Annual Competitiveness Report 2009: Volume 2

Ireland's Competitiveness Challenge

Creating a Better Future

Forfás

National Competitiveness Council

Introduction to the NCC

The National Competitiveness Council was established by Government in 1997. It reports to An Taoiseach on key competitiveness issues facing the Irish economy and offers recommendations on policy actions required to enhance Ireland's competitive position.

Each year the NCC publishes the two-volume Annual Competitiveness Report.

- Volume One, **Benchmarking Ireland's Performance**, is a collection of statistical indicators of Ireland's competitiveness performance in relation to 17 other economies and the OECD or EU average.
- Volume Two, **Ireland's Competitiveness Challenge**, uses this information along with the latest research to outline the main challenges to Ireland's competitiveness and the policy responses required to meet them.

As part of its work, the NCC also publishes other papers on specific competitiveness issues.

This publication, Ireland's Competitiveness Challenge, assesses the competitiveness challenges facing Ireland, and in particular our exporting sectors in more detail. It highlights the policy directions that will sustain Ireland's competitiveness and future prosperity. The National Competitiveness Council hopes that this report will stimulate further debate and action on the competitiveness challenges that face Ireland.

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Foreword by the Taoiseach

Ireland has been profoundly affected by the global financial crisis over the past 12 months. It is no exaggeration to state that responding to this crisis is one of the greatest challenges the country has faced since independence.

When the global economy recovers, Ireland must be well positioned to take full advantage of the opportunities that will be presented. The lesson from severe global recessions in the past is that as well as weathering the economic storm, countries need to restructure their economies to target the next wave of economic growth. We must think smarter and work smarter: expanding productive capacity and raising knowledge intensity. The Government's Smart Economy Framework sets out a clear vision for repositioning our economy.

Over the past year, the Government has taken significant steps to re-orientate policy so as to place Ireland firmly on the path to economic recovery; notably to reduce the gap in the public finances and to tackle the banking situation in order to restore credibility and confidence and get credit flowing. Further steps are needed to restore the competitiveness which has been lost in recent years. Without the option of devaluation, that means reducing costs and increasing productivity right across the economy.

Ireland will only thrive if we play to our strengths. As a small, open economy, a sustainable recovery depends on increasing our exports of goods and services to world markets. We need thousands of thriving Irish companies creating high-value products and services that will provide well-paid, quality employment. To ensure a prompt improvement in competitiveness the public service and sheltered sectors of the economy must also play their full part in making the adjustment.

We already have one of the best concentrations of high-tech multinationals in Ireland. Our plan is to encourage them to invest further in the high-value activities that provide secure employment and increase exports. We are already investing billions in research and we need to get the best possible return on that investment. We will now move this to a new level and create an exemplary research, innovation and commercialisation ecosystem.

It is our people that will always be the most critical ingredient in our national performance. We have one of the youngest and best educated workforces in Europe. It is their ingenuity and creativity which will drive the next phase of Ireland's economic development. That is the Irish advantage, and I am in no doubt that if we build on the natural advantage of our human capital and adopt new, strategic ways of thinking and doing business, we can expect a major acceleration of trade and investment between us and foreign markets over the coming years.

Education and business are the basic building blocks of any knowledge based economy. Education has been at the core of what we have achieved as a nation in the last fifty years. We must not only encourage our people to upskill as part of a lifelong learning process, but we must also challenge our educational establishments, particularly at third level, to continue to provide the thought leadership and the courses which will provide our leaders of tomorrow, our innovators and our entrepreneurs with the skills to succeed on the global stage. Developing the skills of those who have lost their jobs in recent times is a key priority.

Strong action now is required to provide a sound basis for export-led recovery. The decisions in the Budget were not easy or pleasant decisions - but the exceptional circumstances demand an exceptional response. We have to recognise the situation we are in as it is, not as we might like it to be, and deal with those realities. The challenges ahead of us are great but by working together in a positive spirit I have no doubt we can overcome them.

The National Competitiveness Council continues to make an important contribution to our understanding of a rapidly changing global environment. I would like on behalf of my colleagues in Government, to thank the Council for its important work at this difficult time. The Council has been an important source of advice to Government throughout 2009 and I am pleased to introduce Ireland's Competitiveness Challenge 2009 which provides a clear analysis of the further challenges which lie ahead.

Brian Cowen TD
Taoiseach

Chairman’s Preface

Following a sustained period of increasing competitiveness in the 1990s and early 2000s, we took a wrong turning later in this decade when strong growth in the domestic economy replaced exports as the key driver of economic growth. Growth derived from housing and consumer spending, fuelled by low interest rates and reckless lending, was not a sufficient basis for sustainable growth and it damaged our competitiveness. Improving our export performance and raising productivity across all areas of the economy (including the non internationally traded sectors and the public services) are the only sustainable strategies for securing long term prosperity and reducing unemployment.

As highlighted in the NCC’s recent report, *Driving Export Growth: Statement on Sectoral Competitiveness*, significant opportunities exist to increase our exports. We retain and we can build on a wide range of competitive strengths, including education, research and development, the presence of many vibrant internationally trading enterprises and a successful track record as a location for inward productive investment. But in order to realise these strengths we must achieve higher levels of productivity and performance in all areas of economic and social activity and continue to address the fiscal challenges.

While Ireland’s competitiveness has improved during 2009, this to a great extent reflects the sharpness of the recession rather than competitive advantages arising from structural change. Urgent action is required to develop an enduring competitive operating environment for business and enable exporters to trade successfully in difficult international markets.

This report highlights the priority policy actions to restore Ireland’s international competitiveness, which include:

- reducing the costs of doing business, especially energy, waste and professional services;
- enhancing the skills of those in employment and improving the employability of those who have lost their jobs;
- the need to ensure open competitive markets in all sectors of the economy and to drive competition in non-traded services sectors in particular through the effective implementation of Competition Authority recommendations;
- fostering innovation at all levels of economic activity including R&D programmes which have strong industry relevance and participation;
- developing world class advanced broadband networks and services in key regional centres to support the smart economy; and
- continued action to restore the sustainability of the public finances and ensure credit is channelled to viable businesses.

Ireland can have a bright future provided we confront these challenges and exploit the opportunities for creating a more competitive economy.

I would like to thank the Council members and advisors for their valuable contributions throughout the development of this report and to acknowledge the Forfás secretariat for the work that they have done in preparing material for consideration by the Council.

Dr Don Thornhill
Chairman, National Competitiveness Council

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Executive Summary

The Irish economy of the future will be very different to that of the boom years. Growing exports and raising productivity across the economy is the only sustainable path to reducing unemployment and securing long term prosperity. In the past 12 months, Ireland's competitiveness has improved - exporting sectors are performing relatively well, supported by easing cost pressures and the greater availability of skills. However, improvements in our competitiveness to date largely reflect the sharpness of the recession rather than competitive advantages arising from structural change. Further efforts to restore Ireland's competitiveness are critical to enable Irish exporters to compete successfully in difficult international markets.

Improving national competitiveness is not easy. Competitiveness encompasses a diverse range of factors including costs (e.g. pay, property, utilities, professional fees, transport) and productivity, education and training, entrepreneurship and innovation, social, economic and technological infrastructure and the taxation and regulatory regime. Competitiveness is underpinned by stable public finances, a working banking system and a broad vision for the economy and society. The overarching goal of national competitiveness is to improve living standards and quality of life by enhancing the ability of the enterprise base in Ireland to trade in international markets.

Given the need to enable exporting sectors to compete successfully in international markets, this report's high level objectives are to advise on restoring macroeconomic stability, improving cost competitiveness and increasing productivity growth. The NCC recommends that the following policy actions are prioritised to restore Ireland's international competitiveness:

1. **Restore the Sustainability of the Public Finances:** The strategies to restore balance to the public finances must be consistent with the need to improve competitiveness. In addition to reducing Government expenditure, broadening the tax base is central to repairing the public finances. As set out in detail in previous statements, the NCC believes that additional revenues should be raised by broadening the tax base. These include:
    - Introducing a valuation based property tax;
    - Removing outstanding tax exemptions where the cost-benefit justification is not clear. In particular, tax incentives that promote investment in property over investment in the productive sector should be eliminated; and
    - Introducing user service charges for treated water, third level education and roads.

    The NCC welcomes the introduction of a carbon tax in Budget 2010 and the proposals to introduce a property tax and water charges for domestic users. In the absence of measures to broaden the tax base, taxes on income will inevitably have to rise further in the future. Higher taxes on income are a disincentive to people to remain in or return to the labour market.

2. **Reduce the Costs of Doing Business:** The costs of doing business in Ireland must fall relative to our trading partners. Initial signs are positive – for example, office rental costs have fallen significantly. However, the cost base in Ireland remains high and many Irish exporters are

acutely affected by the strength of the euro. The rate at which incomes and price levels generally adjust to the changed economic environment will have a considerable bearing on how fast Ireland can recover.

- The price of land, office and factory space and housing in Ireland needs to adjust to the levels justified by their underlying potential for adding value or earning rent. In this context it is important that the actions taken by the banking sector and the National Asset Management Agency (NAMA) support an appropriate adjustment within the property market. The tax treatment of property should also be progressed to limit future housing boom and bust cycles, in particular, the proposal to introduce a value based property tax should be advanced quickly. Falling land and property prices do not reduce the necessity for structural change in respect of land planning;
- Limited competition in locally traded sectors of the economy, particularly in the professions, has serious implications for the costs of doing business in Ireland. Ensuring that competition law applies to all sectors of the economy and removing barriers to competition in sheltered sectors is critical. A systematic process is required to address these barriers. In addition, the State should use its purchasing power to exert downward pressure on professional fees;
- High utility costs in Ireland are damaging the competitiveness of important exporting sectors like food, ICT hardware and engineering. Recent energy price reductions were necessary but are not sufficient. The NCC set out a range of recommendations in its recent Statement on Energy which are summarised in section 3.3. In the waste sector, planned increases in the landfill levy should not be implemented until alternative cost effective waste treatment options are available; and
- Local authority charges have been highlighted as a significant cost for exporters in the NCC's recent statement on sectoral competitiveness, *Driving Export Growth*. Careful consideration needs to be given to freezing and, where possible, reducing commercial rates. However, alternative methods of raising revenue for local authorities must be implemented – e.g. the proposal to introduce charges for treated water to domestic users. This must be accompanied by local government reform.

3. **Ensure Credit is Channelled to Viable Businesses:** While it is inevitable that credit growth in Ireland is falling from the unsustainably high levels of recent years, it is critical that viable businesses do not face obstacles through the tightening of credit standards or the high cost of capital. Steps are being taken to get credit flowing in the economy. The NCC has identified the following priority actions:
    - It is important that the measures put in place to improve credit flows are assessed to ensure that they are meeting their objectives. Bank lending rates and charges should be benchmarked to ensure they are competitive with those in other Eurozone countries; and
    - Stronger banking regulation and closer supervision is required to ensure that banks do not re-engage in reckless lending in the medium term. As recommended by the OECD, more effective macro-prudential policy instruments should be developed and applied.

4. **Promote Innovation:** Responsibility to innovate rests primarily with enterprises and individuals themselves; however, public policies that support and enable innovation are also important.

The NCC recommends that the following actions are prioritised to support a vibrant innovative exporting base:

- Continued investment in research and development is critical to the development of the smart economy. Given the need to reduce Government spending, the NCC recommends that public R&D funding prioritise programmes which have strong business relevance and participation, leverage private sector investment and drive consolidation in existing research infrastructures and centres;
- The NCC favours the development of a funding stream which encompasses a statutorily guaranteed, multi-annual funding package for science research, covering all State funded scientific research. Strategic R&D and innovation funding priorities should be agreed every 2-3 years by Government and provide the framework for the coordinated funding stream; and
- Under the current R&D tax credit system, the credit in foreign owned companies often accrues to the corporate headquarters and is therefore not captured in the costs and revenues of the Irish plant. Reforming the operation of the tax credit so that it is applied to the cost of employment in Ireland could increase the volume of R&D activity taking place here without changing the value of incentives offered.

