element in our taxation system. It has been a cornerstone of our industrial development in the last decade I want to emphasise that this rate of tax is not for changing upwards and it will continue to be a central part of Ireland's economic brand. Ireland's economic prospects are dependent on a vibrant and modern business base and I know that virtually all sides of this house will agree with me that our rate of Corporation Tax is essential to this.'*[38]

Given the aforementioned link between tax and US corporate investment behaviour, alongside the clear view of the RoI government about the role that corporation tax has played in their past economic development, a reduced rate of corporation tax in Northern Ireland would clearly help the province become much more competitive at capitalising on US FDI on the island of Ireland. Yet whilst initially protecting, and then subsequently maximising FDI from the USA is critical, a lower corporation tax would also enable Northern Ireland to diversify and develop a strategy to attract FDI from other global regions, such as the BRIC nations and others (see section 7.2). **Mr. Michael Carroll, a senior pharmaceutical industry consultant** concurred regarding the benefits of a lower rate of corporation tax. Mr. Carroll authored a report for One North East looking at pharmaceutical development in the north east of England, and in this report it is stated that: *'Whilst by no means the sole driver, the level of corporation tax remains a very important consideration in FDI decisions.'*[39]

**6.3 - Political opinion on corporation tax**

This paper questioned its contributors on the issue of corporation tax. **A Special Advisor to First Minister Peter Robinson MP MLA** told this paper that: *'The* DUP *made executive submission to the Varney Report. We made recommendations on corporation tax but at that time they didn't find favour with The Treasury. It could be the case that they may not find favour with any party. It may be however that corporation tax is not the 'silver bullet' it was once seen to be with RoI downturn. There are EU issues to this also. There was a judgement made about Portugal and The Azores, where a similar thing was tried. The implication of this for Northern Ireland could be that it can only have a lower rate of corporation tax if this was offset by a loss to some of Northern Ireland's block grant (derived from the Barnett Formula). The subsequent cost of policing this could be high administration wise.'*

**Former Taoiseach Bertie Ahern TD** told this paper that he was also involved during the Varney submissions on behalf of Northern Ireland assembly members. Mr Ahern stated: *'There were and are difficulties with the corporation tax issue. There was some pressure at the time for corporation tax to be lowered but I knew there were numerous difficulties on this, so pressed for other strategic processes. The EU will probably not agree with selective corporation tax.'* Mr. Ahern also mentioned the Portugal and Azores case as an issue when referring to the challenges presented by the EU. However, when considering economic competitiveness, **Conall McDevitt MLA** stated: "*Ideally Northern Ireland should be harmonized with the Republic of Ireland's rate of corporation tax.*"

**Head of the ERINI Victor Hewitt** told this paper that *'The corporation tax issue was resisted at the time by Gordon Brown and The Treasury, but it does not necessarily mean that the issue is dead. Careful reading of the Portugal /Azores case suggests it is possible to lower corporation tax in Northern Ireland but the cost of this has to be borne by the local region i.e. Northern Ireland. Therefore this EU concern is not a fundamental barrier so long as this point is understood. The concern could be more of an administrative issue, as a company will have headquarters where it's convenient, so the* *concern is companies would set up in Northern Ireland causing issues on transfer payments for the Inland Revenue .'*

**6.4 - 'The Azores Case' -Portugal v The European Commission, Case C-88/03**
As can be noted from the expert insight above, the 'Azores Case' is routinely raised as an issue potentially prohibiting a preferential rate of corporation tax (versus the wider UK rate) for Northern Ireland from being granted. It is therefore worth spending a moment to summarize the salient points of this case.

Due to various structural disadvantages that the Azores faced given its remote geographical position, in 1999 its autonomous government adopted rules that would enable the Azores to pay less tax on revenue in order to try and stimulate investment into the region. A year later - after this scheme was already thought to have been enacted - Portugal notified the European commission. After discussions, the commission deemed this to be selective aid and case C-88/03 ensued. From this, three key questions were raised:

1) The taxation decision must have been taken by a regional or local authority which had, from a constitutional point of view, a political and administrative status separate from that of the central government.
2) The decision must have been adopted without the central government being able to directly intervene regarding its content.
3) The financial consequences of a reduction of the tax rate for undertakings in the Azores must not be offset by aid or subsidies from other regions or central government.

Despite the Constitution of the Portugal detailing the Azores as an autonomous region with its own political and administrative status, and its own self-government institutions with the power to exercise their own fiscal competence, the Commission claimed that this case had to be viewed from the context of the state, and not from the regional imperative. In this context, therefore, the Portuguese law that was passed to enable the Azores to adopt a lower rate of taxation on revenue was deemed to infringe European law since the authorization would only benefit the companies of a certain region, and therefore be considered as a state aid.

The European Commission also asserted that the actual autonomy of the Azores was limited, and that the Portuguese State, under the principle of financial solidarity, is in charge of balancing the budget by completing the absence of income that would stem from the rate decrease in the Portuguese insular territory.

