Ireland's Competitiveness Challenge 2011

Forfás

National Competitiveness Council

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Introduction to the National Competitiveness Council

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

Each year the NCC publishes two annual reports.

- **Ireland's Competitiveness Scorecard** is a collection of statistical indicators of Ireland's competitiveness performance in relation to 17 other economies and the OECD or EU average.
- **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.

The work of the National Competitiveness Council is underpinned by research and analysis undertaken by Forfás – Ireland's policy advisory board for enterprise, trade, science, technology and innovation.

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Foreword by the Taoiseach

This is without question an enormously challenging period in our nation's history. Since coming to office, my Government has been working very hard to restore our public finances to sustainability, to rebuild our international reputation and to tackle the jobs crisis. We are beginning to see signs of recovery but these are fragile given the current volatility in the global economy. We need to accelerate our efforts to return our economy to sustainable growth and to protect and create jobs. Renewed international competitiveness is central to any such recovery.

Notwithstanding the fiscal, banking and economic challenges, Ireland remains a great place to do business. We offer investors a flexible and highly skilled labour force, and a supportive pro-enterprise environment. Our traditional strengths remain largely intact. This is borne out by the continuing strong performance of our exporting sector and by Ireland's continued attractiveness as a location for Foreign Direct Investment.

The challenge now, however, is twofold. We must ensure that our export led recovery is not derailed by ongoing global economic difficulties. In order to do this, we must maximise the competitiveness of our exporting companies and indeed, of our entire economy – driving down costs wherever we can, boosting productivity and enhancing skills, and ensuring that our physical infrastructure meets the needs of our businesses. We must also continue to promote and enhance Ireland's international reputation.

In parallel, we must also support our small and medium sized businesses working within the economy. This will involve driving efficiency and innovation including through increased levels of competition and we must engender confidence about the future in our entrepreneurs. The goal of the Government is to make Ireland the best small country in the world in which to do business by 2016.

These challenges cannot be taken lightly. In order to overcome them, significant structural change is required in the economy, and in the structures of Government. Indeed, it is only through significant reform of institutions and practices that we can be sure of delivering sustainable change. Our international commitments should just be the starting point for reform. Through Budget 2012- including our Comprehensive Review of Expenditure report, our Public Service Reform Plan and the measures to support job creation, we have put in place a strategy to achieve the required structural change and build a new sustainable economy.

It is in this context that I welcome the National Competitiveness Council's Competitiveness Challenge 2011. I would like to thank the Council for its work which continues to form an essential input to our understanding of competitiveness and will inform further actions we take on the road to economic recovery.

Enda Kenny TD

Taoiseach

Chairman's Preface[1]

The economic challenges confronting Ireland in restoring economic stability and returning to a sustainable path of economic growth are the most daunting we have faced for a generation. More than ever enhancing our competitiveness is vital – even more so in the face of international economic uncertainty and possible risks of downturns in some of our main markets. Improving export performance has been our only source of economic growth and will remain essential to achieving the recovery needed to work our way out of our economic and social difficulties.

Competitiveness embraces costs, productivity, fiscal balance and a range of structural policies particularly in education, labour market activation, and investment in infrastructure and R&D. There is some evidence that competitiveness is improving but this is not happening quickly enough to improve the prospects for people who need jobs. Decisive and calculated actions are required to create an environment where business can flourish, job creation can become a reality and exports continue to grow. The depth of Ireland's economic challenges has meant that policy actions which hitherto were considered too unpalatable to implement, are now increasingly required to support recovery. We must continue with the momentum achieved to date and push ahead with the reform agenda to deliver improved competitiveness.

Ireland's Competitive Challenge 2011 addresses what the Council sees as the most important policy changes needed. The actions proposed by the Council focus on achieving four complimentary objectives - reducing our cost base, enhancing productivity, restoring macroeconomic and fiscal stability and ensuring delivery of world class performance standards. While the remedies proposed are specific to Ireland's circumstances, they are closely aligned to the *Principles to Guide National Competitiveness in the Global Economy* developed by the Global Federation of Competitiveness Councils (see appendix 1).

As a society we have demonstrated considerable resolve in facing up to the economic difficulties of the past number of years. Insights from recent developments in psychology and neurosciences show that for each of us as individuals, the balance we maintain between positive and negative thinking is vital to our ability to function effectively in our daily lives[2]. The importance of maintaining this balance is, I suspect, even more essential at the collective level of society. In our present circumstances anger, frustration and, for some a sense of hopelessness, are understandable – but it will not help to surrender to these feelings. It is vital in addressing our challenges with energy and resolve that we as a people exercise confidence, judgement and discernment and that in our

[1] This preface is written in a personal capacity.
[2] Gaffney, Dr M., Flourishing , Penguin Ireland, 2011

policies and actions we take care not to damage the incentives to work, to invest and to engage in public service.

At a time of profound economic and social adjustment when very many people have suffered economically and financially it is important that the burdens of adjustment are borne equitably and that this is seen to be the case. This puts a particular responsibility on the better off in our society and, particularly from a competitiveness perspective, on those who have the potential to contribute more to national welfare by abandoning restrictive practices, by increasing flexibility in the work place, and by facilitating the opening up of areas of the economy and public service to the provision of greater choice and contestability.

I would like to thank the members and advisors of the Council for their valuable contributions in producing this report. On behalf of the Council, I would also like to acknowledge the work of the members of the Forfás Executive for their essential support for the Council and for their work in regard to the preparation of this report.

Dr. Don Thornhill

Chairman, National Competitiveness Council

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Executive Summary

As Ireland returns to positive economic growth, international and national events pose risks to the pace of recovery. Notwithstanding these risks, Ireland stands to regain lost competitiveness as a result of pro-competitive actions taken to date and through maintaining momentum on the reform agenda. This report focuses on the need to return to competitiveness fundamentals – achieving competitive costs, boosting productivity, delivering a sound macroeconomic environment and continuing with an ambitious reform agenda. Further improvements in competitiveness are required if Ireland is to successfully overcome the challenges we currently face. Both the public and private sector will be required to take action in order to enhance Ireland's international competitiveness. A series of specific recommendations are set out in the report and are summarised below.