5. **Enhance Productivity Growth through Technology Deepening:** Improving productivity growth across all sectors of the economy – private and public, locally and internationally trading, manufacturing and services, indigenous and foreign owned - is central to the future success of our exporting sectors. The NCC has identified the following priorities:
    - Investment in technology can play a key role in reducing costs and improving productivity growth. Given the increasing limitations at EU level on government aid for capital investment, it is critical that tax incentives are reviewed to incentivise investment in productive sectors to support sustainable economic activity and employment rather than in property; and
    - Access to high quality, resilient and competitively priced, advanced broadband in key regional centres is essential to enable many exporting sectors to exploit future growth opportunities. Better use of technology can also play a key role in enhancing the productivity of the wider economy. Recommendations are set out in section 4.5 which would incentivise private sector provision of advanced broadband and ensure the best use of State infrastructure and funds to deliver advanced broadband access.

6. **Improve Ireland's Skills Base and the Delivery of Training:** A strong emphasis on skills development can support the competitiveness of existing firms by enhancing their capabilities and increasing productivity growth. It will also keep unemployed workers close to the labour market and help prevent the drift to long term unemployment. The NCC recommends the prioritisation of the following actions:
    - Target education and training funding to address pressing enterprise skills demands which can support immediate improvements in competitiveness – see Appendix I for specific skills needs. Given the high returns from education and training, further funding for relevant training would yield significant benefits as compared with basic job subsidy schemes. In spite of the significant pressure to shift investment towards those who have lost their jobs,

retaining funding for training those in employment, particularly those with low skills in low productivity or vulnerable sectors, remains critical;

- Resources dedicated to labour market activation are relatively low in Ireland. We need to ensure that existing labour market interventions are appropriate to the new challenges. The skills development needs of the newly unemployed are more diverse than in the past (e.g. construction workers, professionals). While recent increases in the number of activation and training places are a welcome development, the nature and quality of the retraining options available remain an issue. It is essential that these initiatives are kept under review to ensure that they are providing an effective response to improve the employability of those that have lost their jobs. The Community Employment Scheme, which shares many of the characteristics of a social inclusion programme rather than a labour activation programme, needs to be reviewed and reformed as it reduces the limited resources available for labour market activation; and
- A stronger focus on formal accredited qualifications is required. Given the likely duration of our unemployment problem, a more long term view of skills upgrading for those losing their jobs is needed. This provides significant challenges for our universities, institutes of technology and certification bodies in terms of ensuring that courses are relevant, delivered flexibly to meet the needs of those in employment and those seeking work (e.g. evening, module based, online), as well as being cost effective and accredited.

7. **Prioritise Infrastructure Investment to Support Enterprise:** Reducing capital expenditure to maintain current expenditure will not help long term competitiveness. However, clear prioritisation and lower cost delivery can offset some of the impact of reduced budgets. The NCC has identified the following priorities:
    - It is vital that the infrastructure projects likely to have greatest impact in terms of attracting overseas investment and supporting firms in Ireland to compete successfully are front-loaded. Specific road, public transport, broadband, water and energy projects are highlighted in section 4.5. Given the central role that Dublin and our other main cities play in driving national competitiveness, the re-prioritisation of capital expenditure should focus resources on their development;
    - The potential to coordinate the rollout of different infrastructure services such as roads, broadband, water, electricity and gas needs to be considered. This has the potential to deliver significant cost savings particularly where projects are undertaken simultaneously; for example, the civil works account for up to 80 percent of the cost of rolling out fibre for advanced broadband services. A strengthening of existing institutional arrangements to enable the sharing of investment rollout plans across Government departments and agencies needs to be established without delay; and
    - There is also significant scope for Government to improve infrastructure capacity and services without the need for Exchequer investment. Addressing specific policy and regulatory barriers outlined in section 4.5 can promote more efficient State investment (e.g. the establishment of a national water authority) and greater private sector investment (e.g. greater regulatory certainty in the waste market).

8. **Implement Public Sector Reform:** Strained public finances have potentially acute implications for public services. We need to rise to the challenge of delivering better public services with fewer resources. The alternative is a reduction in the services provided to the public. The public sector has the capacity to be at the forefront of the adjustment process in the economy in moving to higher levels of productivity growth and innovation. A range of recommendations from the OECD and others remains outstanding.
    - Recommendations to reform the public sector need to be implemented without delay. In particular, a greater focus on improving productivity and flexibility, better integration in delivery, improvements in management capabilities and an effective redeployment of existing resources are central to delivering better public services with reduced resources.

Conclusions: Focus on Delivery

Ireland is currently experiencing one of the deepest recessions in the developed world, driven by a steep decline in the domestic economy and the international financial crises. As the world economy is likely to return to growth more rapidly than the Irish economy, export driven growth can play a key role in restoring the Irish economy to growth. In addition to sustaining and growing employment in exporting sectors, export success will increase sub-supply demand for Irish goods and services across the economy and can help support a recovery in consumer demand.

Irish competitiveness has improved over the past 12 months. In addition, as recognised by the OECD and others, significant progress is being made in addressing the serious banking and fiscal challenges facing this country. However, further action is required to improve competitiveness. The NCC believes that the speedy implementation of the priority actions highlighted in this report is as fundamental to Ireland's future as the steps being taken to address the banking crisis and to arrest the decline in the public finances.

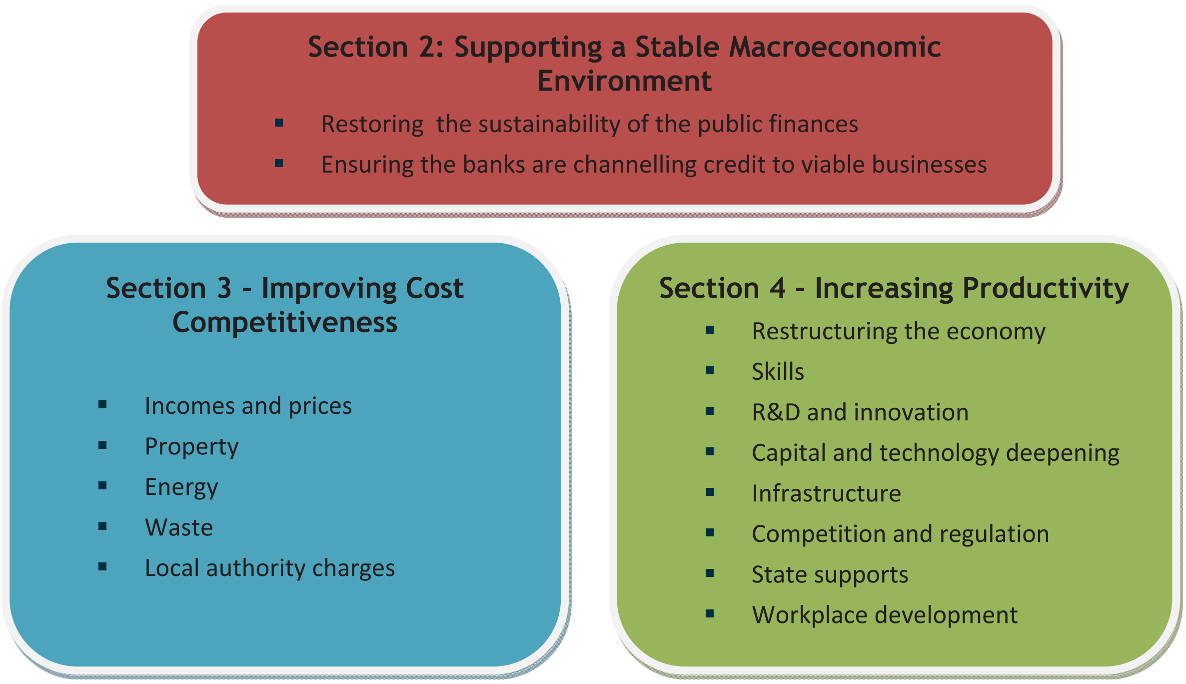
As the activities of a wide range of Government departments and agencies will critically affect our ability to restore our competitiveness, we need to have structures, processes and the capacity in place to ensure that Government departments and agencies act quickly in mutually complementary and supportive ways. It is important that we have a clear understanding of the basic drivers of competitiveness and of what needs to be done to improve Ireland's international competitiveness. It is also important that there is a centrally driven process to restore competitiveness where each department and agency has clearly defined actions with timelines and a focus on delivery to enhance Ireland's competitiveness. Building on the existing impact assessment process, we believe it is essential that the implications of all Government decisions for Ireland's international competitiveness are rigorously assessed.

1. Introduction

Export led growth is the only sustainable route to maintain Ireland's living standards and secure long term prosperity. Restoring Ireland's competitiveness and driving investment in the productive sector and internationally trading enterprises, rather than in property as has been the case in recent years, is critical to enable Irish exporters to compete successfully in international markets.

National competitiveness is a broad concept that encompasses a diverse range of factors and policy inputs including costs (e.g. pay, property, utilities, professional fees, transport) and productivity, education and training, entrepreneurship and innovation, economic and technological infrastructure and the taxation and regulatory framework. This report focuses on the national competitiveness issues of most importance to enable our main existing and emerging exporting sectors to compete successfully in international markets (Figure 1).

Figure 1: Ireland's Competitiveness Challenge 2009



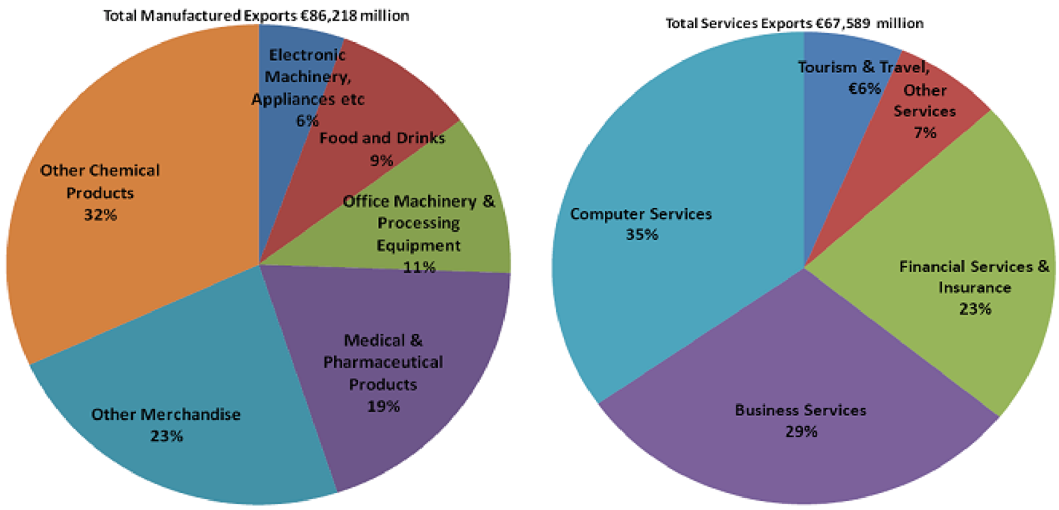
Expanding our export base is critical to overcoming our current challenges. While economic activity in Ireland declined by 7.9 percent in the first half of 2009, net exports contributed 4.1 percent to economic growth[1]. This represents an increase on net exports' contribution in 2008, which was 2.7 percent. Export growth can create the resources required to reduce unemployment, fund public services and manage the national debt. We need to improve our attractiveness to overseas investors and create a business environment that encourages greater entrepreneurship and the development of more innovative, globally-competitive and largely-export focussed Irish owned companies. The indigenous internationally trading enterprise base has been transformed over the last decade, with

1 CSO, Quarterly National Accounts, September 2009.

a major restructuring towards higher value added activities and knowledge-intensive employment, particularly in services. However, a number of key weaknesses remain including lack of scale and technological intensity, a lack of sectoral diversity and continued high dependence on the UK market.

