

## **High consumer costs damage enterprise competitiveness and must be tackled as part of jobs strategy - Forfás**

**Irish prices improve relative to euro area but further efforts needed**

### **Forfás launches Consumer Costs and Inflation Report prepared as part of Action Plan for Jobs**

Forfás, the national policy advisory board for enterprise, trade, science, technology and innovation today (6 February) published *Consumer Costs and Inflation*, which benchmarks Irish inflation and price levels against our key competitors.

The report was prepared at the request of Minister for Jobs, Enterprise and Innovation, Richard Bruton TD, as part of the Government's Action Plan for Jobs.

Consumer costs are a key part of Ireland's international competitiveness. High consumer costs lead to increasing wage demands, which are the most significant cost component for most businesses, which in turn lead to reduced international competitiveness - ultimately impacting on job-creation. The report sets out a range of recommendations to improve Ireland's consumer prices as part of a drive on cost competitiveness.

**Minister Bruton** said: "A key part of the plan that this Government put in place to address the jobs challenge has been targeting improvements in our international competitiveness, and our rankings have improved from 24<sup>th</sup> in 2011 to 17<sup>th</sup> in 2013. However if we are to create the numbers of jobs we need we must sustain and build on this record with further major improvements in this area.

"Consumer costs play a major part in this. If consumer costs rise then we start to see demands for wage increases to keep up with the cost of living. Given that labour costs are generally the most significant cost faced by businesses, increasing wages has a major impact on our international competitiveness. As we saw during the last decade, increasing consumer costs can create a vicious cycle of increasing wages causing further increases in consumer costs causing further wage demands - a cycle which we must avoid if we are to create the jobs we need.

"That is why as part of our drive on competitiveness and job-creation I asked Forfás to prepare a report on consumer costs, identifying the areas where problems exist and the actions we can take to address these issues. The report we are publishing today shows that we have made significant progress since 2008, when we were the most expensive country in the Eurozone, in addressing the legacy problems. The report will form an important input into the Action Plan for Jobs 2014, and the drive on competitiveness which we must pursue if we are to create the jobs we so badly need".

**Martin D. Shanahan**, Chief Executive of Forfás said "Consumer prices matter for both individuals and enterprises. High prices (and high inflation) for individual goods and services feed through to the overall price level, leading to increased wage demands, undermining competitiveness and damaging standards of living."

"Competition policy has a significant positive impact upon consumer price levels. Strong levels of competition keep prices down, improve choice and quality for consumer and support national competitiveness and economic growth - we must, therefore, promote competition wherever and

whenever we can, driving out inefficiencies and maximising value for money for both consumers and enterprise” continued Shanahan.

“Inflationary pressure is most evident in the services sectors of the economy, particularly those sectors shielded from international competition. Action is required, therefore, to enhance trade in services, thus encouraging competition, innovation and price reductions. The ongoing development of the Single European Market is a particularly important tool in addressing high rates of services inflation. Similarly, the successful negotiation of the planned EU/US transatlantic Trade and Investment Partnership also offers significant potential to create trade opportunities and to lower business and consumer costs,” commented Shanahan.

The report notes that Ireland’s annual average inflation rate (0.6%) for the 2008-2012 period was among the lowest in the EU and significantly below the euro area inflation rate (2.1%), representing a competitiveness gain for Ireland. This is in stark contrast to the period 1999-2008, when annual inflation in Ireland averaged at 3.4% compared to 2.1% in the eurozone.

Services inflation remains a cause for concern and has been the notable driver of inflation in Ireland - services inflation here has been higher than euro area-17 services inflation over the 1997 to 2012 period. More specifically, Irish inflation since 2008 has largely been driven by price increases the cost of health insurance; Public transport; Alcoholic beverages and tobacco; and Education.

In 2008 Irish consumer price levels were almost 29 per cent above the euro area average but by 2012, as a result of lower rates of inflation in Ireland, the difference in price levels had narrowed to 13.6 per cent.

The report found that despite reductions in Irish price levels that Ireland is the third most expensive country in the euro area. Areas where prices in Ireland have improved relative to the eurozone average include food and non-alcoholic beverages, restaurants and hotels and furnishings and household equipment.

The report makes a range of recommendations that aim to encourage competition in specific sectors where price levels and/or inflation are relatively high. These include actions to promote competition in the public transport, health insurance, pharmaceutical and dentistry sectors. Continued implementation of the Government Policy Statement on Economic Regulation as a means to enhance Ireland’s cost competitiveness across a range of utilities is also highlighted as a policy priority. In addition, Forfás has highlighted the need for investment in essential economic infrastructures as means to improve efficiency, enhance productivity and lower costs.

## **Key Findings**

### **Inflation Performance**

- Since 1997 Ireland’s inflation performance has been more volatile than the euro area average. Ireland experienced higher year-on-year inflation for the period up to 2008. However, since then Ireland’s average annual inflation rate has fallen below the euro area average.
- For the period 1997 to 2012 Education (6.1%), Health (5%), Miscellaneous goods and services (4.3%), Housing and utilities (4.2%) and Alcoholic beverages and tobacco (3.9%) experienced the highest average annual rates of inflation in Ireland. Since 2008, the highest rates of inflation have been recorded for Education (5.6%), Miscellaneous goods and services (4.5%) which is driven by health insurance, Health (2.8%) and Alcoholic beverages and tobacco (2.4%).

