

Getting Fit Again: The Short Term Priorities to Restore Competitiveness

June 2009





Introduction to the NCC

The National Competitiveness Council was established in 1997 as a Social Partnership body, reporting to An Taoiseach on key competitiveness issues facing the Irish economy and offering 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-15/Eurozone 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.



Chairman's Foreword

It might be helpful to compare the Irish economy over the last decade with the situation of a high performance athlete. Our economy became increasingly competitive until 2001. Exports, employment and incomes all increased. Unfortunately, by mid-decade the effects of Ireland's deteriorating competitiveness were becoming evident - as shown by high property prices, rapidly increasing costs particularly in those parts of the economy not exposed to international competition, and the declining share of Irish exports in world markets. We had been ranked as one of the world's most competitive economies but this was eroded through overheating of the economy, so by the time we encountered the world recession the economy was very vulnerable to economic setbacks.

So like a high performing athlete we need to up our game again.

In this short publication, the Council sets out the measures which we believe will, if taken without delay, strengthen our capacity for economic recovery.

Our emphasis in this report is on immediate measures. But we stress that these should not crowd out or in any way reduce the importance which must be given to the long term policies such as investment in infrastructure, research and development, innovation, education and training which are necessary to provide enduring conditions for growth. We addressed these longer term measures in our 2008 Competitiveness Challenge report and we will return to them later in the year when we publish the next Competitiveness Challenge report.

I would like to thank Council Members and the Advisors from the relevant Government departments for their work on this document, and to acknowledge the Forfás Secretariat for the work that they have done in preparing material for consideration by the Council.

Don Thornhill

Chairman, National Competitiveness Council

Council Members

Dr Don Thornhill	Chairman
Mr Rory Ardagh	Telecom Property Holdings Limited
Mr Brendan Butler	Director of Strategy, Trade, EU and International Affairs, IBEC
Mr Donal Byrne	Chairman, Cadbury Schweppes Ireland Limited
Mr Shay Cody	Deputy General Secretary, IMPACT
Mr Martin Cronin	Chief Executive Officer, Forfás
Mr Pat Delaney	Director of Sectors and Regions, IBEC
Ms Clare Dunne	Assistant Secretary, Department of Enterprise, Trade and Employment
Ms Annette Hughes	Director, DKM Economic Consultants
Mr William Prasifka	Chairperson, Competition Authority
Mr William Slattery	Executive Vice President and Head of European Offshore Domiciles, State Street International (Ireland) Limited
Mr Paul Sweeney	Economic Adviser, Irish Congress of Trade Unions
Mr John Travers	Consultant and Founding Chief Executive Officer, Forfás and Science Foundation Ireland
Prof Ferdinand von Prondzynski	President, Dublin City University

Council Advisers

Mr Paul Bates	Assistant Secretary, Department of Arts, Sports and Tourism
Ms Mary Doyle	Assistant Secretary, Department of the Taoiseach
Mr Mark Griffin	Assistant Secretary, Department of Environment, Heritage, and Local Government
Mr Kevin McCarthy	Assistant Secretary, Department of Education and Science
Mr Eamonn Molloy	Assistant Secretary, Department of Communications, Energy and Natural Resources
Mr David Moloney	Assistant Secretary, Department of Finance
Mr John Murphy	Assistant Secretary, Department of Transport
Mr Liam Nellis	Chief Executive, InterTrade Ireland

Research and Administration

Mr Adrian Devitt	Forfás
Ms Caoimhe Gavin	Wilton Park House
Ms Gráinne Greehy	Wilton Place
Mr Eoghan O'Briain	Dublin 2
Ms Mary Twomey	
	Tel: 01 607 3000 Fax 01 607 3030
	Email: ncc@forfas.ie
	Web: www.competitiveness.ie



Table of Contents

Executive Summary	6
1. Overview of Ireland's Competitiveness	11
1.1 Introduction and background	11
1.2 Ireland retains a wide range of competitive strengths.....	12
1.3 Irish exporters are performing relatively well in an adverse environment	12
1.4 Conclusions	13
2. Positioning Ireland for Recovery.....	15
2.1 Stabilising the public finances	16
2.2 Resolving the banking crisis: ensuring access to credit	20
3. Restoring Competitiveness and Supporting Jobs.....	22
3.1 Improving cost competitiveness	22
3.2 Tackling labour market challenges	26
3.3 Restoring Ireland's reputation	29
4. Conclusions	30

Executive Summary

The Irish economy is currently undergoing a painful adjustment to the bursting of the property bubble, the international financial crises and the downturn in world trade and investment. National income is declining rapidly and unemployment has risen sharply.

The recession is resulting in high human costs as incomes fall and economic uncertainty increases. Ireland's reputation overseas and business and consumer confidence at home have been damaged. However, while Ireland's competitiveness has deteriorated in recent years, we retain a wide range of competitive strengths including a young and comparatively well educated workforce, growing levels of research and development activity, a modern internationally trading enterprise base and a long track record as a successful location for overseas investment. These strengths have been supported by improvements in infrastructure, education, and research and development. It is notable that Irish exporters are currently performing relatively well in extremely difficult international markets.

Targeting export-led growth is the only sustainable longer-term strategy to maintain living standards and to secure long term prosperity. This will not be easy in a time of falling global demand for goods and services and contracting world trade. But there is no alternative. The Irish economy needs to respond to the current crises and position itself to benefit from a global recovery. Small open economies, like Ireland, will be more severely affected by changes in the global economy. However, our economy will also be capable of faster growth once the global economy starts to recover, provided we progress the priority actions to restore competitiveness without delay.

The short term policy priorities identified in this paper are consistent with the medium term strategy for sustainable growth, as set out in the Smart Economy Framework. Much of the attention to date has quite rightly focused on resolving the public finances and the banking crisis. Further action in these areas is necessary but unless it is accompanied by a significant restoration of competitiveness, we will not sustain jobs and achieve a return to growth. In particular, Ireland urgently needs to implement an action plan to improve cost competitiveness, sustain employment, foster innovation at all levels of economic activity and enhance training and education opportunities. As the measures introduced to restore the sustainability of the public finances and tackle the banking crisis also have implications for competitiveness, priority principles in these areas are also highlighted in this paper. The priority principles are summarised below.

Restoring the sustainability of the public finances

Restoring the health of the public finances is critical. Future actions must concentrate on:

- **Raising revenue:** In view of the severe decline in tax revenue, it is clear that additional revenues are required. The NCC believes that additional revenues should be raised by broadening the tax base (i.e. valuation based property tax, user service charges) and that the competitiveness of our labour tax wedge should not be diluted through further increases in income taxes. While Ireland has one of the lowest employers' social security contributions in the OECD, a low labour tax wedge is vital to encourage labour force participation across all income categories and is an important competitive advantage in attracting highly skilled and internationally mobile workers to Ireland;

- **Cutting current expenditure:** While painful, international evidence highlights that targeted expenditure cuts must be central to restoring the public finances. It is estimated that the cumulative correction agreed to date in the budget balance is about five percent of GDP. Despite these cuts, the projected deficits for 2009 and 2010 could stand at over 11 percent of GDP;
- **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. The alternative is a diminution in the services provided to the public. 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; and
- **Prioritising capital expenditure:** There is increasing competition for scarce resources across key investment categories including physical infrastructure, education and R&D. A rapid review of NDP investment priorities which front-loads infrastructure projects likely to have greatest impact on competitiveness needs to be progressed quickly. This should be supported by a refreshed National Spatial Strategy which focuses investment and development in Dublin and other key centres. In relation to the public R&D programme we should prioritise programmes which have strong industry participation, leverage private sector investment and drive consolidation in existing research infrastructures and centres.