The conclusion therefore was that the three conditions of institutional, procedural and economic autonomy have to be fulfilled. The judgment report pointed out that, although in the case of the Azores the first two requisites might have been fulfilled, a real economic autonomy did not exist in the case of the adopted fiscal measurement, since it is the Portuguese State that would finance any decrease of income provoked by the reduction of the rate of tax - evidence of economic dependency. Under these circumstances the community court decided to reject the Portuguese case.

It is notable that the British and Spanish governments supported the Portuguese position, most likely because of the complexities that devolved regions in these countries present, in this context, Northern Ireland. However, as **Victor Hewitt** also told us, it is clear from this case that some commentators believe a reduced rate of corporation tax in Northern Ireland is legal under EU law if power over corporation tax is devolved to the Northern Irish Executive, that the Northern Ireland Executive alone decides on any reduction to the corporation tax rate, and that The Treasury institutes a reduction to the Northern Ireland Executive's Departmental Expenditure Limit, requiring the province alone to face the fiscal consequences of such a policy.

### 6.4.1 - 'We will negotiate the return of powers from the EU'[40]

A central pillar of the Conservatives Party position on Europe is their oft-repeated policy of bringing powers back to Britain from the EU. Indeed, in a speech in May 2009, David Cameron stated:

*'It's no wonder people feel so disillusioned with politics and parliament when they see so many big decisions that affect their lives being made somewhere else. So a progressive reform agenda demands that we redistribute power from the EU to Britain.'*[40]

More recently, in the aftermath of the ratified Lisbon Treaty, The Conservatives have entrenched their position on Europe by suggesting that, if elected, they would:

*'…Introduce a new law, in the form of a United Kingdom Sovereignty Bill, to make it clear that ultimate authority stays in this country, in our Parliament.'*[41]

It seems clear from the comments of the contributors to this paper that should the UK Government wish to grant Northern Ireland a distinct corporation tax rate that would differ from the UK mainland, whilst maintaining current levels of block grant funding to the province, the precedent set by the 'Azores Case' could lead to intervention by the EU.

This paper therefore sought the opinion of legal experts in this area to see what likelihood there is of David Cameron being able to negotiate the return of this power back into the remit of the UK Government. The **Head of Tax at a City law firm** with over 15 offices around the globe commented:

*'The situation with the corporation tax issue is not straightforward. The overarching principle is that all taxpayers are to be treated equally, although this has been modified to some degree in the case of some of the powers devolved to Wales and Scotland. The problem here would be the state aid rules, any modification of which in turn requires approval from Brussels. Amending the corporation tax rules for Northern Ireland based businesses would need Brussels approval. The state aid rules are fundamental to economic integration and so would probably evade any powers Cameron may wish to bring back.'*

## Summary and Recommendations

- It would be the assertion of this paper that a lower rate of corporation tax is generally beneficial and would be of value to Northern Ireland in attracting FDI. This would ultimately aid the development of the private sector in the Northern Irish economy.
- However, it appears that if a prospective Conservative government wished to consider a distinct corporation tax rate for Northern Ireland, David Cameron would either have to devolve corporation tax to Northern Ireland and accept that the costs of this tax rate reduction would be borne by the province, or negotiate with the EU in a way that hasn't been seen in recent years regarding repatriation of powers.
- As the state aid rules are considered fundamental to economic integration, this would probably mean reshaping the UKs relationship with the EU, the consequences of which may be politically difficult and something that despite the rhetoric, a newly formed Conservative government may see as a distraction rather than immediate priority.
- It should be noted that if there is an inclination to implement a preferential rate of corporation tax for Northern Ireland, it may be worth doing this with immediacy, as the current financial situation – and reduced levels of FDI - may lesson its impact. This may provoke challenges from the EU and see some short-term pain for Northern Ireland, but it would provide a long-term platform for private sector development.

## 7.0 - Education, Skills and Workforce

The second area which this paper sees as key to the economic development of Northern Ireland is the education and skills of the Northern Irish workforce. It is clear from scrutinising the factors behind the high levels of growth in the RoI economy (see section 3.1) that education and skills were a key driving factor, and that in general, if a labour force does not have the skills required by companies, investment and jobs are unlikely to follow.

The Varney Reports highlighted strengthening of the skills base, improving levels of economic inactivity and fostering innovation through better partnerships between universities and business as challenges to the Northern Irish economy.[6] The more recent 'Barnett Report'[24] highlighted that it was widely recognised in submissions to this report that skills and innovation were central to enhancing productivity and future prosperity in Northern Ireland. As such, it was noted that Northern Ireland's major attraction would be as a knowledge-based economy with a highly educated and skilled labour force.

Whilst it is acknowledged that improving the skills across the workforce is vital, the Varney Report also mentioned the importance of prioritising STEM skills as a key issue that will support the aim of the above mentioned knowledge-driven economy, based on higher value-added sectors.[6] This section will look primarily at the STEM subjects.