1. Reducing the Costs of Doing Business

The cost base for enterprise has undoubtedly reduced in recent years, but not enough. We need a consistent focus across Government on driving down the cost structure of enterprise.

Commercial Property Cost

Despite reductions, commercial property costs in Ireland remain relatively expensive compared to other locations. Property costs need to be able to adjust to reflect their potential economic value. In this regard, it is important that NAMA release property units onto the market in a timely fashion as provided for in the NAMA Business Plan. Additional information on the loans it has acquired and how NAMA assets will be disposed of would also be welcome. More generally, readily available price information within the State's possession should be published regularly with minimum delay. In order for markets to operate efficiently, transparent pricing information is of paramount importance.

Energy

The Council believes that a number domestic cost drivers (including the cost of supporting renewable energy, peat generation and grid upgrades) which add to customers' final electricity bill need to be revised or indeed phased out. The subsidy for peat generation, for example, is costing customers €40.5 million between October 2011 and September 2012. As advances have been made in improving Ireland's security of supply the justification for providing subsides for peat generation no longer exist and consideration should be given to phasing these out when feasible. As onshore wind is now regarded as a mature technology, the REFIT scheme should be revised in order to phase out subsidies for new projects over time. Emerging renewable technologies (e.g. wave, tidal and offshore wind), should be supported, where appropriate, through R&D grants and incentives, rather than price supports. Our focus should be on lowering costs and risks in order to encourage the market to invest in the renewable energy sector. This will involve providing certainty in the policy environment (i.e. planning, licensing, grid development, financing, etc.) and focusing on renewable developments of scale. Measures to reduce planning delays and improve efficiency in the planning approval system would avoid unnecessary costs imposed on electricity users (e.g. €20-30 million p.a. arising from delays in delivering a second North-South interconnector). To avoid costs which would be borne by customers, high-tension cables should continue to be placed above ground. Finally, the demand for energy has weakened because of reduced economic activity. We need to review the timing of the grid investment in light of this, while at the same time ensuring that enterprise needs are met.

Commercial Rates

We need to progressively rebalance the funding streams of local authorities. Such a move should include the introduction of a broadly based and equitable residential property tax and water charges. Further, the mechanism used to calculate commercial rates needs to be transformed to reflect current market conditions. As a first step, a broad based reduction in the annual rate of valuation (AVR) should be advanced using the savings generated from implementation of the Local Authority Efficiency Review Group recommendations. This should be followed by an expedited revaluation exercise. There are a number of avenues that could achieve this including self-assessment or the outsourcing of valuations.

2. Boosting Productivity

In spite of moderating price levels, Ireland remains an expensive country. A reduction in our cost base can play an important role in restoring our competitiveness but we also need to increase productivity across the economy. The Council urges the continuation of efforts to boost our productivity. By concentrating on actions to improve educational standards, up-skill and re-skill the labour force, facilitate labour market adjustment, prioritise our expenditure on R&D and enhance our infrastructure, we can take actions now to deliver lasting improvements in our livings standards.

Improve our Formal Education System

At the broadest level, Ireland needs to improve educational attainment across the board.

Primary School Reform: At primary level, the mathematical standards of students need to be advanced. A greater proportion of the school day needs to be dedicated to this subject as it underpins the basics of problem solving and is a central component of everyday life. Implementation of the actions outlined in the National Strategy to Improve Literacy and Numeracy would also ensure that Ireland make strides in improving mathematical standards.

Training and Teaching Quality: We need to continuously strive to improve teaching standards across all levels of the education system. Continuous and progressive professional development for teachers (including participation in training courses outside of term time where feasible) should be central to the education system at national and school level and not limited to the introduction of new syllabi. Teaching standards would also benefit from collaboration and peer reviews, including during initial training.

Leaving Cert Reform: At second level, there is widespread concern that the leaving certificate mechanism does not instil appropriate learning skills in students. We also need to develop an alternative method of determining entry into third level to replace the CAO points system. The method chosen must be meritocratic and should promote critical thinking, self-directed learning, communication skills and innovation, while maintaining access, transparency, and fairness.

Third Level Funding: The quality of our education standards needs to be maintained at third level also. For this to be realised it needs to be properly resourced. This inevitably will require that undergraduates contribute a greater portion of the cost of their education. In implementing this, policymakers should be cognisant of avoiding barriers to participation.

Up-skilling and Re-skilling

Labour market programmes need to tackle the growing trend of long-term unemployment, high rates of youth unemployment, and a significant skills mismatch arising from the construction collapse. Programmes need to be tailored to deliver a pathway from training to employment for different target groups with different needs. This is one of the most important challenges facing public policy makers amid profound economic adjustment. We should prioritise education programmes that incorporate traineeships/work placements, which provide experience to individuals, thus increasing their employability. State support for management training should be targeted towards internationalisation skills (marketing, sales, etc.) in order to grow export markets.

Facilitate Labour Market Adjustment

Labour market conditions need to be conducive to employment growth. A careful balance needs to be struck in the social welfare system to ensure individuals are protected while, at the same time, ensuring they do not become disconnected from the labour market. In this regard, action needs to be taken to ensure replacement rates do not exceed 70 percent; replacement rates in excess of 70 percent can act as a disincentive to take up employment. The Council support proposals that housing benefits be transferred to a separate funding stream so that financial supports for housing would depend on income rather than employment or unemployment status, and that individuals be permitted to temporarily retain some housing benefits for a period after returning to employment, subject to certain income thresholds. Such a move would have a positive impact on replacement rates and would remove a significant disincentive to take-up employment.