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, particularly small firms, in terms of their ease of access to finance and its cost. It is critical that the success of viable businesses is not hindered by the tightening of credit standards or the high cost of capital. The ongoing efforts to resolve the banking crisis should:

- **Support viable businesses:** ensure that the State uses its funds and influence to ensure that banks are lending to viable businesses;
- **Protect the public finances:** ensure that the interests of the taxpayer are protected by minimising the exposure of the State to bank risk. It is critical that, as far as possible, responsibility and risk is delegated to the banks to resolve the problems they have caused; and
- **Allow the property market correction to proceed:** ensure that NAMA does not unnecessarily slow the continuing correction in the property market by not releasing the assets of failed developers onto the market. Falling industrial and residential land and building prices improve our cost competitiveness and, thereby, stimulate Exchequer revenues.

Restoring cost competitiveness and sustaining jobs

Cost competitiveness: Restoring cost competitiveness will protect our attractiveness as a location from which to do business and is fundamental to arresting the ongoing rise in unemployment. Despite recent price falls, Ireland has only seen a modest improvement in its international cost competitiveness because prices levels here are significantly higher than in many competitor countries. It also appears that recent price falls in Ireland are a cyclical response to the recession rather than the result of structural changes in the Irish economy. The priorities to improve cost competitiveness are:

- **Adjusting rapidly:** A quick adjustment in price levels is essential to achieve swift improvements in competitiveness and to protect jobs. While painful in the short term, the alternative is a prolonged period of weak or negative growth, high unemployment and emigration;
- **Adjusting incomes:** Wage inflation in Ireland was approximately 50 percent higher than the eurozone average during the 2004-2007 period. However, growth in labour costs slowed significantly in 2008 (latest data available) and was lower than the EU-15 average. 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;
- **Lowering property costs:** Despite recent declines, Irish land and property prices remain high relative to the costs faced by businesses in other countries. Falling land and property prices do not reduce the necessity for structural change in respect of land planning;
- **Lowering energy costs:** Recent energy price reductions were necessary but are not sufficient. Further actions are required to bring down energy costs;
- **Tackling administered costs:** Despite general deflation, inflation in public services and administered prices is projected to average 13.2 percent this year. Government needs to issue policy directions to its regulators and agencies to ensure that national economic and competitiveness objectives are prioritised in all regulatory decisions; and
- **Supporting competition:** A number of outstanding Competition Authority recommendations require action. It is critical that competition law is applied in all sectors of the economy.

Tackling labour market challenges

The current deterioration in the economy presents a serious challenge in terms of the scale of the response now required. Investment in training and education needs to be targeted, outcomes focused and related to national enterprise objectives i.e. meet the future needs of existing and emerging exporting sectors. The National Skills Strategy sets out a plan to develop the future skills requirements of the Irish economy.

Labour market programmes and investment need to address two major challenges:

1. Introducing immediate measures to sustain employment

At an overall level, training for those in employment contributes to sustaining employment and to stemming the flow into unemployment as firms upgrade their skill base. Key principles include:

- **Maintaining investment:** In spite of the significant pressure to shift investment towards those who have lost jobs, retaining funding for training those in employment, particularly those with low skills in low productivity or vulnerable sectors remains critical;
- **Prioritising supports:** We need to focus on the provision of demand-led courses to support employer/employee identified specific skills needs. It is critical that any interventions do not artificially prevent or delay necessary restructuring in the labour market; and
- **Supporting productivity growth:** In addition to improving their skills base, firms need to increase their productivity growth rates by investing in technology. We need to ensure that the State can assist firms that want to invest in product, process and services innovation to improve their productivity.

2. Enhancing education and training opportunities for the unemployed

Ireland now faces a serious long term unemployment problem. Due to the unexpectedly sharp rise in unemployment, existing labour market policies and institutions are no longer suited to addressing the scale or nature of the unemployment crisis. A key challenge is to swiftly reorient the existing system designed to target 'hard-to-activate' people in a buoyant labour market to one capable of dealing effectively with a broad based unemployment crisis. Key principles should include:

- **Monitoring existing labour market interventions:** We have already introduced a range of measures aimed at maintaining people in employment, re-skilling the labour force and facilitating better access to allowances, while avoiding undue negative impacts on vulnerable individuals. While the recent significant increase in the number of activation and training places is a welcome development (an increase from 66,000 to 128,000), the nature and quality of the retraining options available to develop and enhance the skills sets of the newly unemployed remains an issue. It is essential that the recently introduced activation initiatives are kept under review to ensure that they are providing an effective response to improving the employability of those that have lost their jobs.
- **A greater focus on formal accredited qualifications:** Given the likely duration of our unemployment problem, we need a greater focus on formal accredited qualifications. The proposed provision of 2,000 full-time places and 2,500 part-time places in third level institutions, and the 1,500 post leaving certificate places in VECs for the unemployed by September 2009 represents a modest start given the scale of our unemployment problem. The NCC welcomes the recent establishment of a Higher Education Labour Market Activation Response Group which in our view needs to respond quickly to the challenge.
- **Targeting use of limited resources:** We need to target the limited resources available for activation, training and re-skilling at those individuals most at risk of becoming detached from the labour market and at areas where there are likely to be labour demands in the upturn. High levels of unemployment, particularly among younger and lower skilled workers highlight the importance of ensuring that the unemployed remain as close to the labour market as possible.
- **Role of second level education sector:** There is an urgent need to strengthen efforts to prevent early school leaving and to equip those who already have left school and are now unemployed with the capacity to learn and benefit from completing educational qualifications.

Restoring Ireland's reputation

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. There are a number of aspects to this challenge:

- Delivering on the key commitments contained in the Smart Economy agenda and the April Supplementary Budget (which set out plans to restore the sustainability of the public finances);
- Enhancing the effectiveness of the regulatory environment. Regulatory failures both in Ireland and overseas highlight the need for effective, balanced and transparent regulation;
- Maintaining and strengthening our traditionally strong engagement with the EU is vital for the future success of Irish exporters and sustaining high levels of mobile foreign direct investment. A positive outcome to the Lisbon Treaty referendum is critical; and
- Continued emphasis on marketing Ireland overseas as an attractive location for investment, businesses and tourism will be necessary.



Conclusions

Economic circumstances in Ireland have changed dramatically over the past 18 months. The challenge for Ireland is to restore our reputation overseas and confidence at home, by developing and implementing a short term action plan to restore competitiveness. Progress has already been made in restoring the stability of the Government finances and in ensuring the banks are channelling credit to viable businesses. However, without determined actions to restore our international competitiveness, it is possible for the Irish economy to enter a prolonged period of depressed economic activity and for the convergence of Irish living standards on other high-income countries to unwind. It is therefore critical to mobilise broadly-based support for the immediate policy actions which will ensure that Ireland can emerge from this serious recession with a vibrant enterprise base capable of sustaining high living standards.

This paper sets out the short term priority actions required to improve our competitiveness and protect jobs. The NCC will revert to Government with proposals for policy actions to address Ireland's longer term competitiveness challenges later in the year.

1. Overview of Ireland's Competitiveness

1.1 Introduction and background

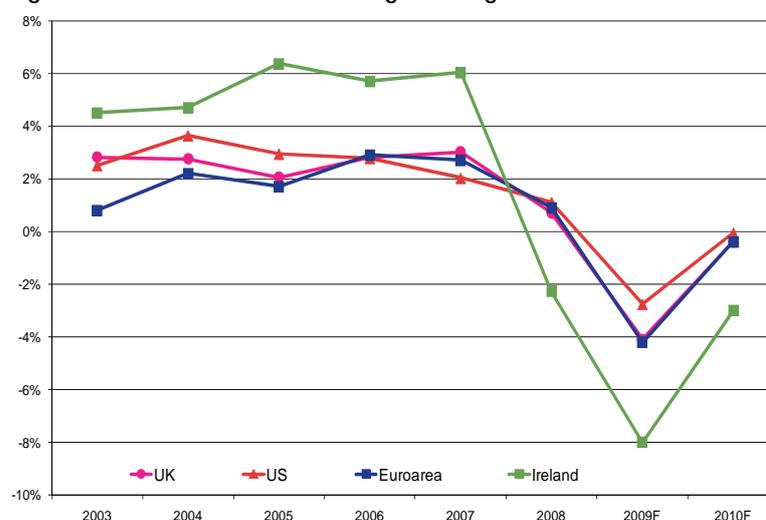
The Irish economy is currently facing enormous challenges. While the economic crisis is global in scope and unprecedented in terms of scale and synchronisation, the recession in Ireland has been among the most severe of developed economies to date. The ESRI is forecasting an 8.3 percent decline in Irish GDP and a 9.2 percent decline in GNP in 2009¹. This compares poorly with GDP forecasts for the US (-2.8 percent), the UK (-4.1 percent) and the Eurozone (-4.2 percent)². These figures highlight that the citizens of many developed countries, particularly Ireland, are facing significant drops in real incomes and living standards.