There are low numbers of graduates in the STEM subjects in Northern Ireland, degrees in which are highly sought after by innovative businesses in the financial services, technology and life science sectors (see section 4.3). It is also clear how the RoI economy was able to craft their workforce into having adequate supplies of skills in the STEM subjects. A recent report has suggested that whilst increasing graduates in STEM subjects is a key priority for the Northern Irish Executive – outlined in the Programme for Government (PfG) – the current flow of graduates in STEM subjects is unlikely to hit the necessary targets.[42] The MATRIX report of 2008 - mentioned in section 4.3.3 – also highlights the need to embed STEM subjects as the bedrock of the economy. It appears clear that further action is required to increase the number of calibre STEM graduates.

The issues around STEM subjects in Northern Ireland are a cause for all major parties. Speaking in an assembly motion tabled in 2009 about the concern at the decline in the number of students enrolling in STEM subjects, **Paul Butler MLA of Sinn Fein** stated: *'This is an issue of huge significance for people right across the Six Counties. The Programme for Government made clear commitments in relation to STEM and it is of course an issue of concern that the number of students enrolling in these subjects has declined.'*

As part of the debate on this motion, **Alasdair McDonnell MP MLA of the SDLP** stated: *'We all know that we are in very challenging economic times in which there is a great need to take advantage of every opportunity that arises to rebuild our economy. Foundations for a future high-wage, high-value-added economy must be laid today. If we are to meet the demands and requirements of new technologies and new high-value-added industries, we must plan well in advance. The birth of the Celtic tiger had a lot, if not everything, to do with STEM subjects, because the Irish Republic invested substantial amounts of money in those subjects and in technology colleges. The Celtic tiger's birth was well-planned and did not come about by accident. I would like to see Celtic tiger II being born in the North and producing that sort of economy there. The fact that the Celtic tiger is hibernating does not preclude us from hoping for another round. If we make the appropriate plans, that hope will be well founded. If we are to be successful in attracting foreign direct investment and if we are to grow and sustain indigenous firms, we must be able to compete on a global stage and invest in the STEM subjects; their importance to the economy cannot be overstated.'*

Invest NI told this paper that they would support the promotion of STEM subjects. The economists that were consulted told us that further promotion of STEM subjects could be done very easily by lowering university fees for specific courses in this area, possibly through cross-subsidising through higher fees elsewhere in higher education, or through 'golden hello' incentives to students opting for a STEM course. Equally, action on repayment of student loans at the other end of the degree cycle could form part of the incentives package.

This would not only help prioritise STEM subjects but address the wider 'brain drain' - mentioned in section 2.1 - confronting Northern Ireland. Once STEM subject students have qualified and graduated, it is vital to the Northern Irish economy that these individuals are retained, so that these skills and value are added to the local economy and overall value proposition to attract in FDI. Retention of graduates in the growth sectors of business and financial services, technology and R&D were raised as a concern in the Barnett Report.[24] Longer term, this would be made easier by a healthy supply of jobs and prospects in the private sector, paying competitive salaries. However, it is just as important to 'make a start' and retain graduates in the short term. One economist told this paper that increasing the attractiveness of graduate recruitment schemes could be prioritized. Skills could be identified by a business, financial support could then be given to firms so as to enable them sponsor students through the latter years of their degree and then ultimately employ the graduate for a period of two years, for example, post degree.

**Former Taoiseach Bertie Ahern TD** agreed that something innovative had to be done to retain high quality graduates, particularly in STEM subjects, saying: *'Something imaginative has to be done on education and skills to stop people leaving Northern Ireland. Perhaps more money is needed for those people doing research, or a higher tax allowance. Opportunities in the private sector are limited for graduates due to its size, so incentives to do these courses initially are needed, with incentives towards helping them stay as well. Ultimately, it is not that hard to commit as these people are the future and you don't want to see your future disappear.'*

It is not just jobs that attract graduates to stay. It is also the quality of the culture and social activities available to people in a given location, which is addressed in section 5.0. After all, if graduates feel they have a good job and a competitive salary but have a low quality of life outside of work, they may well be inclined to move.

**Northern Irish Finance Minister Sammy Wilson MP MLA** agreed with the type of incentives to encourage students to study the value added STEM subjects, and suggested that for those already in the work place, government needed to facilitate the ability for business to up-skill their staff, but business themselves need to understand what skills they require and to be proactive.*'Employers must take risks on skills with government there to facilitate this process. Employers are ultimately better placed to know what skills are needed, but need to be proactive and take some managed risks if they want to expand.'* Mr Wilson also mentioned that the Northern Irish government is aware of what skills are required for jobs in certain sectors saying: *'Take financial services. We know what skills are needed, and so we should teach these in schools. In fairness, Arlene Foster is doing some good development work on this.'*

### 7.1 - Emerging Industries: Green Technology

It would also be the assertion of this paper that Northern Ireland looks to develop a significant presence in developing sectors of the economy, such as green technology. It is clear that with global concerns over climate change, this sector is a growth industry. Northern Ireland could look to develop its higher education system to provide excellence in this area for example. Northern Irish universities could look to develop partnership links and exchange programmes for their students with leading global universities in this field. From a policy position, Northern Ireland should look to create an environment conducive to green technology entrepreneurs, start-ups and multi-nationals alike (see section 4.5). This would enable Northern Ireland to get 'ahead of the curve' in a growth area of the global economy, with the possibility of establishing 'green clusters' akin to Silicon Valley in California.