Prioritise State Spending on R&D and Innovation

As it becomes ever more important to maximise the use of state resources, we need to prioritise public expenditure on R&D that will deliver the most competitiveness gains and improve prospects for economic growth. Implementation of the recommendations of the National Research Prioritisation Exercise regarding the priority areas around which public funding of R&D should be focused is essential in this regard. It is important that implementation is progressed rapidly, based on clear objectives and metrics (including economic impact metrics) underpinning the priority areas. Performance against these metrics should be monitored on annual basis.

Enhance Infrastructure

Funding: Where a priority infrastructure requirement is identified, innovative approaches (e.g. pension funds) to encourage private sector investments should be developed. Greater use of user charges could support additional investment in critical areas.

Broadband: The widespread availability of advanced broadband infrastructure and services is essential to realising future growth potential in existing and emerging sectors. The regulatory and planning environment needs to be conducive to investment by reducing investment costs and risks. A market assessment should be undertaken to map where deficits will arise outside of existing telecommunications networks and committed investment plans. When deficits are identified, the State should make a commitment to providing or sourcing the funds required.

Intelligent infrastructure: ICT use in infrastructure delivery (i.e. intelligent infrastructure) has the potential to bring about efficiency gains and cost savings (e.g. reduced congestion, reduced investment requirements, increased energy/water efficiency, increased safety, etc.). Building on advances already made, further scope exists for the deployment of intelligent infrastructure to optimise scarce resources, enhance competitiveness and create enterprise opportunities. In this regard the capital appraisal process should incorporate a requirement to examine the potential use of intelligent infrastructure (e.g. use of intelligent transport systems instead of building new roads) to substitute or complement traditional capital investment.

3. Restoring a Sound Macroeconomic Environment

Stable government finances and a functioning financial system are central to supporting competitiveness.

Fiscal Policy and Taxation

Placing our public finances on a sound footing is one of Ireland's greatest challenges. Despite progress, the EU Commission estimates that Ireland will have the largest deficit (% of GDP) among the euro area 16 countries in 2011. The Medium Term Fiscal Statement has forecast the cumulative adjustment for the 2012-2015 period to be €12.4 billion.

Broadening the Tax Base: Ireland needs to broaden the tax base through the introduction of a broadly based and equitable residential property tax, and through greater use of user charges.

Maintain a Competitive Tax Regime for Labour: The fiscal environment must not create conditions where it is unattractive for an individual to take up work. Marginal income tax rates are in excess of 50 percent for single individuals earning €32,800 or above (a salary level which is below the average wage). This position should not deteriorate further and should be reviewed when conditions improve.

Ensure Ireland Remains Conducive to Developing Competitive Enterprises: Continued extension of Ireland's tax treaty network (with a focus on key emerging economies) would ensure that Ireland is best placed as an operating base for multinational firms.

As our economy increasingly becomes reliant on services as a source of growth, our taxation regime should reflect this. Our taxation system should not discriminate between intangible and tangible assets – this is an important issue for the taxation treatment of withholding tax on royalties.

In order to increase Ireland's attractiveness as a location for R&D investment and building on measures in Budget 2012, the Council recommends a move to a full volume based R&D tax credit, subject to the results of a cost-benefit analysis.

Improve Cash Flow: Companies are facing risks to their cash flow position because of contractions in credit supply and an increase in debtor days. There are steps that the State can take to improve the cash flow position of firms, by changing the timing of tax liability payments. These recommendations relate to timing of the R&D tax credit instalment refund, the existence of professional services withholding tax where a tax clearance certificate exists, and an examination of the merits and impact of increasing the qualifying threshold for the cash accounting method.

Improve Access to Funding for Enterprise

The banking system has to be fit for purpose if the economy is to realise its growth potential. The over exposure of the banking system to the property market has left deficiencies within the system. Our banking system now needs to adapt to the needs of the real economy and the skills capacity within the banks should reflect this.

Restore Bank Lending: We need to ensure that credit products and their conditions (i.e. availability of products and the cost of these products) are not undermining the ability of our enterprise sector to compete. Prior to the current crises, many exporters felt that the banking system did not fully serve their needs by providing relevant banking products and developing pro-active overseas networks. In particular, concerns have been raised about the availability of products such as international invoice discounting, performance bonds and specialised leasing, amongst others. As banks seek to shrink their balance sheets in order to meet regulatory requirements, this must not adversely impact upon enterprise. We need to benchmark the availability and cost of finance products in Ireland relative to that of our competitors, and encourage the banks to match offerings available to exporters in other countries. Secondly, choice and competition in the credit market is also a concern given the small number of operators remaining in the market. Banking systems that are national and fragmented also lead to higher costs for SMEs. In this regard, Ireland should support the development of a pan European financial system.

Promote Investment in Enterprise: Three years of very difficult trading conditions have left many enterprises undercapitalised. Equity investment represents a mechanism to help over-indebted but viable businesses to rebalance their balance sheets. Taxation policies should seek to encourage equity investment into productive areas of the economy. In addition, where businesses which can demonstrate future viability through a recovery plan – possibly by separating performing and non-performing assets (e.g. property investment), the potential to develop a process that results in debt/equity swaps or debt write-off and restructuring needs to be considered.

4. Ensuring Delivery of World Class Performance Standards

Reform of the Public Sector

Adopt a Stronger Output Focus: Reform of the public sector needs to encompass structural measures rather than solely relying on cuts as a mechanism for driving change. In this regard, the public sector should develop a stronger output focus, requiring agencies and departments to produce output and outcome indicators that can be measured and monitored over time. Budgetary processes also need to adapt to this refocus. The introduction of zero-based budgeting, the use of verifiable metrics, and the formal adoption of ex-ante evaluation of expenditure programmes are important steps in tailoring the funding processes to the reform agenda.

An absent feature of public sector reform has been the use of frequent external evaluations of government departments and regulators. This exercise would greatly inform the reform agenda by assessing whether these entities are meeting their objectives effectively and whether alternative processes can be introduced to maximise efficiencies.