The Irish economy is experiencing a painful adjustment to the bursting of the property bubble, the international financial crises and the downturn in world trade and investment. As a small, open and competitive economy, Ireland prospered from an export boom in the 1990s and early 2000s. In recent years, strong growth in the domestic economy, driven by spending on housing and consumption, replaced exports as the key driver of growth.

Though economic growth rates remained strong, our international competitiveness weakened as the domestic boom increased the costs of doing business here and as reforms to improve national competitiveness were delayed.

Growth derived from asset price inflation, fuelled by low interest rates, reckless borrowing and lending and speculation has now been proven a poor basis for sustainable growth both in Ireland and internationally. The falling value of property and other assets has eroded the capital base of lenders, reversed trends in private sector credit (including mortgages) and led to a sharp reduction in domestic money supply. The confluence of a domestic banking crisis and property market crash with a severe slowdown in global trade is presenting unprecedented challenges for the Irish economy.

Figure 1.1: Real GDP Percentage Change over Previous Year



Source: IMF, World Economic Outlook, April 2009

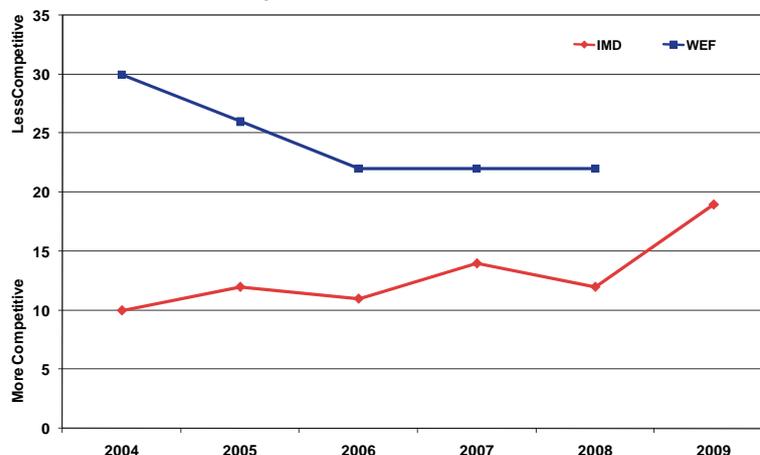
1 ESRI, Quarterly Economic Commentary, Spring 2009.

2 IMF, World Economic Outlook, April 2009.

1.2 Ireland retains a wide range of competitive strengths

While Ireland's competitiveness has deteriorated in recent years, we retain a wide range of competitive strengths. These include a young and comparatively well educated workforce, growing levels of research and development activity, a modern internationally trading enterprise base and a long track record as a successful location for overseas investors. These strengths have been supported by increased investment and improvements in infrastructure, education, research and development and the creation of an environment that is conducive to business.

Figure 1.2: Ireland's Competitiveness Position in International Rankings



Source: IMD, *World Competitiveness Yearbook 2008*; WEF, *The Global Competitiveness Report 2008-2009*

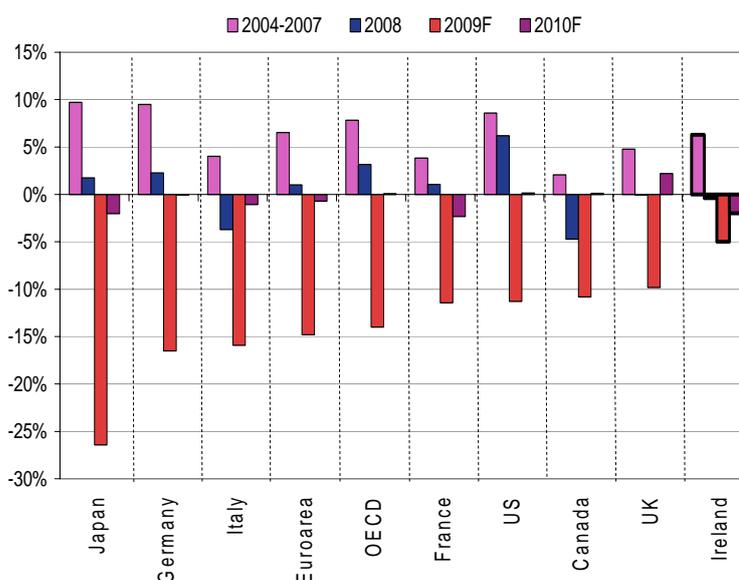
Ireland's competitiveness position, while weakening over a number of years, has not changed dramatically in the past year. Ireland continues to perform relatively well on international competitiveness rankings including the World Economic Forum and the IMD World Competitiveness Yearbook (Fig 1.2).

1.3 Irish exporters are performing relatively well in an adverse environment

The ability of Ireland to protect the gains in living standards of recent decades and to secure future increases rests on our ability to succeed as competitive exporters of high quality goods and services.

While the global economy is declining for the first time in over sixty years, Irish exporters are performing well and are increasing their share of world trade. Merchandise exports declined by three percent in value terms in 2008. The performance of some key sectors such as pharmaceuticals and medical

Figure 1.3: Percentage Change in Volume of Exports of Goods and Services, 2004-2010(f)



Source: OECD *Economic Outlook, Interim Report, March 2009*. ESRI, *Quarterly Economic Commentary, Spring 2009*.



technologies remains robust. However, exports in the predominantly Irish owned food and beverage sector fell by 7.3 percent, reflecting the consequences of the sustained appreciation of the euro relative to sterling.

Irish services exports continued to grow in 2008, albeit at a much slower rate than previous years. Services exports grew by three percent in value terms, with growth in computer services (8.9 percent), business services (5.1 percent) and royalties (17.6 percent) offsetting declines in other services. Unsurprisingly, financial services (-7.2 percent) and insurance services (-4.3 percent) were particularly weak while tourism and travel exports declined by 2.3 percent³.

Irish exports are expected to perform relatively well in 2009. While exports of goods and services are expected to decline by five percent in 2009, this must be set in the context of the severe difficulties facing exporters globally⁴. The OECD forecasts that the volume of exports of goods and services for the OECD will fall by 14 percent in 2009 with significant falls in Japan (-26.5 percent), Germany (-16.5 percent) and the US (-11.3 percent). Non-OECD countries such as Singapore and China are also experiencing significant falls.

The outlook for global trade remains poor given sharp falls in consumer and business confidence globally. Recent IMF projections forecast a contraction of 1.3 percent in global economic activity during 2009⁵. This decline in real GDP will be sharpest in developed economies - our key markets. The fall in the value of sterling is also a significant challenge, particularly for indigenous exporters who are focused on the UK market and compete against UK firms in other markets. Encouraging export led recovery will require a determined effort to provide expanding market access opportunities for our exporters.

1.4 Conclusions

The Irish economy has undergone dramatic changes in the last 18 months. Many of these changes are the result of unanticipated global shocks. However, some of these changes have been specific to the Irish economy. Our over reliance on construction and consumer spending has left us particularly vulnerable.

Recent developments have had a negative impact on Ireland's reputation overseas and have damaged business and consumer confidence within Ireland. The recession is also resulting in high human costs as people lose their jobs, and/or are facing reduced incomes (due to job losses, pay cuts and higher personal taxes) while their assets (e.g. houses, shares, pensions) are falling in value. In addition, reduced Government revenues have affected investment levels in areas such as health and education and on supports to those on social welfare.