**7.2 – Emerging Markets: BRIC**

The last decade has seen unprecedented growth in emerging markets such as Brazil, Russia, India and China (collectively known as BRIC nations). Growth in large, developing markets presents great potential trade and investment opportunities for other nations. Northern Ireland should ensure that its education system, businesses and Invest NI are 'fit for purpose' with regards to engagement with emerging markets such as the BRIC nations in order to maximize investment opportunities in these areas. An example of this, involving long term planning, can be drawn from Singapore, an economy often held up as one that is successful and forward looking.

Lee Kuan Yew, former Prime Minister, launched a campaign as long ago as 1979 urging Singaporean parents to speak to their children in Mandarin and rather than English, given that English would be spoken in Singaporean schools. He stated: *'China wants to collaborate with us because through English, we are able to connect with the West. At the same time, our Mandarin is fluent enough to communicate with PRC Chinese on different topics and subjects….with Mandarin you can speak to 1,300 million Chinese from all provinces in China.'*[43, 44] In 1980 Mandarin speakers accounted for just 26% of the population but by 1990 this figure had increased to 60%[45], which has increased Singapore's ability to do business with the major Western markets along with the rapidly emerging Chinese economy. Northern Ireland should therefore review its languages programmes in schools and universities to ensure they are congruent with the major emerging economies and their wider plan for attracting FDI, so that Northern Ireland can maximise its FDI potential in these markets relative to its competitors. Invest NI should also ensure it has the requisite knowledge of these markets, along with linguistic capability to ensure effective engagement.

**7.3 – Converting university expertise into economic output**

Following from this, Northern Irish universities – as with wider UK universities – enjoy a good reputation for R&D, but it has been questioned how well this 'know-how' is transferred into tangible economic gains.[6] It is also clear – as mentioned above - that stronger links between academia and business are required, with innovative thinking about ways of engaging the international community and globalised economy necessary.

It was suggested by one economist that alongside universities, research institutes could be established which could offer a form of shares for purchase internationally through auctions. This would grant investors exclusive access to products coming through the university R&D pipelines, with multi-national companies offering the know-how needed to take innovative concepts to market. For a multi-national technology company for example, this would represent in relative terms, a small investment for a reasonable chance of backing a winner. This could then provide direct job links from universities to private sector companies who - if the institute was successful - would likely wish to develop a presence in Northern Ireland.

**7.4 - Innovation outside of STEM**
It is also important to note that innovation should also be promoted outside of the STEM subjects. Whilst there is a key value added benefit to having a workforce skilled in the STEM subject disciplines, it is also important to have industries outside of this area committing to innovation. This is equally applicable to the public sector, where innovation and productivity will be essential in an era of constrained public spending.

A recent publication by The National Endowment for Science Technology and the Arts' (NESTA) showed that two thirds of private-sector productivity growth between 2000 and 2007 was driven by innovation.[46] The report argues that whilst scientific R&D will remain important to the UK's economy in the future, success will also depend on the ability to commercialise and profit from research and ideas and to innovate in the service sector and the creative industries, with organisational innovation also important. An example of this is that whilst it would not surprise many that innovative software firms experienced faster growth than non-innovative ones (13% average revenue growth per year compared to just over zero), innovation in legal services has also yielded impressive growth results, with innovative firms enjoying average revenue growth of over 10%, with non-innovative firms' revenues on average shrinking.[46]

**7.5 – Workforce Incapacity**
As touched upon in the introduction and section 2.1, Northern Ireland also faces challenges of high levels of working age people without qualifications, high levels of economic inactivity and high numbers of incapacity benefit claimants. At their 2009 party conference, the Conservatives detailed extensive plans that would require people claiming incapacity benefits to be assessed as to whether they could have the capacity to perform some form of work. This paper would commend these proposals as a good model for Northern Ireland to follow. In addition, whilst providing and promoting programmes to help economically inactive people improve their skills through services such as the job centre, The Northern Irish Executive could also encourage those out of work to engage in community work. This would enable individuals to gain skills and experiences whilst benefiting the community, and would enhance an individuals CV for future paid employment opportunities. Local Councils could pilots innovative schemes whereby council tax reductions are made to individuals engaged in community work programmes. Policies on incapacity claimants should also be geared towards what an individual is able to do – and thus add to the economy – and not what they are not able to do, with medical assessments utilised where appropriate to gauge this.