Improve the Allocation of Public Sector Resources: While the overarching objective of addressing the cost of the public sector pay bill is necessary, we also need to enhance public sector productivity. A more effective method of achieving cost reductions, while maintaining a focus on productivity would be to allocate a (reduced) pay budget target to each state entity and a series of output targets, which must be met. It would be up to each entity to determine how to allocate and use resources to best meet these targets. To incentivise good practice in the effective achievement of outcomes within a defined pay bill, funding procedures and other methods should be tailored to reward good resource management.

Reform of Corporate Governance

Restoring public trust at home and rebuilding our reputation internationally are two of the major challenges facing Ireland. The financial crisis revealed shortcomings in corporate governance in Ireland and other countries. A range of initiatives are underway to improve identified deficits and any action to reform corporate governance should consider the significant work being undertaken by (amongst others) the EU Commission.

The Council have focused on two issues. Firstly, at present, a listed company choosing to depart from the Corporate Governance Code has to explain which parts of the code it has departed from and the reasons for doing so. Mirroring the sentiments expressed in the EU Green Paper on Corporate Governance, the Council believes there is a need to introduce more stringent requirements upon companies departing from the code (i.e. companies should be required to explain not only the reasons for departure from a given recommendation, but also a detailed description of the solution applied instead).

Secondly, the Council believes that there is merit in examining the role of Board's of Directors and of Auditors. Measures to reform these and improve their effectiveness, however, must also be cognisant of the need to maintain a pro-enterprise regulatory regime.

1. Introduction

Internationally, the factors influencing the pace of global recovery and growth remain profoundly weak. Unemployment remains high across most OECD countries, inflation has risen strongly in many countries, and downside risks have increased. Internally, the requirement to pursue a significant budgetary adjustment agenda is impacting upon growth and as a small open economy Ireland is buffeted by external events. Despite a strong export performance, partly fuelled by improving cost competitiveness and improved productivity performance, domestic demand remains extremely weak and unemployment remains high. A modest upturn in growth is expected in 2011, but doubts persist about the prospects for growth in 2012[3].

Over the last two or three years, an array of strategies, reform programmes, agreements and plans have been suggested by a wide range of stakeholders. In general, the policies adopted by successive Governments have focussed on the stabilisation of the banking system and on correcting the public finances. The policy environment has also been dramatically shaped by EU/IMF intervention. Indeed, the intervention of external parties has provided an additional stimulus to a programme of structural reform[4] and many of the pro-competitive policy measures taken recently will deliver competitive gains for Ireland (see table 1). Notwithstanding potential risks, Ireland is poised - more so than many of its competitors - to benefit from any global recovery. Our exports, which have been the only significant source of growth since 2008, account for more than 100 percent of GDP.

The issue of a two speed economy - exports flourishing while domestic demand contracts – is of concern. These traits are a function of a recovering international environment where commercial opportunities for competitive trade exist; and of a domestic economy, where weak demand restricts growth prospects. At eurozone level, a restoration of growth and competitiveness through aggressive monetary easing, a weaker euro and stimulatory policies in the core, while the periphery undertakes austerity and reform, would be welcome but is largely outside our influence[5].

The Council support action to improve consumer confidence, and recognise the importance of well planned and thoroughly evaluated programmes to stimulate domestic demand. In the longer term, however, the primary solution to delivering sustainable competitiveness lies not in creating short term incentives to encourage domestic consumption, but rather in a long term plan that facilitates an investment and export driven recovery. This report outlines the conditions necessary to instil the competitiveness improvements required. These imperatives are made even more compelling by the ongoing prospect of difficult international economic circumstances. The recommendations put forward by the Council are centred on four familiar but important objectives:

- Reducing the costs of doing business;
- Boosting productivity;
- Restoring a sound macroeconomic environment; and
- Ensuring delivery of world class performance standards.

Notwithstanding progress, the central theme of this report is the need to embed structural reform in order to ensure that Ireland returns to a sustainable, export and productivity led growth path. This will involve policymakers confronting some long established traditions, and dismantling some

[3] ESRI, Quarter Economic Commentary, Autumn 2011, December. 2011; Central Bank, Quarterly Bulletin Q4 2011, Oct. 2011; Department of Finance, Medium Term Fiscal Statement, November 2011

[4] See Statement at http://www.imf.org/external/np/sec/pr/2011/pr11374.htm

[5] Nouriel Roubini , Four Options to Address the Eurozone's stock and flow imbalances, unpublished, www.roubini.com/analysis/165338

protections, which have traditionally sheltered vested interests. Our international commitments should just be the starting point for building a new sustainable economy.

Table 1- Key Competitiveness Enhancing Measures Underway

A series of measures have been taken to remove structural barriers to growth.

- In the area of costs, reforms have been announced to the system of statutory wage fixing mechanisms arising from the EU/ECB/IMF agreement and a recent court case[6]. As part of the EU/ECB/IMF agreement, an independent assessment of the electricity and gas sectors has commenced. The Legal Services Bill has been published and can be expected to impact positively on the cost of legal services[7].
- On the activation and up-skilling front, a number of programmes have been introduced recently, designed to up-skill unemployed workers, and provide them with practical work based experience. The Council welcome the greater emphasis on evaluation, targeting, and accreditation which has accompanied the development of recent programmes (e.g. Jobbridge[8] and Springboard[9]). In terms of structural reform, the Government has approved the establishment of a new education and training authority (SOLAS) which is intended to bring a more integrated approach to the provision of further education and training in Ireland[10]. The Council welcomes the Irish Universities Association agreement to introduce bonus points for students taking leaving certificate higher level mathematics from 2012.
- In terms of infrastructure, the Government has recently announced that it is to establish a strategic investment fund (NewERA), which will oversee the management and potential sale of its stake in state assets, while also acting as a strategic investment fund. The fund will centralise the management of the public stake in a series of commercial semi-states, and channel resources from the National Pension Reserve Fund (NPRF) towards productive investment in the economy.
- Ireland continues to make progress on reducing the budget deficit. The Council note and welcome the establishment of an independent fiscal council. The introduction of a household charge in line with the requirement in the EU/IMF Programme of Financial Support for Ireland will broaden the tax base and heralds a move towards the introduction of an equitable, broadly based, recurring, valuation based property tax[11].
- In terms of improving access to finance for enterprise, initiatives have been developed to build business banking relationships (e.g. the 'Code of Conduct for Business Lending to SMEs' and the establishment of the Credit Review Office), to train bank staff and to increase lending (e.g. setting lending targets for the two recapitalised banks). The introduction of a partial credit guarantee scheme and a micro-finance fund in 2012 will bring Ireland a step closer in terms of its product offering in international terms.