3 CSO, Balance of International Payments, 26th March 2009.

4 ESRI, Quarterly Economic Commentary, Spring 2009.

5 IMF, World Economic Outlook, April 2009.



The challenge for Ireland is to restore our reputation overseas and confidence at home by taking immediate actions to restore competitiveness. The short term recommendations in this report support the Government's Smart Economy strategy which focuses on re-orientating the economy towards exporting goods and services⁶. Despite the harsh operating environment for Irish exporters at present, targeting export-led growth is the correct and only sustainable longer-term strategy to maintain living standards and secure long-term prosperity. The Irish economy needs to prepare and position itself to benefit from the global upswing when it occurs. While the decline in economic activity is worrying and has painful consequences in terms of individual living standards and rising unemployment, Ireland should focus on building upon the strengths of our economy - which remain considerable despite the ongoing recession.

⁶ Building Ireland's Smart Economy: A Strategy for Economic Recovery, December 2008.

2. Positioning Ireland for Recovery

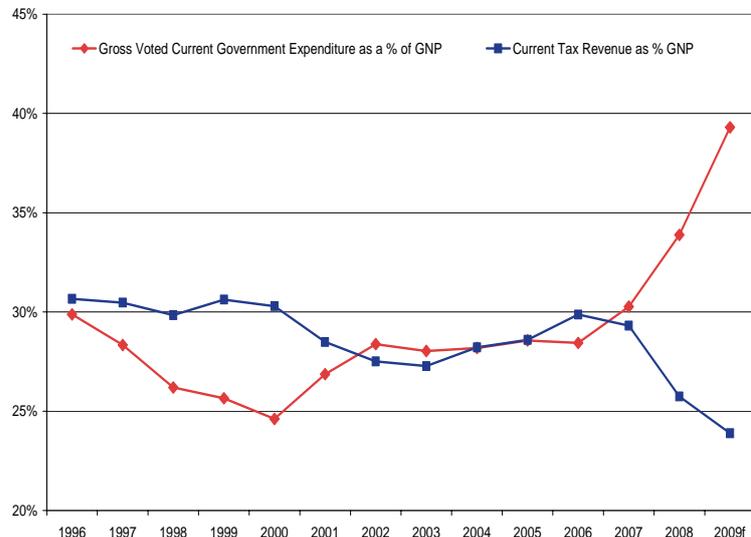
The NCC believes that the challenge for Ireland is to restore the competitiveness of our exporting sectors and our attractiveness for inward investment in order to ensure that Ireland can take advantage of global recovery. It is essential that we implement a credible and widely supported programme to:

- restore the stability of the public finances;
- ensure that the banks are channelling credit to viable businesses;
- restore cost competitiveness and sustain jobs; and
- restore Ireland's international reputation.

Much of the attention to date has quite rightly focused on tackling the public finances and the banking crisis. Action in these areas is necessary but unless it is accompanied by a significant restoration of our competitiveness, we will not sustain jobs and get back on a growth path. Without appropriate actions to support competitiveness, it is entirely possible for the Irish economy to enter a prolonged period of depressed economic activity and for the convergence of Irish living standards to other high-income countries to unwind.

The challenge now is to mobilise broadly-based support for the immediate policy actions to respond to the current crises and to ensure that Ireland can emerge from this serious recession with a vibrant enterprise base capable of sustaining high living standards. ESRI research indicates that Ireland has the potential to achieve an average growth rate of over five percent over the years 2010 to 2015 if we take **additional decisive actions** to repair the public finances, improve cost competitiveness, and adopt suitable labour market policies to avoid a permanent increase in the numbers of long term unemployed⁸.

Figure 1.4: Gross Voted Current Government Expenditure and Exchequer Revenue as a Percentage of GNP in Constant 2006 Prices, 1996-2009(f)



Source: Department of Finance⁷

7 Budgetary Statistics, September 2008, Macroeconomic and Fiscal Framework, April 2009 and CSO, National Accounts.

8 ESRI, Recovery Scenarios for Ireland, 2009.

2.1 Stabilising the public finances

The severe contraction in the housing market and the associated negative impact on the labour market and consumer and business confidence has led to a sharp deterioration in the public finances. In 2008, Irish tax revenues fell sharply. Revenues comprised just 26 percent of GNP in 2008 compared to gross voted current government expenditure of 34 percent of GNP (Fig. 1.4).

In recent years, Ireland relied heavily on transaction-based property taxes. The collapse of the property bubble has resulted in a sharp decline in revenue from property transaction taxes (stamp duties, VAT and capital gains tax). The precipitous fall in yield from these taxes has exacerbated the impact of falling yields from the main taxes on income and expenditure.

While Ireland's net debt remains low relative to other developed countries, there are significant concerns about the scale of the Exchequer's financing requirement at a time when governments around the world are seeking to finance substantial stimulus packages and unprecedented fiscal deficits. Ireland's general government consolidated debt as a percentage of GDP has risen sharply since the end of 2007 and stood at 43 percent of GDP at the end of 2008⁹. While Irish government debt as a percentage of GDP has been considerably lower than the Eurozone average in recent years, it is forecast to converge rapidly with it by the end of 2010¹⁰. The Department of Finance has forecast that gross debt will reach 59 percent of GDP by 2009 and 73 percent by the end of 2010¹¹.

The collapse in revenue and the exposure of the State to the property-related loans of Irish banks is also having a detrimental impact on Ireland's ability to borrow funds at competitive rates. Interest payments on Irish Government debt were 3.8 percent of tax revenue in 2008 and are forecasted to rise to 9.4 percent in 2009, reflecting higher borrowing costs and larger debt¹². It is clear that Ireland will face additional difficult decisions if we are to ensure the sustainability of the public finances over the medium term.

Key Principles

Ireland has begun a process to restore the sustainability of public finances by increasing revenues and reducing spending. While a range of difficult decisions have already been taken, it is clear that the restoration of the health of public finances will take a number of years and that the transition process, while essential, will be painful. It will be critical that the 2010 Budget achieves the additional reduction in the deficit that the Government has already announced.

Revenue

In view of the severe decline in tax revenue in 2008/2009 and the need for rapid revenue-raising measures to address the growing gap in the public finances, measures to date have primarily focused on raising taxes on income.

9 Deducting the value of the National Pensions Reserve Fund and Exchequer cash balances held by the NTMA from the gross debt gives a net Debt/GDP ratio of 20% at the end of 2008.

10 NTMA, Q1 Update, April 2009.

11 Department of Finance, Macroeconomic & Fiscal Framework, Supplementary Budget, April 2009.

12 Ireland lost its triple A rating in March 2009 and its long term credit rating was reduced to a double A rating in June as Standard & Poor revised the cost of rescuing Irish banks upwards to €25 bn. from its previous forecast of €15-€20 bn.

While restoring the sustainability of the public finances should be a key driver of tax policy, it is critical that this is achieved in a way that continues to support economic growth and competitiveness. The NCC supports recent Government commitments to maintain a **competitive tax wedge** on labour - the difference between the take home pay of employees and the costs to the employer. While Ireland has one of the lowest employers' social security contributions in the OECD, a low tax wedge is vital to encourage employment growth across all income categories and is an important competitive advantage in **attracting and retaining highly skilled and internationally mobile workers**.

Broadening the tax base is central to repairing the public finances. 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. The introduction of a levy on non-principal private residences is a step in the right direction. Further and alternative methods of raising revenue should also be considered, including **charges for all users of services** (e.g. water, third level fees) and a carbon tax (subject to exempting firms already engaged in EU-ETS or alternative binding energy-efficiency agreements and recycling revenues to improve competitiveness). We look forward to the recommendations of the Commission on Taxation.

Finally, our **corporate tax regime** has been important in stimulating enterprise and attracting mobile foreign investment. It is critical that our corporate tax regime remains competitive to promote enterprise activity and sustain jobs.