## Summary and Recommendations

- It is clear that STEM subjects are recognised by politicians, economists and business alike as vital to the long-term development of the Northern Irish economy, and therefore action is required across the education system to address this issue.
- Investment is therefore necessary, with innovative thinking required to attract students into STEM subjects. This may require lower tuition fees, 'golden hellos' or preferential repayment aid for STEM student loans to encourage students to uptake these vital, value added subjects.
- Collaboration across government departments, Invest NI, universities and business will be required to plan for the development of skills in the education system that are required by industry.
- Northern Ireland should review whether it is effectively geared to capitalize on opportunities for attracting FDI from emerging markets such as the BRIC nations *as well* as vital FDI from the USA. This review should be conducted from the classroom through to Invest NI, and the Northern Ireland Executive itself.
- Development of university ties with business to increase tangible economic outcomes of R&D should be enhanced. This would not only potentially increase the rate at which world class academic research is converted into tangible economic output, but could also foster stronger bonds that could increase job opportunities for graduates, whilst providing a skilled talent pool for employers.
- As part of this, a renewed focus on high quality graduate schemes in the private sector should occur to prevent highly skilled graduates immediately defaulting to the public sector, due to its increased size and higher average salary.
- Commitment to innovation outside of STEM should be encouraged and promoted, including within the public sector, where process and organizational innovation could be improved to produce resultant productivity gains that are vital in the current economic context which requires more from less from public spending.
- A focus on high value added 'emerging industries'- such as green technology and others - should be applied to university courses and skills packages, to enable Northern Ireland to compete in this growth market and get 'ahead of the curve' versus competitors.
- Collaboration of Northern Irish universities with other leading universities across the globe should be actively encouraged to enhance opportunities and expertise for graduates and business alike.
- Northern Ireland desperately need to tackle economic inactivity and should follow the Conservative Party back to work policies. More radical still would be to impose a 'tough love' style policy on job seekers allowance payments so that a finite time is placed on an individual finding a suitable job and thereafter payments are reduced for every job that is declined. Payments could be linked to the willingness of a claimant to 'up-skill' through courses and training, providing a carrot and stick approach.

**8.0 - Transport**

Transport infrastructure is a major factor in determining investment decisions. It can affect a range of essential business necessities from employee attendance, business networks, manufacturing supply chains and distribution outlets. Ernst & Young's annual 'European Attractiveness Survey' is designed to gauge the opinion of international business executives across a range of industries, regions and business models. The 2007 survey placed transport at the top of the list of investment decision criteria, with nearly 55% of respondents in this survey stipulating that this was 'very important' and nearly 90% saying it was either very important or 'of some importance'.[47] As a comparison, in 2006, The Republic of Ireland allocated 38.1% of its investment into transport, whereas Northern Ireland invested just 15.7%.[6] The recent Barnett Report also stated that a number of respondents to that paper had highlighted the need for improvements to physical infrastructure, with transport infrastructure seen as a key factor inhibiting competitiveness.[24]

**Former Taoiseach Bertie Ahern TD** further highlighted the importance of transport infrastructure to this paper**.** Mr. Ahern emphasized his personal belief in the necessity of an 'all-island economy' stating: *'I passionately believe in all-island economy, in partnership with the UK, within the EU, in the framework of a globalised economy. There is enormous potential for growth between Belfast and Dublin, which would benefit Northern Ireland. For example, we built a road from Dublin to Belfast, which increased investment; it attracted Sainsbury's to Newry, which is the biggest in the UK. The greater the cooperation and trade between Dublin and Belfast, North and South, the better. It also helps multinationals as they want an all-island economy; they can't understand the policy differences on such a small island.'*

**Conall McDevitt MLA** used Derry as an example of a Northern Irish city that would benefit from further development in the Northern Irish transport infrastructure, stating: '*There are still major infrastructure issues. For example, Derry remains disconnected in road, rail and energy terms, and this is something that must be addressed.'*

**8.1 - Roads**

Road infrastructure in Northern Ireland was generally felt to be of a reasonable standard by almost all of those who contributed to this paper. Indeed, the above comments by Bertie Ahern give examples of where planning and investment has gone into the road networks, linking Northern Ireland and the RoI together. Indeed, the Investment Strategy for Northern Ireland 2008 – 2018 commits to increasing the capacity of motorway and dual-carriageways, along with link corridors, in order improve overall journey times and improve efficiency.[35]

**8.2 - Trains**

A good example of where Northern Ireland's transport infrastructure lags behind the UK mainland is train links. If we consider the insight from **Bertie Ahern TD** above, regarding the huge potential for growth between Belfast and Dublin and the need to optimize this all-island trade, there appears to be a need to develop the train service from ***Belfast to Dublin*** **–** and wider rail network - thus better connecting the largest economic centres of the island of Ireland. This will be increasingly important as we seemingly move towards an era of 'green taxes' that will have a prohibitive affect on the motorist, whilst an increase in the use of rail over road will enable the Northern Irish Executive meet its carbon reduction commitments. The morning midweek trains from *Belfast to Dublin* – the service that would be used by a typical worker traveling to make a meeting or conference – are just over two hours in time but run at the following frequencies[48]:

6.50am (arrives 9.04am) – 8.00am (10.00am) – 10.35am (12.44pm) – 12.35pm (2.44pm)

The above indicates clearly that if one train is missed for any reason, a lengthy wait ensues before the next train arrives, impacting upon business efficiency and productivity. **The Head of Northern Ireland for a global commercial bank** told this paper: *'Trains from Belfast to Dublin could and probably should be quicker, and his probably needs to be developed. I'm sure this could in theory be taken down to 1 hour 30 minutes travel time and it is true that the trains aren't especially regular.'*

A similar story is apparent in Northern Ireland itself, when considering ***Belfast to Londonderry***[48], the provinces two largest cities:

6.20am (9.00am) – 9.10am (11.14am) – 10.50am (12.53pm) – 12.30pm (2.44pm)

This can be contrasted to the links between ***London and Manchester*** for example. Manchester is considered as an example here due to the journey time from London to Manchester being broadly similar to that of the Belfast to Dublin journey. Along with London, it is also one of the UKs major city economies, as Dublin and Belfast are on the island of Ireland. As of 2007, it was the fastest growing in the UK, with inward investment second only to the capital. [49] In 2007 and 2008 it was rated as the second-best place to do business in the UK[50], and in 2009 was rated third best in the UK and sixteenth in Europe[51], representing over £42 billion of the UK GVA.[52] With an average time of just over two hours, the frequency of train links from London to Manchester are as follows[53]:

6.55am (9.07am) – 7.20am (9.28am) – 7.35am (9.49am) – 8.00am (10.07am)

It is demonstrable from the above that if one train is missed from London, a 25-minute wait is all that ensues before the next service arrives. This will have incalculable benefits to the Manchester-London economy over the Dublin-Belfast or Londonderry-Belfast equivalents. Indeed, with the advent of high speed rail (HSR) the Manchester-London economies will be brought ever closer, as a journey from London to Manchester via HSR will take just over one hour.[54] The story is similar for other major cities on the UK mainland such as Birmingham, Leeds, Liverpool and Newcastle. Indeed, in a piece of research published by The Bow Group in January early 2010 by **Tony Lodge - Chair of The Bow Group Energy & Transport Committee** – and **former Deputy Prime Minister Lord Heseltine** place the value added to the economy through HSR at £63 billion over 60 years.[55]

Indeed, the Conservative Party position on HSR is positive. They state the following, linking the investment in this transport infrastructure directly with jobs:

*'We will build a high-speed rail line connecting London, Birmingham, Manchester and Leeds with the Continent through the Channel Tunnel. This will create jobs across the country with a major boost for the economies of the West Midlands and the north and provide a greener alternative for thousands of car and lorry journeys clogging up some of the busiest motorways in the country.'* [56]

It has been reported that Northern Ireland Railways have admitted that the train service from Belfast to Dublin is so frequently disrupted that it requires £500 million of new investment to bring it up to acceptable standards[57]. Other sources suggest that facilitating the development of 140 mph trains that would reduce the journey time to 75 minutes would cost £1.5 billion, with a more modest hourly service – and resultant journey times of 100 minutes - costing just £200 million. [58] In addition, it has been reported that the Belfast-Dublin route - on the fastest non-stop train – presently takes just five minutes less than it did 61 years ago in the age of steam trains[9, 58], making it one of the slowest intercity connections in Western Europe. There have also been calls to upgrade the wider rail network in Northern Ireland, with some commentators suggesting that this is neglected in favour of a focus on the road networks in the province.[59] These figures provide a snapshot as to the current state of the rail systems in Northern Ireland, and an apparent lack of focus and appetite to improve the status quo.

However, it is important to mention at this stage that the topography of Northern Ireland does present certain challenges regarding the development of a coherent network linking the major centres of the province's economy together, and this was something many contributors to this paper noted. However, it is perhaps also important to note that other nations with topographical challenges have managed to develop railway systems that are often highly regarded and have been noted for the economic benefits they bring. Taiwan – a highly mountainous country – has developed a high speed rail system that has seen bus and air links scaled back because of its success.[60] Japan and Switzerland are also noted for the quality of their railway systems, both which have some degree of mountainous terrain.

It is not all bad news however. The Investment Strategy for Northern Ireland 2008 – 2018 reports that recent investment in new trains has proven popular with commuters. Passenger journeys on the Bangor and Portadown lines, for example, have increased 29% between 2004/2005 and 2006/2007 and currently operate at near capacity during peak times.[35] This should provide policy-makers with some evidence of the popularity and effectiveness that a reliable rail network can deliver. It is planned for joint work with the Irish Government to upgrade rail services between Belfast and Dublin, which would build on their commitment in the National Development Plan 2007-2013, whilst train and station upgrades have also been promised.[35] However, implementation of these commitments is imperative.