In 2008, businesses in Ireland exported €154 billion worth of goods and services, with manufacturing exports contributing 56 percent and services exports 44 percent. A small number of sectors dominate our goods and services exports. Within manufacturing exports, the largest sectors are other chemical products (32 percent of goods exports), medical and pharmaceutical products (19 percent) and office machinery and processing equipment (11 percent). The largest services sectors are computer services (35 percent of services exports), business services (29 percent) and financial services and insurance (23 percent) (Figure 2).

Figure 2: Distribution of Irish Manufacturing and Services Exports, 2008



Source: CSO, External Trade December and Balance of Payments, 2008

The recently published NCC report, *Driving Export Growth,* focuses on the sector specific issues that need to be addressed to enable Ireland's main exporting sectors to realise further growth opportunities[2].

Internationally trading services have become major drivers of export growth for Ireland, with our strengths ranging from business, ICT and financial services, to tourism and education services, and they have further potential to contribute more to future growth. Advanced broadband telecommunications, efficient regulation, an attractive tax environment and a high quality of life for internationally mobile staff are key.

In manufacturing there is potential for the medical technologies and pharmaceutical sectors to significantly increase the level of R&D activity undertaken in Ireland. This will require a number of

2 The sectors profiled in the report are food and drinks, medical technologies, chemicals and pharmaceuticals, ICT manufacturing and services, international financial services, tourism, environmental goods and services and other internationally trading services. NCC, Driving Export Growth: Statement on Sectoral Competitiveness, December 2009.

reforms such as the streamlining of the approval process for clinical trials. The key challenges for the food sector are around driving productivity growth in existing activities and increasing capital investment and innovation so as to diversify into new markets.

The report also highlights the potential to increase Ireland's share of the global environmental goods and services (EGS) market, with strong indigenous enterprises and a flow of related inward investment. Given that Ireland is starting from a lower base than a number of competitor countries, public procurement and investment in EGS-related research targeted at specific areas of opportunity will need to be prioritised.

As a small open economy, that is highly dependent on trade and investment, rebuilding our international reputation will be an important element of economic recovery. A survey of multinational corporations in Ireland in mid-2009, found that for 51 percent of respondents, Ireland's reputation within their global organisation had diminished since the beginning of the current economic crisis. The same proportion of respondents stated that this reputational change had materially affected their ability to attract new mandates to Ireland[3]. As highlighted by the National Economic and Social Council (NESC), sustained commitment to the necessary adjustment measures to restore stability to the public finances, the banking system and to improve our competitiveness are the building blocks to improving our international reputation[4].

3 IMI /National Irish Bank, Survey of MNCs in Ireland, 2009.
4 NESC, Next Steps in Addressing Ireland's Five Part Crisis: Combining Retrenchment and Reform, 2009.

2. Supporting a Stable Macroeconomic Environment

Ireland is experiencing one of the most severe contractions in economic activity in the OECD. Unemployment has risen sharply, from 4.3 percent in 2007 to 12 percent in Q2 2009[5]. GNP is forecast to decline by 10.5 percent this year and two percent in 2010. This sharp deterioration in economic activity is forecast to result in a general government balance of minus 12 percent of GDP in 2009 and the State borrowing almost €26 billion in 2009 to bridge the gap in the public finances to cover day to day spending and capital expenditure[6]. The increase in the volume of Government debt will lead to a significant increase in the cost of debt servicing; the Department of Finance estimates that debt interest will account for 8.5 percent of tax revenue in 2009, up from 3.5 percent in 2007. The steep decline in GNP levels represents a significant reduction in Irish living standards - the ESRI forecasts that income per capita levels in 2010 will fall to levels last seen in 2004[7].

Ireland's exporting sectors are performing relatively well, supported by moderating prices and the greater availability of skills. Manufacturing exports were largely unchanged (falling by 0.1 percent) in the first eight months of the year. However, this is driven by the strong performance of medical and pharmaceutical products, and organic chemicals[8]. Services exports declined by two percent in the first half of 2009 compared to the same period in 2008[9].

The NCC believes that the challenge for Ireland is to restore the competitiveness of our exporting sectors and our attractiveness for inward investment in order to ensure that Ireland can take advantage of the global recovery. Lower household wealth, very high household debt, rising taxes and weak incomes growth will dampen domestic spending in the coming years. A stable macroeconomic environment is a prerequisite to enabling export driven growth. It is essential that we implement a credible and widely supported programme to restore the sustainability of the public finances and ensure the banks are channelling credit to viable businesses.

2.1 Restoring the Sustainability of the Public Finances

There is a significant gap between Government revenues and expenditure. In the context of huge increases in public debt and a major current deficit and growing demands as the population gets older, restoring the health of the public finances is critical. The strategies to restore balance to the public finances must be consistent with the need to improve competitiveness. The NCC recommends that future actions concentrate on:

5 CSO, Quarterly Household Survey, September 2009.

6 Department of Finance, Pre-Budget Outlook, November 2009.

7.ESRI, Quarterly Economic Bulletin, Autumn 2009.

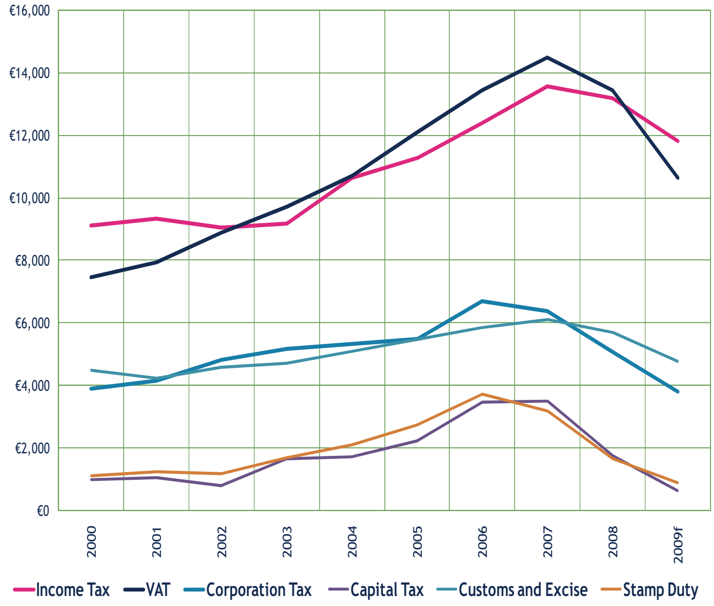
8 CSO, External Trade, November 2009. Medical and pharmaceutical products increased by 24.4 percent in the first eight months of 2009 compared to the same period in 2008, while organic chemicals increased by 9.6 percent. Computer equipment fell by 27.4 percent and food exports declined by 13.4 percent.

9 CSO, Balance of International Payments, September 2009. Performance varied considerably across the services sectors. There were declines in tourism (-12.7 percent), insurance (-15.2 percent) and financial services (-12.2 percent) while business services increased by 13.4 percent and computer services rose by 5.2 percent.

Raising revenue

Ireland became increasingly reliant on transaction based revenue sources, particularly stamp duty and VAT, in recent years. The collapse in the housing market coupled with the significant decline in consumption has been a major contributing factor to the 30 percent decline in tax revenues during the period 2007-2009 (Figure 3).

Figure 3: Tax Receipts by Main Sources 2000-2009 (€ millions)



Source: Department of Finance, Finance Accounts

Broadening the tax base is central to repairing the public finances. In the absence of such measures, taxes on income will inevitably have to rise further in the future. Higher taxes on income act as a disincentive to people to remain in or return to the labour market. While the introduction of a carbon tax in Budget 2010 is welcome, the NCC recommends the following actions to broaden the tax base:

- **Introduce a property tax:** The NCC has consistently recommended replacing stamp duty on property with a broadly based tax on the value of residential properties. Unlike increases in income tax, a recurring residential property tax does not act as a disincentive to economic activity. It can also support investment in the local economy. The proposals in Budget 2010 to progress the introduction of a site valuation tax for non-agricultural land and water charges for domestic users are positive developments. Further and alternative methods of raising revenue should also be considered, including charges for the users of services (e.g. third level fees, roads); and
- **Eliminate tax exemptions:** Tax exemptions in the income tax system are far higher in Ireland than the EU average[10]. We need to remove outstanding tax exemptions where the cost-benefit justification is not clear. In particular, tax incentives that promote investment in property and construction over investment in the productive sector should be withdrawn. Continued support for the exemption for patent royalties is an important measure to promote R&D activity in Ireland[11].

10 OECD, Economic Surveys: Ireland, November 2009.

11 Royalty income derived from qualifying patents is exempt from income tax and corporation tax subject to an annual limit of €5 million on the amount of exempt royalty income. An individual who owns a patent is only entitled to an exemption as inventor or co-inventor.

Reducing expenditure

While painful, international evidence highlights that targeted expenditure cuts must be central to restoring the public finances. The OECD estimated that the discretionary actions taken during 2009 amount to a cumulative budget consolidation of around five percent of GDP by 2010[12]. With an estimated budget deficit of 12 percent of GDP in 2009, significant additional adjustments will be required to bring the deficit below three percent of GDP by 2014[13]. While the European Commission has extended the deadline for Ireland to correct its budget deficit, the magnitude of the adjustment required has increased significantly; previously Ireland had four years to effect an adjustment of six percent of GDP, now an adjustment of ten percent of GDP is required over five years[14].

Although declining construction and land costs will enable the delivery of key infrastructure projects more efficiently and with fewer resources, reducing capital expenditure to maintain current expenditure will not help long term competitiveness[15].

Reforming the public sector

Strained public finances have potentially acute implications for public services. We need to rise to the challenge of delivering better public services with fewer resources; public sector reform is critical to enable the reduction in public expenditure required to balance the public finances. The alternative is a diminution in the services provided to the public. A range of recommendations from the OECD and others remain outstanding. A greater focus on improving productivity and flexibility, better integration in delivery, improvements in management capabilities and an effective redeployment of existing resources are central to achieving this.

Improving the fiscal planning framework

There is a need for better planning and control mechanisms, once the economy gets back onto a sustainable growth path. In particular, the OECD outlines the need to create a budget framework which does not allow large instabilities to occur in future[16]. It stresses the importance of changing budget rules and institutions to protect the budget against outcomes where revenues are spent even when they are transitory. Specifically, the OECD highlights the need to evaluate spending programmes before implementation to ensure that their objectives are being achieved at the lowest cost to present and future taxpayers[17]. It also suggests that an independent expert institution such as a fiscal council could be established to produce recommendations on the appropriate overall fiscal policy. Such institutions exist in some European countries, for example the Central Planning Bureau in the Netherlands.

12 OECD, Economic Surveys: Ireland, November 2009.
13 Under the Stability and Growth Pact, member states are required to keep budget deficits below three percent of GDP. Given the serious economic recession, the European Commission recently reviewed deadlines and extended those for Ireland and the UK to 2014.
14 European Commission, Ireland - Commission assessment in relation to the Commission recommendation for a Council recommendation under Article104(7) of the Treaty, November 2009.
15 Capital expenditure priorities are discussed in section 4.5.
16 OECD, Economic Surveys: Ireland, November 2009.
17 The OECD contends that Ireland lags far behind the European norm in terms of ex ante evaluations.