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[6] The aim of these reforms is, in part, to enhance labour market efficiency and flexibility, while at the same time ensuring that there is a robust system of protection for workers in relevant sectors. For further information see http://www.djei.ie/press/2011/20110728a.htm

[7] While the NCC welcomes movements to reform legal services, we are concerned that a number of reforms suggested in the NCC's Cost of Doing Business in Ireland 2011 are not contained in the Bill.

[8] Jobbridge is a national internship scheme, which provides up to 5,000 work experience placements for interns for a 6 or 9 month period.

[9] Springboard is a series of educational courses aimed at areas where there are current or future opportunities (e.g. in finance, green energy, ICT, science and environment, sales and marketing).

[10] Functions previously carried out by FÁS will now be taken over by others. The Department of Social Protection will take responsibility for the Community Employment Scheme and FÁS' employment service functions, while further education and training programmes will go to the Department of Education and Skills.

[11] The Memorandum of Understanding with the EU and IMF commits Ireland to the introduction of a property tax for 2012 and to an increase in the property tax for 2013. The introduction of the Household Charge is an interim measure. Monies raised will be paid into the Local Government Fund and will be allocated back to local authorities by the Minister in General Purpose Grants. This charge represents a step in reforming the way local authorities are funded and follows the introduction of the charge on non-principal private residences (NPPR) in 2009. The initial estimated yield from the household charge is €160m in 2012 and will stay in place until the full introduction of a Site Value Tax.

- From a public sector reform perspective, developments are ongoing which are intended to deliver a leaner, more efficient public sector. For example, implementation work is underway in relation to the merger of Limerick City and County Councils and the Minister has announced a unified County Council will be established in Tipperary with effect from the 2014 local elections.

2. Reducing the Costs of Doing Business

Cost competitiveness is one of the key determinants of every firm's success. Notwithstanding the cost competitiveness gains made since 2008 as highlighted in Ireland's Competitiveness Scorecard[12], a range of business inputs remain relatively expensive compared to other jurisdictions. The Council's recent report on the Costs of Doing Business in Ireland assesses our cost competitiveness in detail and sets out a range of detailed recommendations in the areas of labour, property, utilities and professional services[13]. All of these issues remain important for competeveness, and the issues raised below build on that report. It is also important to note that enterprises themselves can undertake measures to reduce their cost base and improve efficiency[14.]

2.1 Commercial Property Costs

Notwithstanding significant falls, commercial property prices remain relatively expensive in Ireland. The price of land, office and factory space and housing in Ireland needs to continue to adjust to the levels justified by their underlying potential for adding value or earning market rent and to create certainty for potential investors. In this context, it is important that the actions taken by the banking sector and the National Asset Management Agency (NAMA) support the required adjustment within the property market.

It is important that property units be released by NAMA onto the market in a timely fashion. The provision of more information is important if investors are to have confidence in the market and be empowered to make rational decisions regarding investment. Finally, it is important that potential incentive schemes for buyers (e.g. offering a deferred payment scheme for mortgages, linking a proportion of the loan to a market value five years after its sale) do not slow the adjustment process and reduce market transparency.

More generally, in order for markets to operate efficiently, transparent pricing information is of paramount importance. Price information which is already within the State's possession (e.g. data held by Revenue, and the Property Registration Authority (PRA)) should be published regularly with minimum delay.

Recommendation: The NAMA Business Plan[15] provides for a phased and orderly disposal of NAMA assets. In essence, this means that properties associated with loans controlled by NAMA will be brought to the market on a phased basis over the course of the next few years. Further information, however, is required on the loans that NAMA has acquired, and on how it will dispose of the assets associated with these loans.
Responsibility: National Assets Management Agency

[12] National Competitiveness Council, Ireland's Competitiveness Scorecard, 2011
[13] National Competitiveness Council, Costs of Doing Business in Ireland, 2011, 2011
[14] For example, by improving their energy efficiency - Sustainable Energy Authority of Ireland (SEAI) runs a number of programmes that provide financial supports to firms seeking to improve energy efficiency; or by developing and implementing effective route to market systems to reduce distribution costs in the wholesale and retail sector.
[15] National Assets Management Agency, NAMA Business Plan, June 2010

2.2 Energy

As a result of Ireland's reliance on imported fuel, energy costs in Ireland are primarily determined on international markets. To improve our cost competitiveness, we must focus on those aspects of energy pricing that can be influenced domestically.

A public service obligation (PSO) levy is added to each electricity customer's bill to cover the costs of price supports for peat and renewable energy. These supports are designed to underpin the State's strategy of promoting renewable energy while at the same time ensuring security of energy supply[16].

The Department of Communications, Energy and Natural Resources is reviewing the PSO levy on electricity generated from peat, which is costing customers €40.5 million between October 2011 and September 2012[17]. Given recent improvements in energy security, the case for continued subsidisation of peat generated energy no longer holds and consideration should be given to phasing out such subsidies when feasible, particularly in light of the cost implications for electricity customers and the impact on the environment. There are proposals to convert the peat plants to biomass generated capacity. Subject to a positive result on a rigorous cost benefit analysis of the implications for Irish electricity prices, energy security and sustainability of supply, the proposal to convert peat plants to biomass should be progressed.

