

Reduce Costs to Maintain Living Standards - Forfás

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Minister Bruton**

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Shanahan, Chief Executive, Forfás**

Forfás, the national policy advisory board for enterprise, trade, science, technology and innovation today (Monday, 8 April 2013) published *The Costs of Doing Business 2012* which benchmarks Ireland's business costs and recommends actions to improve our cost competitiveness.

Forfás highlights that business costs have reduced significantly over the course of recent years with overall price levels in the economy falling back to the levels last seen in 2002. The improvement in business cost competitiveness has been driven by, amongst other factors, relative improvements in labour costs (total compensation per employee fell by 0.9% per annum in Ireland between 2008 and 2011 while euro area compensation grew by an average of 4.6% per annum), dramatic reductions in property related costs (the cost of constructing a prime office unit fell by 32% over the period 2007 to 2011, while the cost of renting an office unit has fallen by 45%), and falling prices across a range of professional and business services (for example, the price of architecture, engineering and technical testing services has reduced by 12% since 2006, while the price of computer programming and consultancy services, and advertising and media services are almost 5% lower than in 2006). It is important not to overstate the impact of these reductions on the cost base of existing businesses, many of whom are tied into existing contracts.

Vigilance, however, is required. Costs in Ireland remain out of line (i.e. above costs in our key competitors) for a range of business inputs: labour costs, which account for the largest proportion of location sensitive costs for most businesses remain relatively high (over 6% above euro area averages), notwithstanding the reductions achieved to date; energy costs remain a cause for concern, particularly for SMEs where Ireland is the fourth most expensive location in the euro area for electricity; waste costs in Ireland are higher than similar costs elsewhere in Europe; and legal service prices are 11% above 2006 levels, despite the recession.

Furthermore, the report outlines that over half of the recent improvement in Ireland's costs competitiveness is accounted for by favourable exchange rate movements; that the pace of cost improvement has slowed considerably in recent months; and that upward price pressures are emerging and rigidities within the economy persist (e.g. as evidenced by high unemployment, excess property).

**Burden of income taxation, particularly on average incomes, needs to be addressed -
Minister Bruton**

"This Forfás report is of major significance, and shows that while competitiveness has improved over recent years, much of the improvement risks being only temporary. If we are

to create the jobs we need, we must focus relentlessly on continuing to reduce business costs and improve competitiveness.”

“In particular, if we are going to sustain and improve the levels of investment and jobs we have seen over the past two years, we must look carefully at the burden of labour taxation on our competitiveness. As this report rightly points out, the marginal rate of income tax, at 52% for employees and 55% for the self-employed, is higher than in most of our competitor countries. It also kicks in at a much lower level of income - in fact, at €32,800 for a single person, the threshold is below the average income. Tax rates of over 50% on average incomes damages inward investment and entrepreneurship, and makes too many people question whether they would be better off not working at all.

“I believe that if we are to sustain and accelerate the transition in our economy and the jobs recovery that has begun then this Government must continue to keep its promise to avoid any further increases in the burden of taxes on work. We must also as soon as possible begin to reduce the income tax burden, starting with hard-pressed families on average incomes who have endured so much over recent years, and put a little badly-needed extra cash in their pockets”.

Further action required to promote cost reductions for businesses in Ireland - Martin D. Shanahan, Chief Executive, Forfás

Martin D. Shanahan, Chief Executive, Forfás commented “The *Action Plan for Jobs 2013* launched by the Government in February contains further measures to promote cost competitiveness for business. We cannot rely on external or cyclical effects to drive our international competitiveness - we must urgently tackle those elements within domestic control. Structural reform is required to ensure that the improvements we have seen to date in our cost and competitiveness performance are embedded in the economy and enable us return to strong economic and job growth. We need to ensure that price adjustments continue to enhance our competitive position.”

“Despite significant improvements in Ireland’s cost competitiveness there is a lot more that needs to be achieved to reduce costs further. In addition to a sustained focus on business costs, the broader cost of living needs to be addressed if we are to create a virtuous circle between cost of living, wage expectations and business cost competitiveness.”

“Irish cost competitiveness has improved markedly over the last three years or so. Now we need to capitalise on these reductions and introduce further reform to make sure that these crucial price reductions become permanent,” concluded Shanahan.

From the perspective of the individual consumer, the cost of living in Ireland remains high. On average, Irish consumer prices were found to be 12% above the euro area average and Ireland was the 3rd most expensive location in the euro area for consumer goods and services. In particular, Ireland was found to be relatively more expensive for food and non-alcoholic beverages, while the cost of health and education services has steadily increased since 2000.