2.2 Ensuring the Banks are Channelling Credit to Viable Businesses

There are serious concerns that the turmoil in global financial markets and the exposure of Irish banks to bad loans in the declining property sector is affecting Irish firms in terms of their ease of access to finance and its cost. While credit growth in Ireland must fall from the unsustainable levels of recent years, it is critical that viable businesses do not face obstacles through the tightening of credit standards or the high cost of capital. The NCC recommends that the ongoing efforts to resolve the banking crisis include the following actions:

- **Support viable businesses:** It is critical that the State uses its funds and influence to ensure that banks are lending to viable businesses and that the availability of credit is closely monitored by the Central Bank. To ensure the availability of funds, the Government or the regulator may need to consider mechanisms to free up credit for SMEs – for example, agreeing enforceable lending targets or ring fenced funds – while ensuring they do not lead to a return to unsound lending practices in the medium term[18]. However, caution is required in the design of any mechanism to avoid forcing banks to lend to businesses that are not creditworthy. If bad debts ensue this will negatively affect the banks' future capacity to lend to viable businesses.
- **Access to early stage finance and venture capital** is essential to enable the development of high potential start-ups. Continued Government support through the Business Expansion Scheme (BES), subject to a cost benefit appraisal, and further funding for Enterprise Ireland to continue to act as a catalyst for the establishment of new funds and attract venture capital and private equity investment from abroad is vital to ensure competitive and diverse venture capital funding is available to support new businesses;
- **Ensure a competitive banking system:** A challenge exists to ensure that following the establishment of NAMA, businesses and other borrowers can secure adequate loan finance at competitive terms in an environment where there may be more limited competition between the banks and potentially fewer banks (due to mergers and/or market exits). Remaining banks may also attempt to improve their balance sheets by widening the margins between lending and deposits and increasing other bank charges.
    - Competition policy should strongly inform any policy on banking consolidation. The Competition Authority should also be equipped with adequate powers and enforcement capacity to ensure competitive access to credit and savings facilities;
    - In respect of costs, there needs to be a robust regulatory framework in place to ensure that deposit, credit facilities and charges are continually benchmarked and competitive with other countries in the Eurozone;
- **Monitor measures put in place:** A range of measures is being put in place to get credit flowing in the economy. However, the data available on credit demand and supply trends has been limited. It is essential that the efficacy of the range of measures put in place to improve credit flows can be assessed. The Central Bank has a key role to play in monitoring and assessing credit trends across the economy. The establishment of a credit review system to examine and report on the credit policies and practices of the banks for SMEs is a positive development; and
- **Take steps to limit the risk of future property bubbles:** Stronger banking regulation and closer supervision is required to ensure that banks do not reengage in reckless lending. More effective macro-prudential policy instruments should be developed and applied. The taxation of property should also be progressed to limit future housing boom and bust cycles, in

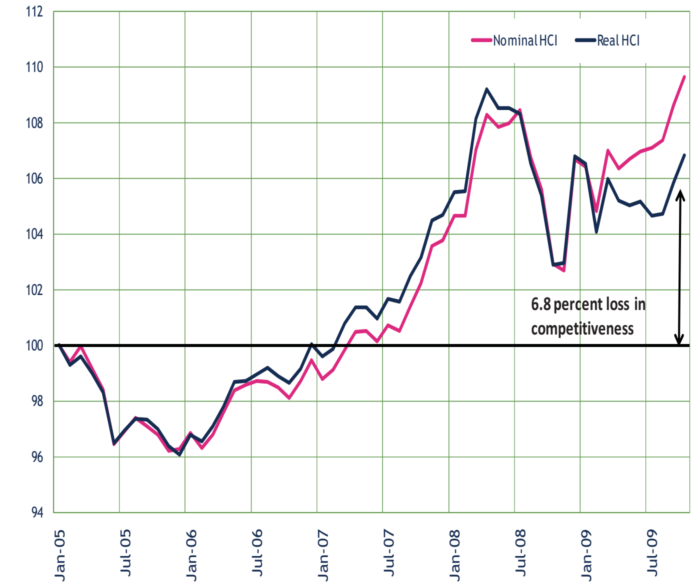
18 Budget 2010 proposes to establish an independent external appeals process to review decisions by the banks to refuse credit to SMEs.

particular a value based tax should be introduced quickly. The proposal to abolish mortgage interest tax relief is a step in the right direction as Ireland is the only country in the OECD to give such relief without having a tax on primary residences. This will also help incentivise investment in productive capital rather than housing.

3. Improving Cost Competitiveness

The Irish economy has deteriorated following a long period of unsustainable growth fuelled by borrowing[20]. A high cost base is a damaging legacy of this era. Improving our relative cost competitiveness requires the cost of doing business in Ireland to fall relative to that of our trading partners. Initial signs are positive but the cost base in Ireland remains high.

Figure 4: Harmonised Competitiveness Indicator, 2005 - October 2009 (January 2005 =100)[19]



Source: Central Bank of Ireland

Those Irish exporters who are focused on the UK market and compete against UK firms in other markets are also acutely affected by the large fluctuations in the value of the euro against sterling. Given that the relationship between the euro and the sterling is unlikely to change significantly in the short to medium term, consideration needs to be given to developing a more strategic response to the problem.

Between January 2005 and the peak of April 2008, Ireland experienced a nine percent loss in its trade-weighted international price competitiveness (Figure 4). Ireland’s current price competitiveness has improved; the loss in price competitiveness between January 2005 and October 2009 is 6.8 percent. However, the downward trend evident during the earlier part of 2009 was reversed in September due to the strengthening of the euro against sterling and the dollar.

Prices in Ireland have moderated during 2009, particularly property prices. In addition, many companies have taken steps to reduce costs and improve productivity. However for the most part, recent price falls in Ireland are a cyclical response to the Irish and international recession (e.g. reduced demand leading to spare capacity, falling interest rates, falling fuel and food prices) rather than a response to structural changes in the Irish economy. Structural changes (e.g. increased competition in the non-traded sectors) are necessary to ensure that prices in Ireland will not escalate and erode competitiveness when the economy returns to growth.

19 The nominal HCI is a nominal effective exchange rate for the Irish economy that reflects, on a trade-weighted basis, movements in the exchange rates vis-à-vis 56 trading partners. The real HCI (deflated by consumer prices) takes into account relative price changes along with exchange rate movements. These indicators are approximate measures of price competitiveness as they suffer from a number of measurement issues.

20 Private sector credit increased from 128 percent of annual GNP in 2002 to 215 percent in 2007, growing at an annual average rate of 20 percent. OECD, Economic Surveys: Ireland, November 2009.

Concerns have been expressed that falling incomes will lower demand and prices further which could lead to a deflationary spiral in Ireland. Given monetary union and the open nature of our economy, it is likely Ireland will import higher inflation as eurozone interest rates increase and as the international recovery drives energy costs upwards.

A quick adjustment in price levels is essential to achieve swift improvements in competitiveness. While painful in the short term, the alternative is a prolonged period of weak or negative growth, high unemployment and emigration. The NCC believes that the policy actions set out in the remainder of this chapter must be progressed without delay to reduce the costs of doing business in Ireland and to sustain jobs.

3.1 Adjust Incomes and Prices

For many exporting firms, labour costs account for over half of their input costs. While Irish pay and income levels are moderate when compared to other developed high income economies, wage inflation in Ireland was running at up to 50 percent higher than the Eurozone average during the 2004-2007 period. However, growth in labour costs slowed significantly in 2008 in Ireland relative to the Eurozone.

The absence of timely official data makes it difficult to determine how labour costs in Ireland are adjusting to the severe downturn in the economy. The most recent national data for Q2 2009, which is only available for limited sectors of the economy, indicates that quarterly average hourly earnings are declining. Basic pay has declined marginally and irregular bonuses have fallen significantly. Between Q1 2009 and Q2 2009, average hourly earnings (including irregular bonuses) fell by 4.8 percent in industry and by 6.1 percent in the financial sector[21]. On an annual basis, average hourly earnings (including irregular bonuses) to Q2 2009 increased by 4.2 percent in industry while the financial sector recorded an annual decrease of 11.9 percent[22]. The number of average weekly paid hours for people in employment in industry fell by 3.4 percent in the year to Q2 2009[23].

Labour costs need to be considered in the context of productivity performance[24]. Quarterly unit labour cost data from the OECD[25] for Q2 2009 suggests that Ireland's relative cost competitiveness improved driven by the industrial sector[26]. While quarterly unit labour costs for the total economy grew by 0.1 percent in Ireland between Q1 2009 and Q2 2009, the increase was greater in the Eurozone (+1.3 percent), Germany (+2.0 percent), the OECD average (+0.8 percent) and the US (+0.6 percent).

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21 When irregular bonuses are excluded, average hourly earnings between Q1 2009 and Q2 2009 fell by 1.2 percent in industry and 0.9 percent in financial services. CSO, Earnings and Labour Costs, November 2009.

22 When irregular bonuses are excluded, average hourly earnings in the year to Q2 2009 increased by 4.8 percent in industry and 0.5 percent in the financial sector.

23 The CSO defines the number of average weekly paid hours as the total paid hours for the quarter divided by the average number of persons employed during the quarter divided by 13 (13 weeks in a quarter). Unpaid hours worked (e.g. unpaid overtime) and unpaid leave are excluded.

24 An increase in unit labour costs indicates that growth in average employee compensation exceeds growth in labour productivity.

25 OECD, Unit Labour Costs and Related Indicators, November 2009.

26 The improvement was driven by the industrial sector where quarterly unit labour costs fell by 0.4 percent in Ireland compared with an increase of 3.9 percent in the Eurozone, 1.5 percent in the OECD average and 0.3 percent in the US. However, quarterly unit labour costs for market services increased by 0.7 percent in Ireland compared with an increase of 0.8 percent in the Eurozone and a decline of 0.1 percent in the OECD average and 1.6 percent in the US.

The rate at which incomes and price levels generally adjust to the changed economic environment will have a considerable bearing on how fast Ireland can recover. As highlighted by NESC, there are trade-offs between the numbers employed and remuneration levels in both private firms and some areas of public services. While Ireland had a structure in place to negotiate pay and related issues for the last two decades, we now lack a clear agreed vision of the approach required to develop and implement an integrated and nationally supported plan across the wide range of Government, economic and social stakeholders who have a role to play in responding to the enormous challenges we face.

3.2 Reduce Property Prices

Unsurprisingly, there have been significant decreases in Irish property prices. National house prices have fallen 24 percent since their peak in February 2007 and 13.1 percent in the twelve months to September 2009[27]. Commercial property prices have fallen by 52 percent in nominal terms between their peak of early 2008 and Q2 2009[28]. The ban on upward only rent review clauses in business leases, which comes into effect on the 28th February 2010, will also help improve Ireland's cost competitiveness. However, many companies are tied into long leases with no opportunity to renegotiate the terms so recent developments will mainly benefit new and expanding or relocating firms.

Falling property prices (e.g. offices, warehouses, residential houses) bring long term economic benefits. While falling property prices may depress consumer demand in the short term, the NCC believes that there are significant long term benefits:

- Property purchase and rental is a major cost for internationally trading businesses. Falling property prices benefit new and expanding enterprises;
- High property prices for residential units have a strong impact on pay and income levels and expectations. Lower house prices can support a moderation in pay demands without lowering quality of life for new buyers; and
- Artificially high property and buildings prices will slow the clearing of surplus assets in the market. While building activity cannot return to boom levels, a sustainable level of activity is not likely to develop until existing vacant premises start to clear. Developers need confidence that prices have fallen sufficiently and perhaps undershot in order to determine if they can profitably supply new units at these prices. Consumers need confidence that house prices are stable or increasing.

It is vital that the property market is left to adjust; the price of land, office space and housing in Ireland needs to adjust to the levels justified by their underlying potential for adding value or earning rent. In this context it is important that the actions taken by the banking sector and NAMA support an appropriate adjustment within the property market.

Falling land and property prices do not reduce the necessity for structural change in respect of land planning. A range of land use policy actions could further increase the availability of competitively priced housing and business premises. Increasing density in Irish cities is critical. Carefully located

27 Permanent TSB / ESRI House Price Index, October 2009.
28 Central Bank, Quarterly Bulletin, October 2009.

and designed high density developments, with social, educational and recreational facilities, together with world class transportation connections offer the possibility of increasing the supply of both commercial and residential property in a more cost effective and environmentally sustainable manner in future[29].