**8.3 - Air Travel**
A second area of importance regarding infrastructure is air travel links. This is particularly important in a globalised economy where traditional barriers such as distance can be mitigated by the relentless march of technology, opening up markets that were previously out of reach.

**Victor Hewitt, Head of ERINI** explained: *'People look at Northern Ireland in a UK context, which is fine, but we also need to look beyond this and look at it in a globalised context. Globalisation produces concentration as businesses cluster. The processes of globalisation will marginalize places, with high growth developing around global cities. And there are currently only two truly global cities – London and New York. Northern Ireland therefore has an opportunity as it has a global city – London - on its doorstep, and Ireland has strong ties with the US. The challenge is thus how to maximise this advantage and thus connections with rest of the world.'*

Mr. Hewitt stated that for this opportunity to be fully realised, Northern Ireland must have the correct levels of transport links to these centres. Mr. Hewitt stated: *'Northern Ireland has 1 flight to US. There must be 20-30 flights daily from Heathrow to New York and many more to the rest of the States….you need to find ways to engage in the process to realise opportunities available.'* Whilst frequent flight paths to all major economies and emerging markets are desirable, it is useful to focus on those to New York in light of Victor Hewitt's comments and the aforementioned statistics regarding FDI from the USA in section 6.2.

Whilst the obvious difference in scale between London and Northern Ireland dictates that comparisons are clearly not analogous, the assertions made by Mr. Hewitt are backed up by the statistics. In 2008, JFK International Airport was the busiest route out of London Heathrow, with 2,802,870 passengers handled on this route.[61] Dublin Airport was the second busiest route with 1,812,028[61], perhaps indicating the RoI's established links with London. It is also worth noting that Dublin Airport's top 5 International arrivals were from the London airports, Birmingham and Manchester, with JFK International also in the top ten. Dublin Airport informed this paper that numerous carriers run at least a daily service to New York plus other major North American cities. Shannon airport also operates daily and double daily services. Dublin Airport media centre also told this paper that *'Ireland punches three times above its weight per population versus other European cities for direct flights to the US. Regarding business, around €90 billion is exported by a significant number of companies to the world.'* The Heathrow Airport Media Centre informed this paper that on a weekly basis during the winter season there are 310 weekly air transport movements to and from New York.[62]

Belfast International is Northern Ireland's main airport for international flights. In 2008 New York's Newark Liberty International Airport was the 7$^{th}$ busiest international passenger route but had experience a 4% drop from 2007 figures.[61] **Deborah Matchett, Public Relations Executive for Belfast International Airport** told this paper: *'Continental Airlines operates a daily service – 175 seats - to New York, which began in May 2005. The service goes down to 5 or 6 a week in winter season (November to*

*March). The service is extremely popular and almost always full with many passengers – perhaps in the region of 500,000 - having used the service since it started. Many people from Northern Ireland travel to Dublin to get to the USA so we are actively seeking further routes to USA and Canada – we would also work with Tourism Ireland in the USA to promote the route to tourists coming to Northern Ireland as in the summer season the flight can have upwards of 50% US tourist on board. The route is heavily supported by many local businesses who operate or have parent companies in USA.'*

In addition, Belfast International also runs frequent flights to the main UK cities, and these flight paths are supplemented by services from Belfast's other airport, George Best Belfast City Airport. When we spoke with the **Head of Northern Ireland for a global bank,** we were told: *'In general the air travel links from Northern Ireland are very good. There are numerous daily flights that take just over an hour to London. There is just one flight to New York but it is usually a very busy flight. However, one thing that currently isn't in existence is a flight direct to* ***London City airport****. From a financial services perspective, this would be highly efficient as you could literally step off the plane and be in HQ at Canary Wharf.'*

### Summary and Recommendations

- From the information and insight gleaned, it seems clear that there is scope for Northern Ireland to invest further in its transport infrastructure.
- The most pressing area would appear to be the rail network. The Northern Irish Executive should conduct a thorough and wide-ranging review of the available evidence regarding the current rail system and its impact on economic efficiency, productivity and growth as part of a long-term plan for the economy.
- It should also analyse the expected benefits of a fully developed rail infrastructure in geographically feasible parts the province – and wider island of Ireland – that would serve to link together the major economic centre's on the island. This would improve the province's carbon footprint in an environmentally conscious era but would also help commuters in an era of rising fuel prices, whilst potentially delivering economic benefits over the long term to the economy.
- Should this review produce a positive affirmation of the need for an improved rail network, The Northern Irish Executive should work with the UK government to agree a phased funding commitment linked to tangible developmental outcomes that would enable resource allocation to be directed into this area of infrastructure.
- The UK government should negotiate with the RoI government over a commitment from them to co-fund this investment given the overall benefits that would be enjoyed by the island of Ireland.
- Where topographical challenges exist that may prohibit rail development, continued investment in the road infrastructure should follow.
- Expansion of flight paths to the USA, specifically to New York, should be explored to try and optimise important trade possibilities with the US market, where close ties are already enjoyed. In addition to this, flight paths to strategic

cities in emerging markets should be explored as part of a wider approach to optimise trade links and investment in emerging markets.