Current expenditure

While painful, international evidence suggests that fiscal consolidations are more likely to succeed if the focus is primarily on targeted **expenditure cuts** rather than tax increases¹³. The recent introduction of the public service pension levy and cuts in public sector procurement costs are important steps - though their impact on total current expenditure remains relatively small. It is estimated that the cumulative correction agreed to date in the budget balance is about five percent of GDP. Despite these cuts, the projected deficits for 2009 and 2010 could stand at over 11 percent of GDP¹⁴. We have some distance to go.

Gross voted current government expenditure (excluding interest payments on the national debt) has risen sharply in recent years, from 28.4 percent in 2006 to 39.3 percent of GNP in 2009¹⁵. Managing public sector expenditure will be challenging:

- Rising unemployment has led to a sharp increase in current expenditure. The budget of the Department of Social and Family Affairs will be €21.3 billion or 37.6 percent of total gross voted current expenditure in 2009¹⁶. Major challenges exist to protect those on low incomes,

13 Alesina, Alberto, Roberto Perotti, and Jose Tavares, 1998 The Political Economy of Fiscal Adjustments, *Brookings Papers on Economic Activity*, 1998.1, pp. 197-266. See also Henriksson, 2007, Ten Lessons about Budgetary Consolidation, Bruegel; Brussels.

14 Challenges for Irish Fiscal Policy, Philip Lane, May 2009.

15 NCC, *Benchmarking Ireland's Performance*, 2009.

16 This is forecast to rise to 23 billion in 2010 or 41 percent of gross voted current expenditure.

ensure that incentives to remain in the labour force are present, and to rein in Government spending.

- The public sector pay bill will comprise almost 60 percent of total projected tax intake of €34.4 million in 2009. The Government has introduced a number of initiatives to reduce the public sector pay bill, such as a moratorium on public sector recruitment, a pension levy, a voluntary retirement scheme and a career break programme. Major challenges exist to manage public sector pay in the context of maintaining investment in infrastructure, education and health, and as automatic social welfare commitments grow.

Strained public finances have potentially acute implications for the users and providers of public services. We need to rise to the **challenge of delivering better public services with fewer resources**. The alternative is a diminution in the services provided to the public. A greater focus on improving productivity and flexibility, better integration in delivery, improving management capabilities and an effective redeployment of existing resources are central to achieving this. It is essential that Government progresses the reform agenda set out in 'Building Ireland's Smart Economy' and the OECD's review of the Irish public service to achieve greater efficiencies in the delivery of public services¹⁷. The recommendations of the Special Group on Public Service Numbers and Expenditure Programmes will be important in this regard.

Capital expenditure

The April 2009 supplementary budget announced that capital spending will be cut by 20 percent in 2010 and 33 percent in 2011. The NCC believes that the severe decline in the public finances necessitates a **rapid review of the investment priorities identified in the 2007-2013 National Development Plan (NDP)**. The review of the NDP needs to be underpinned by a rigorous process of prioritisation of public capital expenditure, based on demonstrable returns on investment and the front-loading of the infrastructure projects likely to have greatest impact in terms of attracting overseas investment and supporting firms in Ireland to trade internationally. Given the central role that Dublin and our other cities play in driving national competitiveness, it is critical that the forthcoming 'refresh' of the National Spatial Strategy focuses resources on their development.

Key infrastructure priorities to enhance Ireland's competitiveness are:

- The completion by 2010 of the main inter-urban motorways linking Dublin with key centres. In addition, finalising the southern section of the Atlantic Road Corridor needs to be prioritised;
- Sustained investment is required in public transport projects (e.g. suburban rail, bus networks) in and between key urban centres;
- The bundling of all of the existing State telecommunications assets (commercial semi state, local authorities, Metropolitan Area Networks) and the extension of existing MANs within key centres in order to provide an open access network capable of providing next generation broadband services;

¹⁷ This includes outcomes-focused performance measures; improved coordination across departments and agencies; new budgetary frameworks to facilitate prioritisation and reallocation of spending; and strengthening the role of ICT and eGovernment.

- The timely delivery of Ireland's planned energy interconnection (i.e. the north-south tie line and the east-west interconnector); and
- The prioritisation of water services investment in key NSS centres, particularly those facing capacity shortages in the next five years.

Given current economic circumstances, there is increasing competition for scarce resources within key investment categories including physical infrastructure, education, 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 (see section 3.2). In relation to the public R&D programme we should prioritise people and programmatic expenditure, with a particular focus on:

- near to market, applied research, commercialisation, demonstration and engineering related expenditures;
- those programmes that are collaborative in terms of investment with enterprise; and
- driving consolidation in existing research infrastructures and centres, thereby building critical mass and achieving higher research productivity, output and economic impacts from investments.

While the double-dividend of short-term employment gains within construction with a consequent easing on social welfare is pragmatic in the short-term, **investment decisions must be targeted at viable projects** that contribute to real and sustained improvements in economic infrastructure. Assessing the viability of projects must entail a strict adherence to proper ex ante evaluation criteria¹⁸. The use of public capital investment with the sole intention of maintaining employment in the construction sector must be avoided. It has also been found that creating employment via public investment results in a relatively high cost per job created. The key mechanism to address the dramatic and largely permanent drop in construction employment should be to develop active labour market interventions (see section 3.2) to assist unemployed construction workers to prepare for other careers.

Reduced capital expenditure budgets need not result in a proportional reduction in infrastructure delivery or in the economic returns from investment. We 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 term¹⁹. Given the reduced urgency to complete key infrastructure projects quickly (as the recession is reducing demand), infrastructure delivery agencies should shift their emphasis from fast delivery to stringent cost control.

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 PPPs as the financing

¹⁸ Morgenroth, Edgar, 2009, Irish Public Capital Expenditure in a Recession, Working Paper 298, ESRI.

¹⁹ 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.



environment improves. Key policy areas include the promotion of integrated land use and transport policy, reforming the regulatory framework for public transport, incentivising private investment in next generation networks and mandating their provision in State infrastructure programmes, progressing implementation of the energy white paper, creating policy and regulatory certainty in the waste sector which promotes investment along the waste hierarchy, and adopting a river basin or national approach to water provision.

Consideration also needs to be given to the **potential to coordinate the rollout of different infrastructure services** such as roads, telecommunications/ broadband, water, electricity and gas. Not alone would this facilitate the provision of infrastructure services in an integrated framework, it also has the potential to deliver significant cost savings particularly where projects are undertaken simultaneously. A strengthening of existing institutional arrangements to enable the sharing of investment rollout plans across Government departments and agencies needs to be established.

2.2 Resolving the banking crisis: ensuring access to credit

The global financial crisis has exposed the vulnerabilities of banks and the absence of adequate regulatory oversight in many developed countries, including Ireland. Our banking crisis is the result of excessive exposure of Irish banks to speculative property investments during the construction boom. Many of these loans to property developers are now bad loans. All across the world, governments have been forced to respond rapidly to the crisis with limited information and time for analysis. The policy response to the banking crisis has far-reaching implications for the availability of credit to firms and the health of the public finances.

Due to the importance of the banking sector, the Irish Government has taken significant steps to support the sector:

- On 28th September 2008, the Government guaranteed the liabilities of six Irish institutions for a period of two years. Unlike other international schemes, this was a blanket guarantee covering all liabilities.
- Ireland introduced a recapitalisation scheme in December 2008 to support three banks. By mid-January, it was decided that the recapitalisation scheme for one of the banks covered, Anglo Irish Bank, was insufficient and it was nationalised. In June 2009, a further €4 billion was provided to support Anglo Irish Bank.
- Ireland is in the process of establishing a National Asset Management Agency as a vehicle to take bad loans off the balance sheets of the banks at a discounted rate on the book value of the loans. The book value of the loans covered is expected to be €80-90 billion. Once bad loans are transferred to NAMA at a discount, the banks will have to write down their capital and realise the loss on bad property loans.
- The European Investment Bank announced a €350 million loan fund to support Irish SMEs. The loans will be distributed through four banks at rates below current lending rates.

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. It is critical that the success of viable businesses, particularly small

and growing businesses, is not hindered by the tightening of credit standards or very high cost of capital. The available evidence on the impact of the banking crisis on access to (and cost of) credit is mixed.