3.3 Tackle Non-Traded Services Prices

In spite of the general price declines this year, there have been significant increases in a range of publicly administered prices, such as bus and rail fares (up 11.7 and 8.3 percent), taxi fares (up 8.2 percent) and health insurance (up 20.7 percent)[30].

Despite some price moderation, Ireland faces significantly higher costs than many of its competitors across a number of key business inputs including utilities and professional services (e.g. legal and accountancy services). These higher costs and the factors driving them must be addressed. The NCC notes the allocation of €2.6 billion for professional services in NAMA's draft business plan[31]. It will be important that this large spend does not provide a price floor for the hiring of professional services in Ireland in the future. Given NAMA's need for extensive legal, accounting and other professions services, the Government needs to use its considerable purchasing power to apply downward pressure on professional fees.

Limited competition in the non-traded sectors, particularly in utilities and the professions has serious implications for the costs of doing business in Ireland. The OECD highlighted the slow progress to date to strengthen competition and the fact that the most significant changes were as a result of initiatives taken at EU level rather than domestically[32]. Removing barriers to competition in the non-traded sectors is critical to bring the cost of vital inputs for Irish exporters into line with our competitors. It will also make the economy more efficient and benefit consumers in the long run.

Following the commitment in *Building Ireland's Smart Economy* to publish a whole of Government response to recommendations contained in reports of the Competition Authority within nine months of their publication, the Department of Enterprise, Trade and Employment initiated an important process to progress outstanding recommendations[33]. The NCC recognises that the issues involved are complex. It is critical that the Department of Enterprise, Trade and Employment continues to advance this process and with other relevant departments works to find ways of improving competition in sectors that affect the costs of doing business while also meeting other public policy goals.

The remainder of this section outlines specific recommendations to reduce costs.

29 NCC, Our Cities: Drivers of National Competitiveness, April 2009.
30 CSO, Consumer Price Index, November 2009.
31 NAMA, Draft Business Plan, October 2009.
32 OECD, Economic Surveys: Ireland, November 2009.
33 Building Ireland's Smart Economy: A Strategy for Economic Recovery, December 2008.

Energy Costs

The NCC welcomes the recent announcement by the energy regulator to reduce energy prices for business users. However reductions in electricity and gas prices to date, while necessary, are not sufficient to improve Ireland's position relative to competitor locations. The NCC's Statement on Energy sets out a range of priority recommendations to lower costs[34]:

- Regulation needs to prioritise bringing the differential in controllable domestic costs (i.e. non-fuel costs) into line with costs in our main competitor countries;
- Given the introduction of the single electricity market in November 2007, it is timely to review the market rules to ensure that the market is functioning optimally;
- Electricity generated from renewable sources and peat receives a guaranteed price. These subsidies (€64 million in 2009/2010 for wind and €93 million for peat) help reduce Ireland's dependency on imported fuel, and in the case of renewables help Ireland to meet its renewables and climate change targets. While public subsidies can play a key role in supporting emerging sectors where the technologies and businesses are developing, the NCC is concerned about the cost implications for electricity customers. As highlighted by the International Energy Agency, policy support mechanisms for renewables should be designed to be transitional with decreasing support levels over time as the technologies mature and deployment occurs. Regular reviews of the mechanisms in place and of the progress achieved are crucial to ensure that renewable energy penetration and deployment occurs smoothly and effectively[35];
- Given that Ireland is likely to have to close its peat plants in future (to comply with EU legislation), there is merit in phasing out the subsidies due to the cost implications, especially now that the amount of spare electricity capacity has increased significantly; and
- The carbon windfall should be recovered from electricity generators and passed back to electricity consumers through lower prices, on an annual basis, to 2012.

Waste Costs

Ireland remains highly dependent on landfill facilities and has one of the highest landfill costs compared to competitor countries. Recent falls in landfill prices, while welcome, reflect a significant reduction in demand as the economy has weakened rather than polices to reduce costs. The recently announced increase in the landfill levy will negatively affect the competitiveness of Irish businesses due to the lack of alternative waste treatment options currently available to them[36]. The NCC recommends the following actions:

- It is critical that waste management policy decisions support national competiveness as well as environmental sustainability policy objectives. Limited consideration is given to our international competitiveness in the recently published international review of waste policy by Eunomia Research and Consulting[37]. A key challenge for Government in developing Ireland's future waste policy is to ensure that waste management policy decisions do not disadvantage

34 NCC, Statement on Energy, October 2009. The report also identified policy priorities to improve security of supply and to move Ireland to a lower carbon economy.

35 International Energy Agency, 2008, Deploying Renewables: Principles for Effective Policies. Paris.

36 In November 2009, the Minister for the Environment, Heritage and Local Government announced that the landfill levy will increase from €20 per tonne currently to €30 in 2010, €50 in 2011 and €75 in 2012 to divert waste from landfill to meet EU targets. An incineration levy in the range of €20-€38 per tonne is also to be introduced.

37 In 2008, the Department of the Environment, Heritage and Local Government commissioned a consortium of consultants to undertake a comprehensive review of Irish waste policy. This report was published in November 2009. For more details see: Eunomia Research and Consulting et al, International Review of Waste Management Policy: Summary Report, September 2009.

Irish businesses relative to their international competitors. In particular, consideration should be given to what measures are required to ensure that alternative waste treatment options are competitive in terms of costs and quality of service and to how favoured waste treatment solutions can be made more competitive (for example, through the use of planning laws and the provision of regulatory certainty), rather than reducing the cost competitiveness of already high cost landfill.

- Planned increases in the landfill levy should not be implemented until alternative cost effective waste treatment options are operational. The proposed incineration levy and cap on incineration should not be introduced until such time as adequate alternative waste treatment facilities are well established and the use of landfill is reduced significantly. When introduced, the incineration levy should be at a lower level than the landfill levy to reflect the position of incineration higher up the waste management hierarchy;
- A decision on the future regulatory structure for the waste sector needs to be quickly made, as the current uncertainty is inhibiting investment in alternatives to landfill. Given the huge challenges facing the Irish economy, urgent action is required to provide policy certainty. In particular, the relative roles and responsibilities of the State in the regulation and management of the waste sector at national, regional, and local level need to be clarified; and
- The regionally based waste planning framework is hindering the delivery of cost effective, commercially viable and sophisticated waste treatment options to Irish businesses. The regional waste management plans need to be coordinated at national level to attract investment in waste infrastructure in a way that maximises potential economies of scale, competition and enables the market to pass on the benefits to businesses and households.

Local Authority Charges

Local authority charges have been highlighted as a significant cost for exporters in the NCC's recent statement on sectoral competitiveness, *Driving Export Growth*. Careful consideration needs to be given to freezing and, where possible, reducing commercial rates.

Although many local authorities are in a difficult financial situation, it is critical that local authority charges on businesses are transparent and reflect the true economic cost of serving their needs. Alternative methods of raising revenue must be implemented – e.g. the extension of charges for treated water to domestic users. Reform is also required. The Special Group on Public Service Numbers and Expenditure Programmes recommended the rationalisation of local authority structures. In addition to reducing costs to the State, a rationalisation of the number of local authorities would facilitate more consistent policy development, and increased coordination in local government by creating greater critical mass. The reduction of the number of local authority structures would also provide greater economies of scale across the range of local authority services facilitating significant efficiency gains. However, effective local government structures are dependent on ease of engagement with citizens and enterprises. Care should be taken to guard against any real or perceived democratic deficit as a result of changes in structure.

As part of the ongoing review of local government structures the opportunity should be taken to have a more comprehensive view of what structures are needed in Ireland, what services they are to deliver, and how they are to be managed and by whom. Clarity as to the role of local bodies, their planning objectives and their decision-making will provide a more predictable environment for enterprise and lead to greater efficiencies in the delivery of services.

4. Increasing Productivity

In spite of moderating price levels, Ireland is an expensive country in terms of the costs of doing business. A reduction in our cost base can play an important role in restoring our competitiveness. However, it is also critical that attention is focused on capturing new opportunities in existing and emerging high productivity sectors and enhancing productivity growth across the economy.

4.1 Restructuring the Economy and the Enterprise Base

The Irish economy has undergone significant changes in recent decades. In the 1990s, economic growth and employment was driven by a very strong export performance. For much of this decade, growth in employment and economic activity has come largely from the domestic economy, particularly the construction and retail sectors.

Between 2000 and 2008, employment in the Irish construction sector grew by 56 percent compared to 15 percent in the EU-15 and 12 percent in the US[38]. As a result, in 2007 at the peak of the housing boom, the construction sector employed one in seven workers in Ireland compared to one in 12 in the EU-15[39]. Employment in the retail sector grew by almost 30 percent in Ireland, more than three times the growth rate in the EU-15 between 2000 and 2008[40], with the share of employment in internationally trading sectors decreasing from about a quarter to less than a fifth of the total employed.

While construction and retail employment and activity levels will in time recover from the low levels of today, they will not return to the unsustainably high levels of recent years. Therefore, future employment and economic growth is dependent on growing the trading sectors of the economy and increasing internationally trading activity in sectors that are currently reliant on the domestic market. Strong internationally trading sectors will also support indirect employment across the economy through sub-supply opportunities and consumer expenditure. Growing internationally trading activity and employment will require a reorientation by the development agencies, especially IDA Ireland and Enterprise Ireland, towards job creation as a central objective. The NCC's recent report on sectoral competitiveness, *Driving Export Growth*, sets out a range of sector specific recommendations to improve the business environment for the main exporting sectors. The role of State supports in promoting the development of the internationally trading sectors is discussed in more detail in Section 4.7.

Improving productivity growth across all sectors of the economy – private and public, locally and internationally trading, manufacturing and services, indigenous and foreign owned - is central to the future success of our exporting sectors. A wide range of factors can influence a country's productivity growth rates, and these stem from decisions made both at Government level and at firm level.

38 NCC, Annual Competitiveness Report 2009, Volume 1: Benchmarking Ireland's Performance, August 2009.
39 NCC, Annual Competitiveness Report 2007, Volume 2: Ireland's Competitiveness Challenge, November 2007.
40 NCC, Annual Competitiveness Report 2009, Volume 1: Benchmarking Ireland's Performance, August 2009.

- From a Government perspective, its institutional structures and policies must be supportive of investment, entrepreneurship, competition and innovation. This includes the existence of a stable macroeconomic environment with well-managed public finances and price stability, continued investment in education, R&D, technology and infrastructure, as well as a regulatory environment that promotes competition and an adaptable labour market, and which minimises unnecessary administrative costs. The enterprise development agencies can also play a key role in promoting higher value added activity in the domestic economy;
- The Government can also directly influence national productivity through productivity improvements in the sectors where it is an employer. These include in the provision of public services (e.g. health, education, justice and civil service), as well as in transport services and utilities; and
- At the firm level, productivity improvements centre on investment in product and process innovation, the use of technology, and management practices.

Ireland's productivity growth since 1980 has been concentrated in a narrow base around modern manufacturing sectors, which employ less than seven percent of the workforce. As an economy, we cannot depend on similar increases in productivity in the same sectors to drive productivity growth in the future. As the costs of doing business have risen and Ireland has moved to a high wage economy, the productivity of locally trading sectors, including the public sector, has become increasingly important, as they provide vital inputs for Ireland's internationally trading sectors.

Re-invigorating Ireland's productivity performance requires a multi-faceted approach. The priority areas to improve the productivity of Irish exporters, as identified by the NCC, are outlined below.