Consumer prices represent important indirect costs for business. They are a reflection of the overall cost environment. Outside of work, employees purchase goods and services. Movements in these prices impact upon wage expectations, and so the impact of price changes in consumer markets spill over into the cost base of the enterprise sector. Lowering the cost of living would have an impact on Ireland’s overall competitiveness, particularly through the impact that lower consumer prices would have on wage

expectations and labour costs. The report emphasises the importance of stimulating a virtuous circle between the costs of living, wage expectations and overall cost competitiveness.

Labour Costs

Findings

- Labour costs have fallen marginally since 2008.
- There has been resumption in wage growth - albeit at a lower level than elsewhere in the euro area.
- Irish unit labour costs have improved significantly but figures are dominated by the performance of exporting sectors.
- The tax wedge in Ireland has been increasing.

Recommendations

- There should be no further increases in the labour tax wedge.
- Social Welfare benefits should decline in line with the length of time a person is out of work which would bring Ireland into line with European approaches to social welfare.
- Replacement rates should not exceed 70 per cent.
- Consideration should be given to extending the lower national minimum wage rate to all workers under 25 years of age.
- Review the impact of Industrial Relations Act in lowering costs.

Property Costs

Findings

- Construction costs and rental costs for both office and industrial space have fallen dramatically (rental costs on new leases for office space, for example have declined by 45 per cent between 2007 and 2011).
- Labour costs in construction have reduced only slightly over the recession.
- Local Authority rates have fallen marginally in the past three years but significant regional differences remain.

Recommendations

- Speed up revaluation process for business rates where the process could be outsourced or self-assessment used.
- It is anticipated by the Property Services Regulatory Authority that the commercial leases database will be put in place during the early part of 2013. Given the dearth of property related data in Ireland, it is essential that this target is adhered to.

Transport Costs

Findings

- Ireland is the 4th most expensive country in the euro area for diesel.

- Prices for transport related services (e.g. road freight, sea transport, warehousing) have remained stable since 2006. The exception being cost of air transport which increased significantly since 2010.
- Ireland is relatively expensive in terms of the administrative cost to import and export goods.

Recommendations

- Planning reform is required to reduce planning delays and to enhance the coordination of infrastructure delivery.
- It is essential that we maintain competition in the airline market. Should the State's share of Aer Lingus be sold, maintaining and developing competition, and expanding the network of routes should be a key criterion in the sale process.

Utility Costs

Findings

- Electricity costs for large energy users and SMEs are the 7th and 4th highest amongst euro area 15. Ireland has the 6th highest industrial gas prices.
- Ireland is 6th most expensive location from 15 countries for water. The cost of water for industrial users remained relatively static since 2007.
- Waste costs in Ireland remain high, particularly in relation to landfill fees
- Ireland is expensive in terms of broadband - particularly when broadband quality is considered.

Recommendations

- In the context of the significant additional costs for consumers arising from the peat PSO, unless there is a clear economic rationale for their maintenance, subsidies for peat generated electricity should be abolished.
- A review of the capacity payment mechanism should be undertaken.
- Proceed rapidly with the new proposals in the waste policy to reduce waste regions from 10 to no more than 3.
- Progress the new national broadband strategy (including actions relating to planning, the use of State assets to enhance rollout, actions to reduce broadband rollout costs, etc.)

Credit Costs

Findings

- The cost of credit for new loans to enterprise in Ireland exceeds the cost in the euro area for a range of loan types and sizes.

Recommendations

- Mirroring the UK, the Competition Authority should consider undertaking a review of barriers to entry to the banking market.

Business Service Costs

Findings

- The cost of the majority of business and professional services has fallen since 2006. The cost of legal services, however, is the exception.

Recommendations

- In addition to enacting the legal services bill, there is potential for further legal reforms including the creation of a single tier counsel system and the opening of conveyancing to suitably qualified professionals other than solicitors. Reform of court procedures also offers significant potential to reduce costs.

Broader Cost Environment

Findings

- Despite progress, Ireland remains an expensive location - 3rd most expensive in euro area. Consumer price levels do not appear to be justified by our income levels. Particularly, rapid growth in health and education costs - sectors where the State dominates in terms of provision/ policy setting. Public sector salaries remain high in an international context.

Recommendations

- In order to help reduce the public sector pay bill and maximise reform, government departments and agencies should be provided with pay budgets within which they must manage headcount, rather than the current assigned headcount target approach. Such an approach would optimise the deployment of resources.

Ends.