- Data from the Central Bank indicates that excluding property related lending and financial intermediation, overall lending declined by 1.4 percent in the year to March 2009, compared to an annual increase of 12.5 percent the previous year.
- A recent Forfás and Enterprise Ireland survey of indigenous agency-assisted companies found that 20 percent of those who applied for credit were refused credit by a bank²⁰. A further six percent of applicants for credit had received approval for credit from banks at a lower level than they requested. According to an IBEC survey of 278 companies, 31 percent of respondents indicated that the availability of working capital to their company had decreased, while 38 percent reported that the cost of investment finance had increased²¹.

A range of factors has contributed to reduced investment and borrowing and this could be driven by a lack of credit due to an unwillingness/ inability to lend on the part of banks, deterioration in the quality of loan applications, or a lack of demand from businesses due to the current challenging business environment.

Key Principles

From a competitiveness perspective, the priority is to ensure that adequately capitalised banks emerge swiftly from the ongoing crisis at least cost to the taxpayer. The ongoing efforts to resolve the banking crisis should ensure that:

- the State uses its funds and influence to ensure that banks are lending to viable businesses;
- the interests of the taxpayer are protected by minimising the exposure of the State to bank risk. It is clear that international bond holders (by demanding a higher risk premium) are highly concerned about the State's exposure to the banking sector as resolving the banking crises will increase the national debt significantly and will result in higher interest payments. It is critical that, as far as possible, responsibility and risk is delegated to the banks to resolve the problems they have caused; and
- NAMA does not slow the continuing correction in the property market by not releasing the assets of failed developers onto the market. In order to ensure NAMA can accommodate a full correction in the property market, the discount rate needs to be appropriately set. There will be an understandable pressure on the organisation to secure the optimum direct return to the Exchequer from the disposal of its property holding. But it may not be in the overall economic interest to withhold the release of properties onto the market. Falling industrial and residential land and building prices will improve our cost competitiveness for new businesses and thereby stimulate Exchequer revenues.

²⁰ Forfás/ Enterprise Ireland, Financing survey of indigenous agency-assisted companies, January 2009 (unpublished).

²¹ IBEC, Survey of credit conditions, November 2008.

3. Restoring Competitiveness and Supporting Jobs

Our future prosperity depends on our ability to increase our exports, which will not be easy in a time of falling global demand for goods and services and contracting world trade. But there is no alternative - high levels of private household debt and the scale of the Government's finances suggest that domestic demand will not support significant growth in the coming years.

To support growth in exports when the world economy recovers, the priority short term issues that need to be addressed are:

- Improving cost competitiveness;
- Sustaining employment;
- Enhancing education and training opportunities for the unemployed; and
- Restoring Ireland's international reputation.

Any policy actions taken to address these issues in the short term must be consistent with the medium term structural reform required to underpin sustainable longer term growth. We have addressed the medium term and structural issues in the 2008 Competitiveness Challenge and will return to them again in our Competitiveness Challenge report for 2009²².

3.1 Improving cost competitiveness

Restoring cost competitiveness will protect our attractiveness as a location from which to do business and is fundamental to arresting the current rise in unemployment numbers.

Strong domestic growth in recent years created the conditions which led to significant increases in the costs of doing business in Ireland. Key business inputs such as pay and incomes, rents, utilities and business services had been rising for a sustained period. The recession induced fall in demand and the strength of the euro (as imports become cheaper) is resulting in a fall in the price level in Ireland. Irish inflation, as measured by the CPI, declined by 4.7 percent in the year to May 2009, the sharpest fall since 1933²³. Inflation fell significantly across most goods and services groups in 2009, but exceptions remain. Housing and utilities experienced the most dramatic change from an annual increase of 6.9 percent between 2005 and 2008 to a decline of 4.5 percent in Q1 2009. We are also witnessing significant falls in house prices. Irish inflation, as measured by the HICP (which excludes mortgage interest payments), declined by 0.7 percent in the year to April 2009, compared to an increase of 0.6 percent in the Eurozone and 1.2 percent in the EU-27²⁴. Administered services inflation (e.g. public transport, health insurance, education) is projected to average 13.2 percent this year²⁵.

22 The 2008 Competitiveness Challenge is available at: http://www.competitiveness.ie/publications/featuredpublications/title_2733_en.php

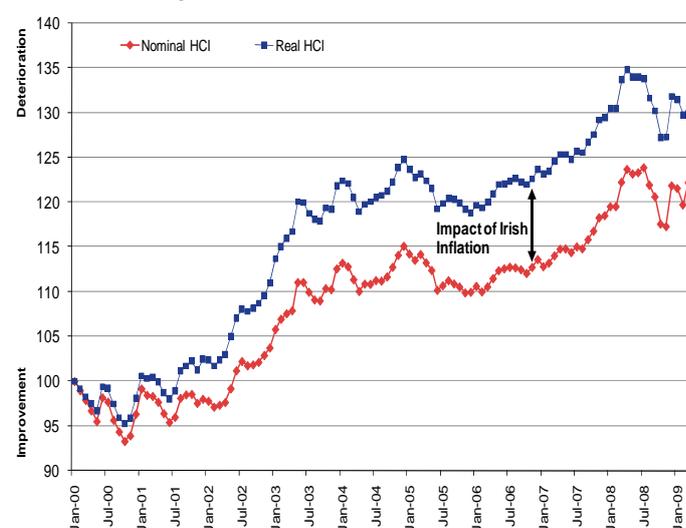
23 Consumer Price Index. Source: CSO.

24 The items included in the Harmonised Index of Consumer Prices are a subset of those that make up the CPI. Source: Eurostat.

25 Central Bank of Ireland, Quarterly Bulletin, April 2009.

Achieving improvements in cost competitiveness requires the cost of doing business in Ireland to fall relative to that of our trading partners. Initial signs are positive but our cost base remains high. Between January 2000 and April 2008, Ireland experienced a 35 percent loss in its trade-weighted international price competitiveness (Fig. 1.5). Ireland's current price competitiveness has improved; the loss in price competitiveness between January 2000 and April 2009 has fallen to 30 percent. This was supported by both falls in relative prices and favourable exchange rate movement vis-à-vis our key trading partners. However, the collapse in the value of sterling means that many indigenous exporters are under severe pressure to reduce their costs as they remain particularly dependent on the UK market.

Figure 1.5: Price Competitiveness Indicator for Ireland (Harmonised Competitiveness Indicators), 2000 - April 2009 (January 2000 =100)



Source: Central Bank of Ireland

Recent price falls in Ireland are a cyclical response to the Irish and international recession (e.g. reduced demand, spare capacity, falling interest rates, falling fuel and food prices) rather than a response to structural changes in the Irish economy. Structural changes are necessary to ensure that prices in Ireland will not escalate and erode competitiveness when the economy returns to growth.

Key Principles

In order for the economy to make the necessary transition from a reliance on domestic demand to sustainable export-led growth in the medium term, policies need to facilitate the convergence of Irish costs, charges, professional fees, rents, pay and incomes towards the levels of our trading partners. As prices and costs are now falling in many developed countries, this means that in order to improve our **relative cost competitiveness** we need to achieve reductions in costs faster than the eurozone average.

A **quick adjustment** in the price level is preferable to gradual decline over several years. Flexibility in the price level is essential to achieving swift improvements in competitiveness for Irish firms and maintaining employment²⁶. While painful in the short term, the alternative is a prolonged period of weak or negative growth, high unemployment and emigration of many young Irish people. Achieving a sharp improvement in cost competitiveness would directly improve prospects for retaining jobs in exporting firms, attracting additional job-creating investment into Ireland and creating spin-off effects for local enterprises. International evidence suggests that it can take a number of years for price levels to adjust fully - hence, the need for immediate action on structural issues to reduce prices.

26 B. Eichengreen, *The Crisis and the Euro*, 2009.



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 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 (latest data available) and was lower than the EU-15 average. The rate at which incomes and price levels generally adjust to the changed economic environment will have a considerable bearing on how fast Ireland recovers.