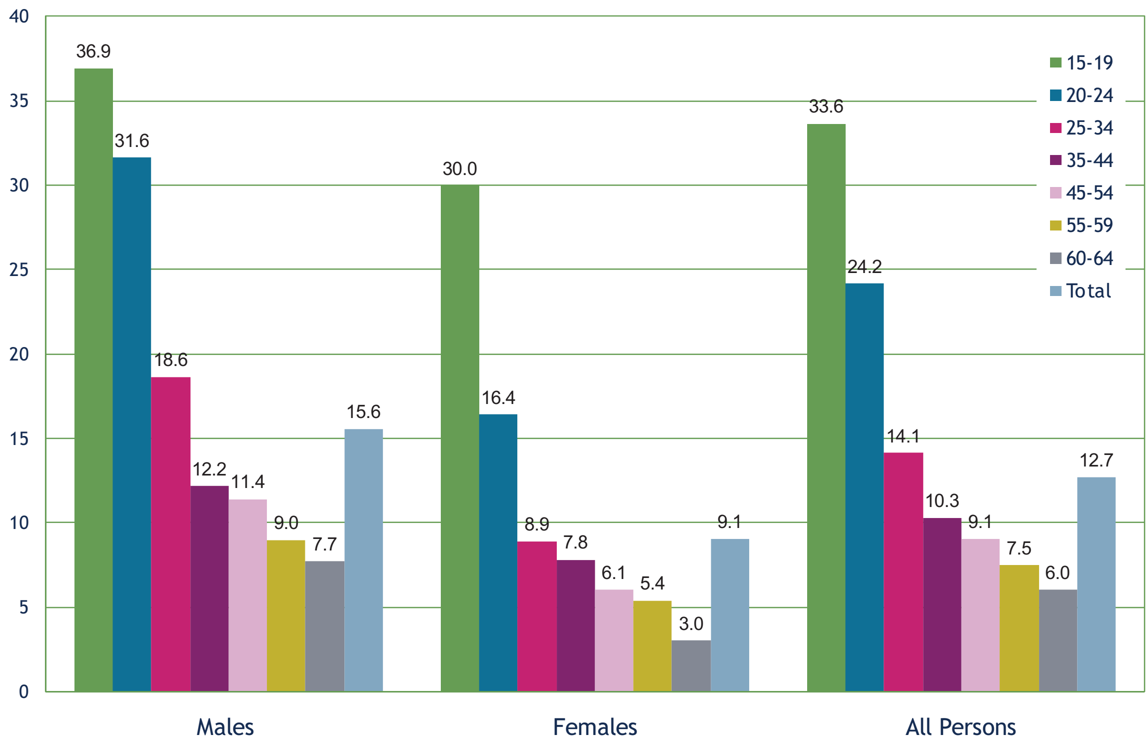
4.2 Improving Ireland's Skills Base and the Delivery of Training

Given current economic circumstances, there is increasing competition for scarce resources within key investment categories including physical infrastructure, education and training, enterprise supports and R&D. Both research and past experience suggest that a greater emphasis on skills development will result in higher long term gains. Enhancing the skills of those in employment and improving the employability of those who have lost their jobs (e.g. from construction), is critical to drive productivity growth. This will require current investment levels to be sustained to enable the ongoing upskilling of people in employment and a channelling of funds from elsewhere to increase the funding for labour market activation measures.

Improving the Skills of the Unemployed

The current deterioration in the economy has led to a sharp increase in unemployment. The unemployment rate increased to 12.7 percent in Q3 2009[41] and is forecast to reach 14.8 percent in 2010[42]. While the downturn is affecting people across all of society, certain groups are particularly exposed. These include lower skilled workers and younger workers. The unemployment rate is particularly high for those under 25, and for males aged 25 – 35. All other cohorts have unemployment rates at or below the national average of 12.7 percent (Figure 5).

Figure 5: Unemployment Rate (%) by Age Cohort Q3 2009



Source: CSO, Quarterly National Household Survey, Q3 2009.

Resources dedicated to labour market activation are relatively low in Ireland, which is not surprising given the low unemployment rate in the recent past. However, Ireland has experienced the second highest growth rate in unemployment since the recession began[43]. An evaluation of almost two hundred active labour market programmes in a wide range of countries since 1995 by the OECD suggests that job-search assistance has relatively favourable short term effects, while classroom and on-the-job training shows better medium term outcomes. Subsidised public sector employment programmes had the least favourable effects. Given the higher returns from education and training, further support for these activities should be prioritised over job subsidy schemes.

41 CSO, Quarterly National Household Survey, Quarter 3, 2009.
42 ESRI, Quarterly Economic Commentary, Autumn 2009.
43 NCC, Annual Competitiveness Report 2009, Volume 1: Benchmarking Ireland's Performance, August 2009.

Increasing the resources to address the training needs of the unemployed is a major challenge. The skills development needs of the newly unemployed are more diverse than in the past (construction workers, professionals, migrants, etc.). Training programmes must be aligned with current and future growth areas. It is therefore important to profile the unemployed so that targeted labour market activation measures can be developed. For example, new graduates need experience while those previously employed in construction or low end manufacturing require upskilling. To improve the skills base of those who have lost their jobs, the NCC recommends:

- **Targeting support at education and training:** Resources dedicated to labour market activation are relatively low in Ireland. When the Community Employment Scheme, which shares many characteristics of a social inclusion programme rather than a labour market activation programme, is excluded, the resources available to upskill the unemployed are almost halved[44]. In light of this, the Community Employment Scheme should be reviewed and reformed as it reduces the limited resources available for labour market activation. The Supplementary Budget in April 2009 and Budget 2010 introduced new measures costing in excess of €200 million, taken from existing budgets, to support those who lose their job. Further increasing the resources to address the training needs of the unemployed is a major challenge;

- **Monitoring and reforming existing labour market interventions:** While recent increases in the number of activation and training places is a welcome development, the nature and quality of the retraining options available to develop and enhance the skills sets of the newly unemployed remain an issue. It is essential that these initiatives are kept under review to ensure that they are providing an effective response to improve the employability of those that have lost their jobs;

- **A greater focus on formal accredited qualifications:** Given the likely duration of our unemployment problem, a more long term view of skills upgrading for those losing their jobs is needed. This provides significant challenges for our universities, institutes of technology and certification bodies in terms of providing places and ensuring that courses are relevant, delivered flexibly to meet the needs of those in employment and those seeking work (e.g. evening, module based, online), as well as being cost effective and accredited;

- **Assessing the labour market effects of the taxation and the social welfare system:** A major challenge exists to protect those on low incomes and social welfare benefits while ensuring that incentives to remain in or return to the labour market exist. Further research is required to assess the effects of the taxation and the social welfare system on the labour market. Further work is also required to assess the range of complex factors that enable firm level restructuring, support the unemployed and offer opportunities for skills development, and enable the transition of people back into the labour market;

- **Streamlining the delivery mechanisms for assisting the unemployed:** There are a large number of agencies involved with providing assistance to the unemployed: the Department of Social and Family Affairs, FÁS and the local employment services. This leads to the risk that the unemployed “fall between the cracks” of different support services, either voluntarily or because of the complexity of the system. Most OECD countries have moved to a system of a single agency dealing with the unemployed and handling both welfare payments and activation

44 The Community Employment Scheme, which provides pay and support for up to two years of employment in the non-market sector, absorbs almost half of the labour market activation budget while catering for just 20,000 of the unemployed.

measures. As many services are being delivered from small local offices, there is also a risk that services are not being delivered in the most efficient manner[45]. Consideration needs to be given to streamlining the delivery mechanisms for assisting the unemployed.

Improving the Skills of the Employed

To enhance the skills of those in employment, the NCC recommends:

- **Retaining funding for in-employment training:** In spite of the significant pressure to shift investment towards those who have lost their jobs, retaining funding for training those in employment, particularly those with low skills in low productivity or vulnerable sectors, remains critical to enabling firms to upgrade their capabilities and employees to utilise their new skills. The significant reduction in the funding for in-employment training in 2010 is therefore concerning[46]. In-employment training should continue to be supported as a key element of the National Skills Strategy;

- **Targeting funding for training at enterprise skills needs:** Limited resources should focus on the provision of demand-led courses to support employer and employee identified specific skills needs (such as Skillnets) and management training to respond to structural and market change. While the greater availability of labour is improving the competitiveness of firms, especially those that are growing, as noted in the NCC's recent report, *Driving Export Growth*, important exporting sectors have identified skills deficits in key areas. Some examples of skills needs in these sectors include:

  - A core requirement for growth in the food sector is to diversify into new markets in the medium term. There are a number of specific skills associated with doing business globally, e.g. language skills, understanding of international trade and regulatory policy;
  - Increased regulation has resulted in a need for specialised compliance skills in a number of sectors such as medical technologies, chemicals and pharmaceuticals and international financial services;
  - The ICT and financial services sectors require additional skills in the area of advanced mathematics if they are to increase the level of high value activities undertaken in Ireland;

  A range of other sector specific skills are required to enable further growth in our key exporting sectors and these are outlined in Appendix 1. In addition to the provision of specialised courses, we also need to consider how we can attract and retain highly skilled and internationally mobile workers in Ireland (which includes Irish workers with specialised skills), particularly as the global economy starts to grow again; and

- **Utilising labour market interventions to drive productivity:** While the recently introduced employment subsidy scheme is an important emergency measure to support exporting firms facing short term difficulties arising from the global economic crisis, it is vital that future labour market interventions are linked to improving productivity through skills development (or

45 OECD, Economic Review of Ireland, 2009

46 The majority of the in-employment training budget is administered through FAS. According to the Budget estimates, this funding is to be reduced by 25 percent to €79.5 million in 2010. The Skillnets budget of €16.6 million is unchanged.

other factors that support productivity growth such as technology deepening) rather than maintaining the status quo.

4.3 Promoting Investment in Research, Development and Innovation

Irish businesses must be responsive to the needs of international markets, react better and faster to changing consumer preferences, and continuously innovate in products and processes, as part of a constant renewal process if they are to compete successfully in increasingly competitive global markets. Responsibility to innovate rests primarily with enterprises and individuals themselves; however, public policies that support and enable innovation are also important.

The outputs of investments in R&D are one important driver of innovation. The Strategy for Science, Technology and Innovation (SSTI), which was developed in 2006, was predicated on four percent GDP growth per annum. In light of the severe contraction of the economy this year, funding for R&D and innovation is now running €266 million behind SSTI and NDP projections[47]. This places significant pressure on the SSTI system generally, but in particular on the ability of companies to invest in R&D and commercialise R&D outputs.

The NCC has identified a number of R&D and innovation priorities to enhance the productivity of Ireland's exporters:

- **Prioritising Government spending:** Given the need to reduce Government spending, the NCC believes public R&D funding should prioritise programmes which have strong industry relevance and participation, with a particular focus on:
  - near to market, applied research, commercialisation, demonstration and engineering related expenditures. This research should be facilitated through in-company R&D support and by developing industry-led, applied research capacity within the higher education institutions;
  - driving consolidation in existing research infrastructures and centres, thereby building critical mass and achieving higher research productivity, output and economic impacts from investments;
  - closer alignment of industry and higher education institutes nationally and internationally not only offers potential revenue streams but will make an important contribution to the development of complementary academic, scientific and entrepreneurial skills;
  - leveraging the significant investments already made. This will require more integrated agency coordination at the client interface, and shared metrics to assess the efficiency of the entire system rather than individual agencies or programmes. Metrics need to become more output and commercially focused;
- **Coordinating R&D funding:** Budget 2010 proposes to introduce a single stream of funding for science research[48].

47 Science Foundation Ireland's capital funding has been reduced from €179m announced in Budget 2009 to €165m. The capital funding for Enterprise Ireland was cut to €126m. The original allocation for the Department of Education and Science's capital budget in 2009 was €256m but it has been reduced to €150m.

48 The Special Group on Public Service Numbers and Expenditure recommended the introduction of a single stream covering all state funded scientific research. This includes all R&D funding channelled at present through Science Foundation Ireland, the Programme for Research in Third-Level Institutions, the Health Research Board and others.

- The NCC favours the development of a funding stream which encompasses a statutorily guaranteed, multi-annual funding package for science research, covering all state funded scientific research. Strategic R&D and innovation funding priorities should be agreed every 2-3 years by Government and provide the framework for coordinating the funding stream. It is important that the benefits achieved from the strong commitment of a large number of Government departments to the research and innovation agenda is maintained in any restructuring of activity;
- It is important that the research stream funds the continuum of research from world class research awarded on the basis of scientific excellence, to applied research and technology transfer.