- Irish services inflation has been higher than euro area-17 services inflation and as a result, services have contributed more to overall inflation in Ireland than in the euro area over the 1997 to 2012 period. While services inflation is higher than goods inflation for both the euro area and Ireland, the gap between the two was much greater in Ireland. Over the same period, inflation in imported services was also higher in Ireland, averaging 4.5 per cent per annum in Ireland compared to 2.3 per cent per annum among the comparator countries.
- Since the recession (i.e. 2008 to 2012), the principle contributors to Irish inflation have been Miscellaneous goods and services which is driven by health insurance, Transport, Alcohol and tobacco, Education and Health.
- Between 2001 and 2012, inflation in Irish administered prices outpaced inflation in administered prices in international peer countries and the euro area. Furthermore, inflation in administered prices has been higher than headline HICP inflation in Ireland. Over recent years, Combined passenger transport, Hospital services, Insurance connected with health, and “Passenger transport by road stand out as particular drivers of headline Irish inflation.

### **Comparative Price Levels**

- Irish price levels were above the euro area average in 1999. Movements in price levels between 1999 and 2008 served to widen the existing gap. A combination of Irish deflation and euro area inflation since 2008 has reduced relative Irish price levels..
- Despite reductions in Irish price levels, Ireland remains within the top three most expensive euro area countries in five out of twelve categories of goods and services; -Alcoholic Beverages and Tobacco, Health, Restaurants and Hotels, Food and Non-Alcoholic Beverages and Miscellaneous Goods and Services). Irish price levels remain above the euro area average in 10 of the 12 categories of goods and services.

### **Recommendations**

- Pay increases should be linked to productivity improvements rather than inflation - only productivity growth can ensure that wages increases are sustainable.
- **Health insurance** is the most significant element within the Miscellaneous goods and services category. A number of outstanding Competition Authority recommendations relating to Health Insurance should be implemented. Consideration should be given to making legislative provision for consumers who wish to switch health insurance mid-way through a cover year to be issued with a certificate or letter of closure similar in purpose to that which is issued when someone is changing their credit card.
- With respect to competition in the **dental sector**, the forthcoming legislation to replace the Dentist Act, 1985 should address a number of the recommendations put forward by the Competition Authority including enabling direct public access to dental hygienists, removing restrictions on advertising, permitting the creation of corporate dental bodies and amending the composition of the Dental Council so that each of the professions regulated is represented on the Council and the majority of membership on the Council is from outside the professions being regulated.
- Further actions are required to create a free market in services, to develop the digital single market and to develop a single European energy market. The successful negotiation of the planned **EU/US Transatlantic Trade and Investment Partnership** also offers significant potential to create trade opportunities and to lower business and consumer costs.
- Implementation of the actions outlined in the **Government Policy Statement on Economic Regulation** is an essential element in enhancing Irish cost competitiveness, particularly in relation to a range of utilities and public transport services. With regard to public transport,

it will be important that the NTA prioritises consumer interests when designing competitive tenders for public transport services.

- In addition to the enactment of the **Legal Services Bill**, implementation of the proposals of the Legal Cost Working Group would result in a downward pressure on insurance premium prices.
- **Childcare** costs represent a major cost element for many families. Considerable efforts are being made to develop and enhance quality standards in the child care sector which are very welcome. Care needs to be taken to ensure that the additional costs arising from higher standards do not increase costs excessively.
- There is a need to monitor the impact of the revised floor space cap and other changes to the **Retail Planning Guidelines** on competition in the grocery sector and schedule a review of the Guidelines. It is also important that policymakers remain cognisant of the potential impact on grocery prices of efforts to rebalance bargaining power between suppliers and retailers.
- Reduce inefficiencies in the delivery of **water and waste water services**. In particular, we need to bring operating, maintenance and capital costs into line with international best practice.
- The Inter-Agency Group on the Property Market should develop policy recommendations to avoid the creation of future sustained **property bubbles**. Combining carefully located, well designed high density developments with social, educational and recreational facilities and world class transportation connections offers the possibility of increasing the supply of both commercial and residential property in a more cost effective and environmentally sustainable manner.
- The State should proceed with a planned review of the alcohol **licensing** regime.
- As an alternative to introducing a ban on below cost selling or minimum pricing, it would be more efficient, effective and beneficial to the State to use taxation policy to encourage a reduction in alcohol consumption.
- An integrated approach to land use and transport policies is critical to allow the efficient movement of people and goods and to improve the viability of **public transport**.
- In relation to increasing the uptake of **generic prescription medicines**, it is recommended that the Irish Medicines Board progress quickly with the publication of the lists of interchangeable medicines and the effectiveness of the Health Act 2013 should be monitored to establish if and to what extent originator and generic pharmaceutical prices fall relative to other countries. There is also a need to promote consumer awareness of price variation in prescription drugs.
- Continued efforts are required to enhance **consumer awareness** about the benefits of switching between service providers. A particular challenge exists for goods/services where product quality is hard to assess (e.g. prescription drugs, health insurance, etc.).
- Review prices in industries where known data difficulties exist. In the apparel industry in particular, it could be useful to monitor price movements and the impact of recent methodological changes to the “Clothing and footwear” index.
- The CPI is composed of over 600 individual goods and services which are consumed in varying degrees by different household types and used to create an economy-wide inflation rate. Some policies and price changes have different impacts on different segments of the population. The report recommends that research be undertaken to assess inflation rates as encountered by different household types.

**ENDS**