Concerns have been expressed that falling incomes will lower demand and prices further which could lead to a deflationary spiral in Ireland. As Ireland is a member of a currency zone, a deflationary spiral in Ireland is only an issue if the Eurozone were to enter a sustained period of deflation, which appears unlikely. For Ireland, it is much better to have a sharp fall in the price level now rather than a gradual decline in the price level over several years with persistently high unemployment.

Despite recent declines, Irish **land and property prices** remain high relative to the costs faced by businesses in other countries. Land and property prices are falling at a faster pace in several competitor countries including the UK. Office rental costs fell by 25 percent in Ireland between 2008 and 2009 compared to 38 percent in the UK²⁷. It is vital that the property market is left to adjust without interference - 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. It is critical that NAMA does not slow down this process by keeping failed developer assets from the market. In addition, falling land and property prices do not reduce the necessity for structural change in respect to land planning (availability of serviced land/ increased densities in Irish cities).

Irish industrial electricity costs are the second highest in the EU-25, having increased by 70 percent between January 2000 and January 2007. Limited interconnection, the relatively small scale of Irish generation plants, and limited competition in generation and supply directly contribute to our uncompetitive electricity costs. Recent reductions in electricity and gas prices were necessary but are not sufficient to improve Ireland's position relative to competitor locations. A number of key actions are required:

- The carbon windfall should be recovered from generators and passed through to electricity users through lower prices, on an annual basis, to 2012²⁸;
- While it is important to continue to incentivise investment in the energy market, a number of reforms would contribute to increasing efficiency and bringing down costs²⁹. These include reforming the regulatory approach to tariff setting, reviewing the market rules for the Single Electricity Market to ensure it is functioning effectively, and redesigning supports for renewable energy sources so that they are market based and linked to the wholesale electricity price; and

²⁷ Irish figures refer to prime location sites in Dublin. Cushman and Wakefield, *Office Space across the World, 2008- 2009*.

²⁸ Under the SEM, the full cost of carbon is being passed through to electricity customers. However, electricity generators receive significant carbon credits under the Emissions Trading Scheme, thereby resulting in windfall gains for the generators.

²⁹ Domestic controllable costs are estimated to account for 30 percent of the difference between Irish and average EU electricity prices in 2004.

- Implementation of our very ambitious renewables target should not proceed in the absence of a finalised assessment of its implications for Ireland's electricity cost competitiveness³⁰.

Inflation in **public services and administered prices** is projected to average at 13.2 percent this year. Price increases were applied across a range of public and administered services including health insurance premiums (+19.4 per cent, year-on-year), taxi fares (+8.2 per cent), rail fares (+13.7 percent) and bus fares (+13 per cent). Inflation in administered sectors of the economy must be brought under control. The main issues to be addressed are outlined below.

- Government needs to issue policy directions to its regulators and agencies to ensure that national economic and competitiveness objectives are prioritised in all regulatory decisions, such as reviews of energy prices, airport charges, bus/rail fares;
- A more coherent approach to utility regulation is required to drive efficiencies and to ensure that common learnings and experience in one area can be applied in another;
- Ireland's waste management charges are among the highest across competitor countries and our relative position would disimprove further with a proposed increase in the landfill levy. Ireland needs to have a rounded approach to waste management which seeks to replace landfill with waste-to-energy (incineration) and other more environmentally favourable waste treatment options while ensuring that business can assess high quality, competitively priced waste management services. More generally, the role of the State in the waste market remains unresolved
- While local authorities provide a range of essential services to businesses and the wider community, it is critical that local authority charges on businesses reflect the economic cost of serving their needs; and
- We also need to remain vigilant about the impact of any new regulatory measures or State charges, which would increase costs to enterprise.

Enhancing competition within Ireland's domestic economy is vital to improving our overall competitiveness. If sheltered sectors of the locally traded services sector are not exposed to greater competition, we will not achieve the required improvement in our cost competitiveness.

- A number of recommendations from the Competition Authority require attention. The NCC welcomes the announcement by the Department of Enterprise, Trade and Employment of a process for progressing recommendations of the Competition Authority and looks forward to further actions to implement them as quickly as possible. Consideration should also be given to establishing a recurring process (similar to Finance Bills but less frequent) where policy and technical shortcomings in competition law would be addressed in legislative proposals placed before the Oireachtas.
- In difficult economic times, pressures can arise to exempt particular interest groups from competition law. This would be detrimental to the necessary adjustments required to improve our cost competitiveness and sustain jobs.

³⁰ In 2008 Ireland committed to producing 40 percent of its electricity generation from renewable sources by 2020 - the EU target is 20 percent.

Easing the **administrative burden** that regulations create can improve the business environment by reducing costs, minimising the time businesses spend fulfilling regulatory requirements and increasing productivity. Government needs to vigorously implement the *Better Regulation* agenda to achieve the target to reduce administrative burdens by 25 percent by 2012.

3.2 Tackling labour market challenges

The current deterioration in the economy has led to record levels of unemployment. There were 2,052,200 persons in employment in 2008 Q4, an annual decrease in employment of 86,900 or 4.1 percent. This represents the largest annual decrease in employment since the labour force survey was first undertaken in 1975³¹. Unemployment in Ireland is now above the OECD average and growing.

The standardised unemployment rate (derived from the CSO Live Register) estimates unemployment at 11.8 percent for May 2009³². This compares with 7.7 percent in 2008 Q4 (QNHS). A downward trend in full-time employment and increase in part-time employment may also indicate a shift in working arrangements for many people such as reduced hours or working days. This situation looks likely to deteriorate further as 2009 progresses. The ESRI forecasts that the unemployment rate will increase to 13.2 percent in 2009 and 16.8 percent in 2010³³. They also suggest that even with five percent annual economic growth over the years 2010 - 2015, unemployment will remain at 6 or 7 percent in 2015³⁴.

Employment declines are no longer confined to the construction and related sectors but are now occurring across a range of sectors, from wholesale and retail to manufacturing, leisure and business services, and among both domestically trading and exporting firms. While the downturn is affecting people across all of society, the latest available data shows certain groups are particularly exposed. These include younger workers and lower skilled workers. For example, in the year to the end of 2008, unemployment increased from 7.2 percent to 12.5 percent for those with lower secondary education in comparison to an increase from 2.4 percent to 4.0 percent over the same period for those with third level educational attainment.

Key Principles

Actions to improve cost competitiveness as set out above, would improve prospects for retaining jobs and for attracting additional job-creating investment. This rapid increase in unemployment presents a serious challenge in terms of the scale of the response now required. Due to the

31 In detail, there were 51,500 fewer jobs in construction in 2008 Q4 compared to the peak in 2006 Q4. Related sectors such as architecture, solicitors and real estate have also been affected by the decline in construction activity. Annual decreases in employment were also recorded in 2008 Q4 in hotels and restaurants (-10,500, -7.9 percent), wholesale and retail trade (-18,200, -5.2 percent) and financial and business services (-11,600, -3.9 percent). Exporters are also experiencing job losses - total permanent full-time employment in development agency-assisted companies decreased by 8,938 jobs (-2.9 percent) in 2008.

32 The Live Register includes part-time workers (those who work up to three days a week), seasonal and casual workers entitled to Jobseekers Benefit or Allowance. It is not designed to measure unemployment. Unemployment is measured by the Quarterly National Household Survey. The latest QNHS figures report an unemployment rate of 7.7 percent in 2008 Q4. The Live Register has established itself as a "headline" measure of unemployment though its short-coming are numerous.

33 ESRI, Quarterly Economic Commentary, Spring 2009.

34 ESRI, Scenarios for Recovery, May 2009.

unexpectedly sharp rise in unemployment, existing labour market policies and institutions need to adjust rapidly to the scale and nature of the unemployment crisis.