- **Reviewing the R&D tax credit:** Under the current R&D tax credit system, the credit to foreign owned companies often accrues to the corporate headquarters and is therefore not captured in the costs and revenues of the Irish plant. Reforming the operation of the tax credit so that it is applied to the cost of employment in Ireland could increase the volume of R&D activity taking place here without changing the incentives offered. While it is important to keep the R&D tax credit under review to ensure that it is as effective as possible, policy certainty is also an important factor in companies' investment decisions. The tax credit has been changed every year since it was introduced in 2004. Any future changes should be made together rather than incrementally as has been the case to date to provide certainty to companies; and
- **Developing IP competencies:** Companies are struggling with the complexity of IP management practices and conditions in public research organisations and are unclear as to how they can use it to their advantage. Research institutions and universities and institutes of technology that are recipients of public funding need to develop quickly the skills base to work with firms to provide access to new ideas and knowledge. There is a role for the development agencies and industry representative bodies to play in developing competencies in this area.

4.4 Incentivising Technology Deepening

Companies compete on the value that they can bring to an increasingly discerning buyer. Investment in technology can play a key role in reducing costs and improving productivity growth. However, investment in machinery and equipment fell at an annualised rate of 33 percent up to Q2 2009 (excluding aeroplane purchases) and is forecast to fall by 21 percent in 2009 as a whole[49].

In recent times, the tax system has encouraged investment in property over investment in productive capacity. Given the increasing limitations at EU level on government aid for capital investment, it is critical that tax incentives are reviewed to incentivise investment in the productive sectors to support sustainable economic activity and employment[50].

Enterprise Ireland and IDA Ireland offer a wide range of mainstream and emergency supports to companies based in Ireland to invest in capital equipment and technology as part of their

49 ESRI, Quarterly Economic Commentary, Autumn 2009.
50 The European Commission, through State Aid rules, has been moving away from capacity grants (typically for capital investment) to capability building (R&D, training, management development). However, the recently introduced, Temporary Framework allows a maximum of €500,000 of State support to companies. Enterprise Ireland is currently undertaking a €100m investment programme over the next two years under this framework.

restructuring and transformational initiatives. While the recently introduced enterprise stabilisation fund and the employment subsidy scheme are important emergency measures to support exporting firms facing short term difficulties arising from the global economic crisis, it is important that existing and additional funding where available is directed to programmes which enable companies to innovate and build the scale and expertise required to diversify into new export markets to support the long term viability of their business.

Use of ICT

Within Irish firms, the evidence suggests that overall business and ICT strategies, coupled with support for efficient ICT investment and managers with both people and ICT management skills achieve the highest productivity gains[51]. Ongoing organisational change and restructuring is also essential. In order to create a more conducive environment to support the effective use of ICT in the workplace, the NCC recommends that:

- Government promote the take-up and development of best practice in ICT by further developing the quality and availability of e-Government services. This would help improve public sector productivity and the performance of private enterprises that use these services; and
- Government support the development of advanced broadband networks and services as set out in the next section.

4.5 Prioritising Infrastructure Investment to Support Enterprise

The availability of a competitively priced world class infrastructure and related services is essential to support the competitiveness of Irish exporters. While the crisis in the public finances necessitates cuts in capital expenditure, it is critical that capital expenditure is not excessively reduced to avoid difficult decisions on current expenditure cuts.

While it is accepted that the public capital investment programme is now more limited than envisaged under the NDP, it is vital that the infrastructure projects likely to have greatest impact in terms of attracting overseas investment and supporting firms in Ireland to compete successfully in global markets are front-loaded. Given the central role that Dublin and our other cities play in driving national competitiveness, the re-prioritisation of capital expenditure should focus resources on their development. We also need to deliver key infrastructure projects more efficiently with fewer resources. With falls of 20 percent in tender prices and up to 50 percent in land prices, reductions in nominal capital expenditure should not lead to a similar sized decline in the volume of activity in the medium term[52].

Consideration also needs to be given to the potential to coordinate the rollout of different infrastructures such as roads, broadband, water, electricity and gas. Not alone would this facilitate the provision of infrastructure in an integrated framework, it also has the potential to deliver significant cost savings particularly where projects are undertaken simultaneously; for example,

51 Maddox and Boyle, Information Technology Performance and Process: Four Case Studies published in Forfás' Perspectives on Irish Productivity, 2007.

52 Costs for many of the 2009 and 2010 projects were committed to before the current recession which has reduced costs. Therefore, there will be a time lag before the benefits of the cost reductions are obtained. There will also be a time lag in benefitting from land price reductions as the price is set by law at the time notice of compulsory purchase order is issued.

civil works account for 80 percent of the cost of rolling out fibre for advanced broadband services[53]. A strengthening of existing institutional arrangements to enable the sharing of investment rollout plans across Government departments and agencies needs to be established without delay.

Delays in the planning process have had a negative impact on the timely delivery of key infrastructure projects. The introduction of the Strategic Infrastructure Act, 2006 is a welcome step in addressing this issue[54]. The new legislation has been used in a limited number of cases to date but it is too early to determine if it has led to an improvement in planning timelines. It is vital that its effectiveness in terms of reducing the lead time to get infrastructure projects approved is assessed in due course. The introduction of a specialist infrastructure court, to deal with medium to large-scale planning and construction cases, modelled on the successful commercial court, could assist in cutting time and costs of delivery of our much-needed infrastructure. Such a system is operated in the UK and Australia.

Developing world class advanced broadband networks and services is essential to enable Ireland to support the smart economy. In particular, access to high quality, resilient and competitively priced advanced broadband in key regional centres is required to enable many of our main exporting sectors (e.g. ICT, medical technologies, financial services, tourism, international education services) to retain the current levels of trading and to enable them to exploit future growth opportunities. The better use of technology (e.g. cloud computing) can also play a key role in enhancing the productivity of the wider economy. Ireland's limited capital budget notwithstanding, Government has a central role to play in developing Ireland's advanced broadband network. The priority measures identified by the NCC to improve Ireland's broadband competitiveness entail:

- Developing a regulatory framework that will incentivise and support private sector investment in next generation broadband infrastructure, and reward providers for the risk involved in undertaking long-term investment (in line with forthcoming EU developments);
- Bundling all of the existing State telecommunications assets (commercial semi state, local authorities, metropolitan area networks) to provide an open access network capable of providing next generation broadband services;
- The extension of existing metropolitan area networks in Cork and Waterford to achieve network benefits of State investment to date, and the provision of metropolitan area networks in the five outstanding National Spatial Strategy centres; and
- Mandating the provision of ducting for telecommunications on an open access basis as part of all State infrastructure development programmes at regional, city, town and local level. The planning regulations should also be changed to mandate fibre ducting in all new public, commercial and residential premises.

A number of countries have determined that fibre connections are critical to the development of a competitive digital economy and are committed to strong public intervention – including direct investment in some cases - to ensure this utility becomes widely available in a timely and cost competitive fashion. This is an option that needs to be considered for Ireland.

53 European Commission, Explanatory Note on Regulated Access to Next Generation Access Networks, 2008.
54 The Strategic infrastructure Act aims to provide a fast track planning procedure for certain major public and private infrastructure projects.

The other infrastructure investment priorities identified by the NCC to support the competitiveness of the productive sector are:

- **Roads:** The completion of the main inter-urban networks linking Dublin with Cork, Galway, Limerick and Waterford by the end of 2010. Finalising the Atlantic Road Corridor (particularly the Cork to Galway section), upgrading the remaining sections of the N11 (Dublin to Rosslare) and relieving bottlenecks in Galway (N6 Galway City Outer Bypass) and Cork cities (N22 Cork Northern Ring Road/N28 Ringaskiddy/Cork) need to be prioritised. The timely upgrade of the N4 (west of Mullingar) and the N5 (west of Longford) is critical for the future development of the medical technologies sector. Given the time span required to deliver new projects, it is important that planning processes continue to be progressed in order to ensure that additional projects can be initiated quickly as resources become available;

- **Public transport:** Sustained investment is required in public transport projects (e.g. rail and bus networks), which offer the highest economic and social returns. The emphasis should be to improve public transport in our main cities, particularly Dublin;

- **Water:** The prioritisation of water services investment in key regional centres, particularly those facing capacity shortages in the next five years (Dublin, Athlone, Galway, Letterkenny, Mallow and Wexford)[55]; and

- **Energy:** Continued investment in energy infrastructure, particularly the east-west interconnector and the second north-south tie-line and the planned electricity grid upgrade to support renewable technologies and to ensure that key regional centres can support energy intensive investment projects.

There is also significant scope for Government to improve infrastructure capacity and services without the need for Exchequer investment. Addressing policy and regulatory barriers can promote greater private investment, and will enhance the potential to utilise public private partnerships (PPPs) as the financing environment improves. Key policy areas include:

- **Energy:** Significant investment in the transmission and distribution networks is planned over the period to 2025, which is to be financed through higher electricity prices. In view of the cost implications and the fact that underground cables are technically inferior from the perspective of guaranteeing security of supply, high tension transmission cables should continue to be placed overhead;
- **Transport:** the promotion of integrated land use and transport policy and reform of the regulatory framework for public transport to ensure quality services in terms of routes served, frequency of service and inter-operability across different transport modes and service providers;
- **Waste:** creating policy and regulatory certainty to promote investment in much needed new infrastructure along the waste hierarchy (such as thermal and biological treatment to recover energy from municipal and industrial waste and facilities for processing recycled material); and
- **Water:** The establishment of a national authority with responsibility for the delivery of water services. This, combined with the extension of charges for treated water, would enable the

55 Forfás, Assessment of Water and Waste Water Services for Enterprise, September 2008.

development of a long term strategic approach to water services policy and planning at national level.

4.6 Enhancing Competition and Regulation

Competition, subject to adequate regulatory oversight, promotes productivity growth in a number of ways. It stimulates productivity growth, investment and innovation as firms invest in the development of new products and processes and as they reorganise to create competitive advantage. Secondly, competition encourages efficiency. As firms face robust competition, they must reduce costs in order to compete for customers. Finally, competition promotes innovation and the diffusion of new technology as firms seek to achieve competitive advantage by reducing costs through adopting best practice or developing new processes, products or improving existing ones[56].

Internationally trading businesses in Ireland face a wide range of competitors. The benefits of being able to compete internationally are clear - the creation of the European single market has been critical to raising Irish productivity levels and living standards. Trade policy, and in particular international trade agreements, (e.g. WTO agreements and free trade agreements between the EU and its main trading partners) have an important role to play in supporting export growth. The growing sophistication of Irish exports means that the barriers to trade are not simply tariff based. Many of the main growth sectors face technical and other non-tariff barriers that restrict the potential to develop markets for new, innovative products. Transposition and implementation of the EU Services Directive is vital to exploit growth opportunities in internationally trading services. The NCC welcomes the action plan that is being prepared by the Department of Enterprise, Trade and Employment on trade, investment and tourism, and the longer term strategy currently being developed by Forfás.

While there are a number of examples of the benefits of greater competition in domestic markets, a wide range of sectors in Ireland are relatively protected from competition. There are a number of reasons for this including the power of producers in these sectors, the nature of the good or service produced, the limited potential for competition, (e.g. natural monopolies, small size of the Irish market), the role of Government and the power of regulators, and weak consumer voice and action.

It is critical that competition law is applied in all sectors of the economy. Non-trading sectors should be as competitive as possible. The NCC has identified a number of policy actions to improve competition in the Irish market:

- The active pursuit of measures to enhance competition, particularly in locally trading sectors of the economy, e.g. solicitors, barristers, banking and non-life insurance, transport, energy and waste services, medical and paramedical professions. Current laws, rules and customs should be reviewed to ensure that they are not anti-competitive. Anti-competitive practices take many forms; for example, they can restrict the ability of people to enter these sectors (e.g. limited training places and limited recognition of overseas qualifications), the ability of commercial companies to provide services and of customers to switch providers easily. Self regulation in the some professions also hinders competition (e.g. legal services);

56 Boyle, D. and Evans, J., 'Competition and Productivity', published in Forfás' Perspectives on Irish Productivity, 2007.