- The UK government and The Northern Ireland Executive should discuss the possibility of expanding London City airport to accommodate a flight path to and from London and Belfast. This would help Northern Ireland to further strengthen ties with the City of London.

**9.0 – Conclusions**

Owen Paterson's aspiration to develop Northern Ireland into an 'enterprise zone' appears to be a sound ambition. Whilst some of the contributors to this paper questioned whether the term 'enterprise zone' is a media friendly sound-bite ultimately short on substance, everybody questioned throughout the course of this paper's research agreed that Northern Ireland's private sector is in great need of development.

Northern Ireland is heavily reliant on subvention from Westminster. A reduction in this dependence would be a positive development for both the province and the UK Treasury. The Northern Irish economy is dependent on public sector spending to an unhealthy and unsustainable degree, especially in an era of limited public finance and constrained government spending. The preponderance of the public sector in the economy of the province fares badly in comparison with other lesser developed regions of the UK, whilst significantly lower wages in the private sector do little to attract talented workers to an area of the economy of limited size and opportunity. To augment the economic arguments for Paterson's 'enterprise zone' aspiration, there is also the postulation that improved social and economic opportunities can play a role in the ongoing peace process.

However, this long term transformation will be tough, and will require political will, long term planning and a financial commitment from central government to enable the level of development that is required to come to fruition. As the Varney Report's show, the current government has not ignored this issue and whilst question marks were raised around some of the conclusions – primarily the corporation tax issue – many sensible recommendations, such as privatizing operations that could be performed effectively by the private sector, or reducing the burden of regulation, have seemingly not been enacted. The Conservative Party therefore needs to be mindful of past inertia, and attach conditions of demonstrable and tangible progress to any increased funding commitments they may choose to make that would enable the development of a Northern Ireland 'enterprise zone'.

Northern Ireland faces a geographical challenge unique to other parts of the UK in so much as it has no land border with the British mainland, yet shares a border another sovereign nation state – the RoI – to its south. However, this does also present opportunities. 'All island' cooperation can be increased to maximise trade and investment opportunities, whilst lessons can be drawn both from the great success of 'The Celtic Tiger'. The 'Celtic Tiger' materialised as a result of long term planning in the Irish

Republic, with a commitment to a low tax, low regulation economy that was tailored to attract foreign direct investment. Education, transport and infrastructure programs were all developed in line with this strategy so that by the mid -1990's, the RoI had a panoply of incentives that enabled it to become a location of choice to invest in, accounting for over a quarter of the entire EU's foreign direct investment from the USA. As three major business sectors highlighted in the research of this paper, for Northern Ireland to mirror the success of the RoI, long term investment in areas such as education, skills, transport and wider infrastructure are essential, whilst attention also needs to be paid to Northern Ireland from a social perspective in order make the province an attractive place for highly skilled workers to live. Small indigenous businesses also needs to be given the opportunities to grow and integrate themselves more efficiently into the supply chains of larger companies and the wider globalised economy, whilst the an environment for entrepreneurs to innovate and thrive in must be fostered. Work must also be done to address the alarming numbers of working age people without qualifications or skills, or on incapacity benefits.

Ultimately, if the Conservative Party is serious about developing Northern Ireland as an 'enterprise zone', a funding commitment will be required to enable a successful long term restructuring of the economy in the areas that are vital in attracting FDI and enabling indigenous business to grow. This is critical given the reliance the province currently has on UK government subvention and within its economy, the public sector, whilst the challenges globalization present necessitates this adjustment. An increased funding commitment may ultimately be easier to implement than a reduced, preferential rate of corporation tax that would present challenges from the EU and other regions of the UK. However, devolving the responsibility for corporation tax to Northern Ireland appears possible, and if this was implemented it would almost certainly aid private sector development. As public finances are constrained in the 'age of austerity', any funding commitment agreed should not be a 'soft budget' handed over to the Northern Irish Executive in 'one lump sum', but should see payments linked to demonstrable and measurable economic improvements and developments over time. A reduction of the wider rate of UK corporation tax for both large and small businesses should be implemented, with a longer term aspiration to reduce these rates below 20%.

In the context of devolution, the UK national government can only do so much, as ultimately it is down to the politicians – and wider community – in Northern Ireland to commit to a long term plan and implement the required changes in a measurable way. In his discussions with this paper, Finance Minister Sammy Wilson intimated that where possible, he would not hit departments that will help the private sector grow in his budgets. This is a positive start, but for Northern Ireland to become an 'enterprise nation', a long-term vision, and active implementation are required by those in the departments of the Northern Irish Executive that hold the power to sustainably develop the economy into the future.

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## Further Information


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