Two overarching principles need to underpin our response to addressing the significant challenges we face in the labour market:

- Investment in training and education should be targeted, outcomes focused and related to national enterprise objectives i.e. meet the future needs of existing and emerging exporting sectors. The National Skills Strategy sets out a plan to develop the future skills requirements of the Irish economy. The recent sharp increase in unemployment does not change the training and education interventions required to meet future enterprise needs.
- A rigorous prioritisation process, similar to that required for capital expenditure, is needed to ensure the best use of the limited education and training budgets. This will necessitate greater coordination between the two departments responsible for education and training policy (Departments of Enterprise, Trade and Employment, and Education and Science) and the organisations they fund to provide courses to respond to the huge labour market challenges we face. It is important that the two departments are operating from a shared view of the future skills needs of the economy and develop a holistic approach to determining priorities for investment, allocating funding according to agreed education and training priorities and joint delivery of courses where appropriate.

Labour market programmes and investment need to address two major challenges:

- Introducing immediate measures to sustain employment; and
- Enhancing education and training opportunities for the unemployed.

3.2.1 Introducing immediate measures to sustain employment

At an overall level, training for those in employment contributes to sustaining employment and to stemming the flow into unemployment. Key principles should include:

- In spite of the significant pressure to shift investment towards those who have lost jobs, retaining funding for training those in employment, particularly those with low skills in low productivity or vulnerable sectors remains critical³⁵;
- Focus on the provision of demand-led courses to support employer/employee identified specific skills needs (such as Skillsnet) and management training to respond to structural and market change;
- Activation measures should be targeted, outcomes focused and relate to national enterprise objectives, i.e. they meet the future needs of existing and emerging exporting sectors. It is critical that any interventions we introduce do not artificially prevent or delay necessary restructuring in the labour market;
- As part of the restructuring of the enterprise base towards high value added activities with growth potential, it is critical that we support firms to increase their productivity by investing in technology. A range of initiatives are in place to facilitate product, process, and services

³⁵ In particular, ICTU has called for the ending the requirement that workers be 'fully unemployed' as this removes any possibility of training.

innovation, like the R&D tax credit and R&D funding, but a greater focus on support for capacity development and productivity improvement is required; and

- Options have been suggested to help retain people in work through job subsidy schemes which would support employment in viable firms that are facing short term difficulties due to a (possibly temporary) fall in demand or adverse exchange rate movements. On the positive side these schemes could be helpful in sustaining employment, but they also present a number of challenges. In particular, they can be difficult to target, they run the risk of having high deadweight costs and of being very expensive³⁶. It is vital that job subsidy schemes are focused on supporting viable firms that are facing short term challenges.

3.2.2 Enhancing education and training opportunities for the unemployed

Ireland now faces a serious long term unemployment problem. Evidence from previous recessions suggests unemployment falls slowly when economic recovery begins. A key challenge is to swiftly reorient the existing system designed to target 'hard-to-activate' people in a buoyant labour market to one capable of dealing effectively with a broad based unemployment crisis with many motivated, highly qualified people in a labour market with far too few jobs to accommodate them. Key principles should include:

- **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. The proposed provision of 2,000 full-time places, 2,500 part-time places in third level institutions and the 1,500 post leaving certificate places in VECs for the unemployed by September 2009 represents a modest start given the scale of our unemployment problem. A greater focus on an educational response for the unemployed would also help better manage expectations and avoid disillusionment with employment outcomes from short-term courses. The NCC welcomes the recent establishment of a Higher Education Labour Market Activation Response Group which needs to respond quickly to the challenge. This provides significant challenges for our universities and Institutes of Technology (IoTs) in terms of:
 - *Relevance of courses:* further work is required to ensure that publicly funded education and training is appropriate for the needs of individuals and enterprise development. The focus of courses should be to deliver competencies required by the labour market in sectors with potential for future employment growth. The Expert Group on Future Skills Needs has identified specific sectoral and occupational skills deficits in a range of sectors including medical devices, ICT, food and beverages and international financial services. It is important that the universities and IoTs respond rapidly to facilitate access to significant numbers of people who can benefit from tertiary courses;
 - *Timing of courses:* many of our educational bodies are still primarily designed and structured to serve the needs of full time students. The flexible delivery of education and training courses is essential to suit those in employment and seeking employment. In addition, courses should be provided on a modular basis. Consideration also needs to given

³⁶ Deadweight costs occur when taxpayers subsidise employment which would be sustained without assistance from Exchequer funds.

to exploiting the opportunities that exist to deliver education and training courses electronically;

- *Costs*: the cost of training should not act as a significant barrier for people eager to up-skill. As outlined in the National Skills Strategy, it is important that the State should pay for the tuition of anybody seeking to reach levels 4 and 5 of the National Framework for Qualifications (the Leaving Certificate or equivalent). At third level, while full time students currently receive free fees, part time students are required to pay. A significant increase in the numbers attending higher educational institutes will require additional investment as well as higher productivity within our educational bodies; and
- *Accreditation*: The current system of accreditation needs to ensure that it is not a barrier to delivering effective training and education interventions to meet our changed circumstances. In particular, we need to ensure greater flexibility in terms of the time required to get a particular qualification and also with regard to who provides the training.
- **Monitoring existing labour market interventions**: Government has already introduced a wide range of measures aimed at maintaining people in employment, re-skilling the unemployed and facilitating better access to allowances, while avoiding undue negative impacts on vulnerable individuals. While the recent significant increase in the number of activation and training places is a welcome development (an increase from 66,000 to 128,000 places), 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.
- **Targeting use of limited resources**: We need to target the limited resources available for activation, training and re-skilling at those individuals most at risk of becoming detached from the labour market for a long period and at areas where there are likely to be labour demands in the upturn. High levels of unemployment, particularly among younger and lower skilled workers highlight the importance of ensuring that the unemployed remain as close to the labour market as possible.
- **Role of second level education sector**: There is an urgent need to strengthen efforts to prevent early school leaving and to equip those who already have left school and are now unemployed with the capacity to learn and benefit from completing educational qualifications.

3.3 Restoring Ireland's reputation

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. There are a number of aspects to this challenge³⁷:

- Delivering on key commitments in the Smart Economy agenda and the April Supplementary Budget (which set out plans to restore the sustainability of the public finances);

³⁷ These points have been discussed in a recent NESc Report 'Ireland's Five-Part Crisis: An Integrated National Response', March 2009 <http://www.nesc.ie/dynamic/docs/NESC-Report-No-118.pdf>

- Enhancing the effectiveness of the regulatory environment. Regulatory failures both in Ireland and overseas highlight the need for effective, balanced and transparent regulation. Ireland's success as an exporting economy depends on a small number of high quality sectors such as medical devices, pharmaceuticals/chemicals, food, and financial and business services which require regulation that is consistent with building and retaining the trust of customers;
- Maintaining and strengthening our traditionally strong engagement with the EU is vital for the future success of Irish exporters and sustaining high levels of mobile foreign direct investment. A positive outcome to the Lisbon Treaty referendum is critical; and
- Continued emphasis on marketing Ireland overseas as an attractive location for investment, businesses and tourism will be necessary.

4. Conclusions

Economic circumstances in Ireland have changed dramatically over the past 18 months. As highlighted earlier in this paper, the challenge for Ireland is to actively restore our reputation overseas and confidence at home by developing and implementing a short term action plan to restore competitiveness, economic growth and jobs. Progress has already been made in restoring the stability of the Government finances and in ensuring the banks are channelling credit to viable businesses. Further actions are required in these areas - the paper endeavours to set out key principles from a competitiveness perspective.

Actions in these areas are necessary but will not be sufficient to enable Ireland to position itself to benefit from the global upswing when it occurs in the coming years. This paper also sets out a range of essential short term actions to improve our cost competitiveness and sustain employment and enhance the employability of the unemployed. The NCC will revert to Government with proposals for policy actions to address Ireland's longer term competitiveness challenges later in the year.

Wilton Park House, Wilton Place,
Dublin 2, Ireland

Tel +353 1 607 3000

Fax +353 1 607 3030

www.forfas.ie



National
Competitiveness
Council