- The NCC welcomes the recent publication of the *Government Statement on Economic Regulation* and the emphasis on the importance of effective economic regulation for competitiveness[57]. Continued efforts are required to ensure regulatory structures and systems are strongly oriented towards consumer interests rather than producer interests. It is critical that regulators have clear targets that are reviewed periodically, and that unnecessary ongoing regulatory costs are avoided. Potential also exists to review the role of informal regulators within Government departments to ensure consistency in terms of strategy and the promotion of competition; and
- In partnership with the European Commission, the OECD is undertaking a review of regulatory processes in Ireland and the other 14 original EU member states. It will include an examination of the use of regulatory impact analysis, the administrative costs reduction process, and approaches to enforcement. The review of Ireland is due to be completed by March 2010 and should make an important contribution to reform.

Sectoral Regulation

Ireland's success as an exporting economy depends on a small number of sectors including medical devices, pharmaceuticals, chemicals, food, and financial and business services which require regulation that is consistent with building and retaining the trust of customers. The NCC's report, *Driving Export Growth*, has proposed a number of sector-specific regulatory recommendations which if implemented would help to improve the operating environment for exporting sectors in Ireland. These include:

- **International financial services sector:** Reform of the regulatory environment to ensure greater transparency and to rebuild trust in the system is critical. It is essential that this reform happens quickly and that the lack of regulatory certainty that currently exists is swiftly addressed so that Ireland can exploit the growth opportunities in the sector;
- **Environmental legislation:** With regard to environmental goods and services, the strategic and timely implementation of impending EU and international environmental legislation can play an important role in developing markets for indigenous green companies and through the development of Irish competencies create first mover advantage; and
- **Best practice in the application of EU regulations:** Across a number of sectors, there is a perception that the implementation of EU regulations in Ireland sometimes goes beyond the standard requirements, placing Irish firms at a disadvantage relative to their competitors in other EU countries. Relevant Government departments, agencies and sector representative groups need to identify best practice in the application of EU legislation elsewhere to ensure that the Irish interpretation and implementation, while meeting the required standard, does not place unnecessary or excessive costs on Irish businesses.

Easing the administrative costs that regulations create can improve the business environment by reducing costs, minimising the time businesses spend fulfilling regulatory requirements and increasing productivity. The recommendations of the High-level Group on Business Regulation have achieved administrative savings of €20 million per annum to date and a wide range of additional proposals to reduce costs are being advanced. The Government is seeking to achieve a 25 percent

57 Department of the Taoiseach, Government Statement on Economic Regulation, October 2009.

reduction target by 2012 which the Business Regulation Forum equated to cost savings of €500 million[58]. In addition, there is potential to achieve greater coherence among regulatory and inspection bodies in their interactions with enterprises and to increase the use of a risk based approach to the enforcement of regulations so as to reduce costs to business. This would be greatly assisted by the timely introduction of a common system of unique business identifiers by State bodies. Notwithstanding the complexity of reducing administrative costs in a fashion that does not damage public policy goals and the increasing pressures on Government departments in terms of resources, every effort should be made by Government to expedite the process. This requires the allocation of resources across Government departments and the setting of clear milestones toward the achievement of the target.

4.7 Enhancing Delivery of State Supports

Enterprise supports have a key role to play in supporting Irish exporters to innovate and develop more competitive products and processes, and to diversify into new markets. The proposal by the Special Group on Public Service Numbers and Expenditure Programmes to streamline all enterprise support activity into a single body can produce a more coherent and efficient approach[59]. However, care is needed in any restructuring to ensure the focus remains on enterprise and export growth as many of the existing bodies to be amalgamated also have wider, non-enterprise responsibilities.

As Ireland seeks to broaden its trade and investment footprint to exploit emerging opportunities in high growth markets, closer IDA Ireland and Enterprise Ireland collaboration is needed. For example, China is already becoming a significant overseas investor. Typically, Chinese firms prefer to enter new market through takeover or partnerships with existing indigenous firms rather than building new greenfield operations. Government to government relationships and partnerships will increase in importance for accessing opportunities in these markets, where strong relations at enterprise level would have sufficed in more developed economies. Ireland is well positioned to act as a hub for such investment.

4.8 Promoting Workplace Development

Firms have to continually increase their productivity either by reducing inputs or by increasing output value in order to remain competitive and profitable. Productivity growth is in every one’s interest. Increases in productivity are best realised in a work environment that is flexible, and in which the creativity, knowledge, skills and experience of the workforce are channelled and rewarded. The major drivers of workplace productivity include[60]:

- Investment in ICT and associated training and organisational change;
- Investment in equipment (e.g. more efficient equipment and technologies that facilitate automation);
- Increasing natural resource efficiency (e.g. energy, water, packaging) and reducing waste;
- Harnessing people power by providing job-related training and variable pay schemes (such as gain sharing) as well as goal setting and feedback for employees; and

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58 Report of the Business Regulation Forum, March 207. This potential savings should be regarded as indicative - the calculation used a relatively basic methodology; 25 percent of 1.5 percent of GDP.

59 These include Shannon Development, Bord Bia, Bord Iascaigh Mara, the National Film Board, the County Enterprise Boards, and the Western Development Commission.

60 Forfás, Boost your Company’s Productivity: Simple Steps, 2009. This guide for managers and employees can be accesed at www.forfas.ie.

- Using benchmarking and ‘world class business’ tools.

Promoting productivity growth and organisational change is a major challenge in an environment where many businesses and employees are struggling to cope with the current recession and where traditional centralised bargaining processes are stretched. However, our past experience of the partnership approach has left us with many of the problem-solving skills and attitudes needed to enable individual workplaces to cope with the current recession.

5. Conclusions: Focus on Delivery

Ireland is currently experiencing one of the deepest recessions in the developed world, driven by a steep decline in the domestic economy and the international financial crises. As the world economy is likely to return to growth more rapidly than the Irish economy, export driven growth can play a key role in restoring the Irish economy to growth. In addition to sustaining and growing employment in exporting sectors, export success will increase sub-supply demand for Irish goods and services across the economy and can help support a recovery in consumer demand.

Driven by improvements in cost competitiveness and greater labour availability, Irish competitiveness has improved over the past 12 months. The NCC believes this improvement largely reflects the sharpness of the recession rather than competitive advantages arising from structural change. However, as recognised by the OECD and others, significant progress is being made in addressing the serious banking and fiscal challenges facing this country. Further action is required to improve competitiveness. The NCC believes that the speedy implementation of the priority actions highlighted in this report is as fundamental to Ireland's future as the steps being taken to address the banking crisis and to arrest the decline in the public finances.

As the activities of a wide range of Government departments and agencies will critically affect our ability to restore our competitiveness, we need to have structures, processes and the capacity in place to ensure that Government departments and agencies act quickly in mutually complementary and supportive ways. It is important that we have a clear understanding of the basic drivers of competitiveness and of what needs to be done to improve Ireland's international competitiveness. It is also important that there is a centrally driven process to restore competitiveness where each department and agency has clearly defined actions with timelines and a focus on delivery to enhance Ireland's competitiveness. Building on the existing impact assessment process, we believe it is essential that the implications of all Government decisions for Ireland's international competitiveness are rigorously assessed.

Appendix 1: Specific Skills Needs in Key Exporting Sectors

The NCC's report, *Driving Export Growth*, highlighted a number of skills needs in key exporting sectors. These include:

- **Food and Drink**
  The NCC supports the implementation of the recommendations identified by the Expert Group on Future Skills Needs for the sector. In particular, the Council would like to highlight the need for skills in process efficiency and innovation commercialisation as well as multi-lingual skills and internationalisation expertise. Industry representatives have also stressed the importance of training for those with low skills to enhance overall firm productivity. Strong management capabilities are also critical for the future development of the sector.

- **Medical Technologies**
  High-level engineering and scientific skills are essential to support innovation in the sector. The availability of skilled labour is sufficiently competitive for the Irish medical technologies sector, but there are specific skills shortages in the areas of quality control and regulation. Marketing and pricing skills will be required in the medium term to facilitate the sector's move towards higher value activities in Ireland. The NCC supports the implementation of the recommendations identified by the Expert Group on Future Skills Needs for the sector. In particular, the NCC would like to highlight the following actions:

  - The entry criteria for the recently developed graduate programmes in medicine has the potential to produce a supply of graduates qualified in both medicine and engineering. Medical and engineering schools should jointly create more opportunities for clinicians in training to undertake studies and/or research in medical technology and biomedical engineering.
  - A master's course in regulatory affairs should be introduced targeted either specifically at the medical technologies sector, or jointly at the medical technologies and pharmaceuticals sectors, but with a medical technologies specialisation. It should be developed in collaboration with the industry in order to ensure relevance and to encourage uptake.

- **Chemicals and Pharmaceuticals**
  Higher level institutions need to include modules that enable graduates to gain a broader based experience through greater exposure to other disciplines including other areas of science and health as well as business disciplines.

  - A master's course in regulatory affairs should be introduced; either targeted specifically at the chemical and pharmaceuticals sector, or targeted jointly at the medical devices and chemicals /pharmaceuticals sectors. It should be developed in collaboration with the industry in order to ensure relevance and to encourage uptake.

- **ICT Manufacturing and Services**
  The projected domestic supply of high-skilled analytical computing and electronic engineering graduates needs to be boosted to meet future demand. The NCC supports the implementation of the Expert Group on Future Skills Needs' recommendations for the sector. In particular, the NCC would like to emphasise the importance of policy action in the following areas:

- Enhance the number of high skilled graduates in the ICT area by creating bursaries for achieving over 500 points in their Leaving Certificate and entering into a computing and engineering degree course.
- Produce more graduates with domain-specific knowledge to meet the needs of software companies that develop products for specific sectors within the market. This will require higher education institutes to modify existing programmes to include modules that develop expertise and understanding of sectors in which the Irish software industry has a strong presence such as banking or telecommunications.

- **International Financial Services**
  Ensuring that the correct skills sets are in place to facilitate innovation in the sector is important. The level of specialisation required in some higher skilled areas of financial services has led to skills shortages.

  The NCC supports the implementation of the recommendations identified by the Expert Group on Future Skills Needs for the sector. In particular, the following actions need to be progressed:

  - Develop new modules, and where appropriate, new courses to meet the needs identified in the Expert Group's report. It will be important that opportunities are provided to specialise in specific areas of financial services through elective modules and that support for the Finuas initiative which is seeking to address skills needs within the IFS sector is continued.
  - Introduce improved training mechanisms to upskill new entrants to the sector. This can be done through the development of mechanisms to support rapid skills development to ensure that resources can develop the requisite understanding of the industry and proficiency in core areas, e.g. eight-week intensive courses incorporating simulated environments.

- **Environmental Goods and Services**
  Skills need to be enhanced in areas such as science, management and installation and maintenance of new environmental technologies to support future growth in the sector. Given the potential shortage of environmental engineering skills, conversion courses could be introduced to enable people with good basic engineering skills to work in the sector.

- **Other Internationally Trading Services**
  Given the broad range of skills required by the other internationally trading services sub-sectors, the implementation of the National Skills Strategy is of crucial importance. Among the types of skills required by the sector are:
  - Generic skills: Employees need a range of personal and interpersonal skills, such as communication and languages, team-working, customer-service, problem-solving, and planning and organising;
  - Humanities and social science skills: Graduates in these disciplines are equipped with a range of knowledge, skills and wider competences that are particularly valued by many service sectors; and
  - Hybrid technical and business skills: Individuals who can combine discipline-specific technical knowledge with entrepreneurial skills and an ability to think creatively will be in increasing demand in the future.

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