With respect to renewable electricity generation, we need to review future renewable subsidies (REFIT) to ensure that they do not adversely affect our long term cost competitiveness[18]. While we need to put in place measures to meet our 2020 renewables targets, we also need to ensure that we have a cost competitive energy supply to support future enterprise development and job creation. Specifically, the price support scheme for onshore wind should be revised so that as we move closer to achieving our renewable energy targets[19], the price support levels for new projects are phased out over time; a recent ESRI paper found that when there are only 2,000 MW of wind on the all island grid, the cost of the REFIT is relatively small (between 0.8 percent and 2.3 percent of the wholesale electricity price). As the percentage, increases, however, the cost increases - if there are 6,000 MW of wind on the all island system (the level of wind required to meet the 40 percent renewables target), the cost of REFIT would be between 3.2 percent and 9.8 percent of the wholesale price[20]. Onshore wind is increasingly regarded as a mature technology and it is projected that it will meet approximately one third of electricity demand by 2020. Consideration should also be given to the ESRI proposals that while subsidies should provide investment certainty with a floor price, the subsidy should be capped to avoid windfall profits.

The development of renewable energy technologies (e.g., wave, tidal, offshore wind), with potentially significant enterprise and export opportunities, should be funded through the use of R&D funding mechanisms, rather than by imposing the additional costs on domestic energy customers through expensive guaranteed price supports[21]. The recent OECD Economic Survey of Ireland called

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[16] The total PSO cost for the period 1st October 2011 – 30th September 2012 is €92.1 million. The direct subsidy to peat accounts for €40.4 million of this and supports for renewable energy generation cost €36.5 million. The remainder is primarily accounted for by administration and capacity related expenditure. There is also a PSO to cover additional capacity commissioned in 2003 to meet an anticipated generation capacity shortfall in 2005 - €30.7 million. The total of €92 million includes an adjustment of -€16 million because actual prices were less than those forecast when the PSO was set for 2010/11.

[17] According to the decision document (CER/11/130) on the 2011/2012 PSO levy, DCENR is reviewing the operation of the peat PSO.

[18] NCC, Statement on Energy, Forfás, October 2009

[19] Sixteen percent of our total energy needs must be met from renewable sources by 2020 under the Europe 2020 targets.

[20] Devitt, C. and Valeri, L.M., "The Effect of REFIT on Irish Wholesale Electricity Prices", The Economic and Social Review, Vol. 42, No. 3, Autumn, 2011, pp. 343–369

[21] A REFIT of €140 per MWH is proposed for offshore wind (the onshore wind REFIT is currently €66 per MWH for large scale wind farms – it is adjusted annually for any increases in CPI) and the proposed ocean energy REFIT is €220 per MWH.

for the discontinuation of supports for offshore, wave and tidal energy[22]. As these technologies become commercially viable, the terms and conditions for price supports need to be carefully considered. In particular, the price support schemes should provide for periodic reviews of the level of support and a progressive reduction of support levels as technologies mature. Recognising the potential benefits of the renewables sector to energy security and job creation, it is notable that a range of practical barriers remain (e.g. foreshore licensing issues; delays in getting grid connections, the need for an International Framework Agreement to facilitate energy exports) to developing renewable energy operations which need to be addressed[23]. In this regard, the relevant government departments need to work together to overcome these barriers and develop a commercial approach to the renewable energy sector which would facilitate creating renewable business opportunities of scale.

Continued significant investment in Ireland's energy transmission and distribution infrastructure is planned over the period to 2025, which will be financed through future increases in electricity prices. State funded capital expenditure projects have already been reviewed in light of changed economic circumstances and the same rationale should be extended to energy infrastructure projects, the cost of which will be borne by customers. Given reduced levels of economic activity, the Council believes that potential exists to extend delivery over a longer period of time and delay projects, which are no longer justified by projected demand growth. The Council welcomes that Eirgrid is reviewing the rollout of specific projects under Grid 25 to best meet the changed circumstances such as the reduction in demand[24]. We also need to ensure more geographically focused renewables investment to minimise the amount of additional grid investment required. In particular, optimal wind sites in terms of electricity generation potential and proximity to the grid should be prioritised. Furthermore, planning delays in completing the North-South interconnector are negatively affecting the efficient functioning of the electricity market and as a result are leading to higher costs for Irish electricity consumers. It is estimated that the total costs of the delay are of the order of €20 million to €30 million per annum and are expected to increase each year that the interconnector is not operational[25]. In addition, the Council believes that high-tension transmission lines should continue to be placed overhead as it provides a technically superior solution from the perspective of guaranteeing security of supply at a fraction of the cost[26]; costs which are borne by the customer.

Finally, one of the big long term energy competitiveness issues is the move to the single European electricity market, which is likely to require significant changes to the all island electricity

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[22] OECD, OECD Economic Survey: Ireland, October 2011. In addition, proposals by the ESRI that price supports should not be paid for exports and that offshore wind farms should be charged the full cost of grid connection merit serious consideration. The Internal EU Electricity Market: Implications for Ireland, Paul K. Gorecki, ESRI Research Series Number 23, October 2011.

[23] See 'Progress Report on the implementation of the recommendations of the report of the High Level Group on Green Enterprise', March 2011. http://www.forfas.ie/publications/2011/title,7602,en.php

[24] http://www.eirgridgroupconference.com/images/Louis%20Fisher.pdf

[25] Speech by the Minister for Communications, Energy and Natural Resources at the Energy Ireland conference, June 2011

[26] There is a significant cost associated with placing high-tension cables underground Eirgrid estimates the incremental cost of using underground cables to strengthen the transmission grid (circa 650 km of transmission cables and 100 km for the North-South interconnector) would be €6 billion — costs that would be borne by all customers. Ecofys, 2008, Study on the Comparative Merits of Overhead Electricity Transmission Lines versus Underground Cables, Report to Department of Communications, Energy & Natural Resources, July 2008. Note: An international expert commission was appointed by DCENR in July 2011 to review the case for undergrounding part or all of the north-south electricity interconnector and is to report within six months. It is critical that the decision of the expert commission is made quickly and that it provides the policy certainty required to progress the significant energy infrastructure investment needed to support future growth and competitiveness.

market[27]. The move to a single European electricity market offers significant benefits both in terms of security of supply and cost competitiveness, as well as a range of challenges.

Recommendation: Consideration should be given to phasing out subsidies for peat generated electricity.
Recommendation: The REFIT scheme should be revised so that the price support levels for new onshore wind projects are phased out over time. Consideration should also be given to the ESRI proposals to cap the subsidy to avoid windfall profits.
Recommendation: The cost of supporting emerging energy renewables technologies (e.g. wave, tidal, offshore wind) should be funded through funding mechanisms for R&D (as is the case for other emerging sectors), rather than by energy customers through price support mechanisms.
Recommendation: The timing of grid investment plans need to be reviewed to take account of the implications of reduced demand and planning delays while ensuring that future enterprise needs are met.
Recommendation: The relevant government departments (DCENR, DECLG and DJEI) should develop a coordinated, commercial approach to the renewables sector which provides clarity and certainty with regard to international trade, planning, permitting, licensing, grid development and Renewable Energy Feed-In Tariffs (REFITs) and which focuses on creating renewable business opportunities of scale, without adversely affecting energy cost competitiveness for the wider business community.

Recommendation: It is vital that actions to reduce planning delays and improve the efficiency of the planning approval system are progressed quickly (i.e. the North-South interconnector).
In addition, high-tension transmission lines should continue to be placed overhead.
Responsibility: Department of Communications, Energy and Natural Resources / Department of Environment, Community and Local Government / Department of Jobs, Enterprise and Innovation / Commission for Energy Regulation.

2.3 Commercial Rates

Commercial rates are a form of property tax levied by local authorities on tenants of commercial properties[28]. These revenues enable Local Authorities to provide services to both businesses and households. The bulk of businesses pay relatively low levels of commercial rates (with 40 percent of businesses paying less than €5,000 per year). However, despite a moderation in rates in the last two to three years, the cumulative increase in commercial rates has been almost double the rate of inflation over the last decade.

The commercial rates system should be simple, transparent and easy to administer. A broad based system with a lower nominal rate is preferable to one with a higher rate and a range of exemptions. As such, the commercial rates regime should not discriminate between firms based on ownership, country of origin, sector or performance, etc[29].

Rates are calculated on the basis of property valuations. While a process of revaluation of all commercial and industrial property started in 2005, this will not be completed until at least 2015.

[27] Under the all island electricity market, all electricity generated must be sold into a gross market pool and all wholesale electricity must be purchased from that pool. Most other EU member states operate bilateral markets (contracts between electricity generators and suppliers). Plans for the development of a single European electricity market are advancing and the target date to achieve the single market is 2014. Ireland will have until 2016 if we decide to put in place transitional arrangements.

[28] The annual rate that any given commercial tenant must pay is calculated by multiplying the rateable valuation of the property by the Annual Rate on Valuation (ARV). The rateable valuation is based on an estimate of the likely rent that a tenant would pay on an annual basis.

[29] Other taxes are more appropriately designed to account for business performance (e.g. corporation tax, capital gains, etc.).

This process is too slow. The Council believes that significant, expedited reform of the valuations process is required to ensure that rates valuations are appropriate to current market conditions.

In the long term, the Government should provide local authorities with sustainable sources of income from an annual recurring residential property tax and user charges (rates, water, development charges etc). The implementation of the Local Government Efficiency Review Group report is also vitally important. The report sets out 106 recommendations that could achieve efficiencies and savings amounting to €500 million[30], which could be passed on in savings to businesses, citizens and Central Government.

Recommendation: The revaluation process needs to be expedited. The process could be accelerated through the introduction of self-assessment (as is the case for many other taxes) or the outsourcing of valuations.
Responsibility: Commissioner for Valuations / Department of Finance
Recommendation: Accelerate the introduction of an annual broadly based and equitable residential property tax and water charges for households. The speedy introduction of such taxes and charges will assist in rebalancing local authority revenue sources and would help to ensure Local Authorities are adequately funded in a sustainable manner.
Responsibility: Department of Finance/ Department of the Environment, Community and Local Government
Recommendation: Implement the recommendations from the Report of the Local Government Efficiency Review Group.
Responsibility: Department of the Environment, Community and Local Government / Local Authorities
Recommendation: As efficiency savings are achieved, these should be used to achieve a broad based reduction in rates by directing Local Authorities to lower their Annual Rate on Valuation.
Responsibility: Local Authorities

2.4 Importance of Competition Policy

Strong competition policy will be at the heart of Ireland's economic recovery – competition is a key driver of efficiency and innovation in business. Competition keeps prices and costs down, stimulates innovation and boosts Ireland's cost competitiveness as it protects purchasing power.

The EU/IMF Programme of Financial Support for Ireland has had a significant impact on the competition policy environment. The Memorandum of Understanding (MOU) emphasises the need for structural reforms across a range of areas of the Irish economy – particularly in relation to how a number of different sectors are regulated. As a consequence, the MOU accords particular significance to the role of competition policy. Significant action has already been undertaken to date – notably the publication of the Legal Services Bill and the Competition (Amendment) Bill.

In response to the Programme, however, Ireland should not undertake reform solely to satisfy the terms and conditions set out by the EU/IMF. Instead, we should seize the opportunity to continue to deliver structural reforms that can lead to long term prosperity, recognising that competition policy is good for Ireland – benefiting consumers and helping to restore Ireland's international reputation. Many sectors continue to engage in special pleading – seeking to maintain restrictions to competition and barriers to entry. The Council support the principle of enhancing competition in *all*

[30] Report of the Local Government Efficiency Review Group, 2010. While most of the recommendations concern efficiency savings, a number of recommendations also extend to cost recovery and revenue rising, with an emphasis on a more equitable distribution of the revenue burden. Of the €511 million total, €346 million comprises efficiency savings, and €165 million is accounted for through improved cost recovery and revenue raising. Advances have already been made on some of the recommendations with announcements that Limerick city / county and North and South Tipperary councils are to merge.

sectors – this was reflected in much of the analysis in the Council's *Costs of Doing Business in Ireland 2011* report.

3 Increasing Productivity

A reduction in our cost base can play an important role in restoring our competitiveness but we also need to increase productivity across the economy. Productivity growth is key to improving living standards, particularly as it allows for sustainable pay increases without eroding cost competitiveness.

Enhancing productivity requires a long-term focus across a range of policy areas including:

Improving our formal education system by reforming primary and secondary education, enhancing teacher training and development, and adequately funding third level education.

Up-skilling and re-skilling by adapting labour market programmes to reflect the needs of the economy and to provide the unemployed with the skills required to gain employment.

Prioritising State spending on R&D to support competitiveness.

Facilitating labour market adjustment.

Enhancing infrastructure by leveraging private sector investment and prioritising investment in next generation networks and intelligent infrastructure.

3.1 Improve our Formal Education System

At the broadest level, Ireland needs to improve educational attainment across the board. In this context, and notwithstanding the changed labour market conditions and concerns over educational standards (e.g. performance in PISA), the targets set out in the National Skills Strategy remain relevant[31].

3.1.1 Primary School Reform – Greater Focus on Mathematics

While primary school children in Ireland spend the second highest amount of time in the classroom of all children in benchmarked OECD countries, Irish children receive the least amount of tuition in mathematics[32]. Greater class time should be dedicated to mathematics, which will require a reduction in the time allocated to other subjects.

In addition, there are weaknesses in how mathematics education is delivered. The Department of Education and Skills has published a literacy and numeracy strategy[33], which sets ambitious targets across six key areas aimed at improving literacy and numeracy outcomes. The areas for action concern (1) parents and communities, (2) teacher education, (3) school leadership, (4) content of the curriculum and improving the learning experience, (5) assisting learners with additional needs and (6) the assessment and reporting on students' progress[34]. The successful execution of the actions outlined in this strategy would improve mathematical standards, and would ultimately enhance the skills and productivity of the future workforce.

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[31] EGFSN, Tomorrow Skills: Towards a National Skills Strategy, Forfás, 2007.

[32] Out of a group of 19 OECD countries where data is available. See Figures 5.39 and 5.43 in Ireland's Competitiveness Scorecard 2011.

[33] Department of Education and Skills, Literacy and Numeracy for Learning and Life - The National Strategy to Improve Literacy and Numeracy among Children and Young People 2011-2020, 2011

[34] Ibid

Recommendation: Greater class time should be dedicated to mathematics at primary school level.
Responsibility: Department of Education and Skills
Recommendation: Implement the actions contained in the 'National Strategy to Improve Literacy and Numeracy among Children and Young People'.
Responsibility: Department of Education and Skills to coordinate

3.1.2 Training and Teaching Quality

The success of any education system is dependent on the quality of its teaching professionals. This requires the attraction of strong candidates (where Ireland performs well – particularly at primary level), their ongoing professional development, and mechanism for improving teaching performance.

In the context of further cutbacks, expenditure on professional development should be protected. In terms of public sector reform, mechanisms for developing the skills of teachers and the quality of their teaching (e.g., mechanism for peer review and collaboration with colleagues) and reduction of out-of-field teachers represent the best path to improving student performance.

Recommendation: Given the necessity of enhancing the quality of teaching in Irish schools, professional and in-service development should be frequent, continuing and progressive during a teacher's career, and not limited to introduction of new syllabi. Where feasible, participation in training should occur outside of term time.
Responsibility: Department of Education and Skills
Recommendation: Teachers should have opportunities to benefit from peer review and collaboration with colleagues, including during initial training.
Responsibility: Department of Education and Skills
Recommendation: The deployment of out-of-field teachers (i.e. teachers teaching a subject in respect of which their qualifications do not meet the subject-specific criteria set down by the Teaching Council for registration purposes) should be reduced.
Responsibility: Department of Education and Skills

3.1.3 Upper Second Level Reform

The Council welcomes proposals to revise the curriculum and assessment system for lower second level[35]. In terms of upper second level, there is widespread concern that the leaving certificate does not instil appropriate learning skills in students.

There is also a need to reform the system of determining entry into third level education. The current CAO points system distorts performance by encouraging students away from vital subjects such as mathematics and the sciences in favour of subjects, which students perceive as being easier. It also promotes and rewards rote learning at the expense of developing more nuanced skills sets such as problem solving, critical thinking and "learning-to-learn"[36]. Finally, there are concerns that the current system can lead to a misallocation of talent at third level as the "point's race" can see strong students chase places in courses considered prestigious as a result of their high points-

[35] For more detail see: http://www.ncca.ie/en/News_Press/Press_releases/November_3rd_2011_Press_release_Minister_Quinn.pdf
[36] Hyland, Á (2011), "Entry in Higher Education in the 21st Century", Discussion Paper for the NCCA / HEA Seminar to be held on 21st Sep 2011, available at: http://www.hea.ie/files/files/file/News/1335_HEA_Conference_01.pdf

based entry thresholds, regardless of whether such courses are aligned with the students' talents or economic needs.

Recommendation: A new method of determining entry into third level education, which is meritocratic and promotes critical thinking, problem-solving, self-directed learning, communication skills and innovation, while maintaining access, transparency and fairness, is required to replace the current CAO points system.
Responsibility: Higher Education Institutes / Department of Education and Skills

3.1.4 Third Level Funding and Performance

In order to deliver a quality mass higher education system that meets the needs of the individual, and supports the development of enterprise and the economy, there is a need for adequate resourcing. The first step is to ensure that current funding is spent in the most efficient manner possible and that maximum value for money is achieved.

Students already contribute some portion through registration fees, which have increased significantly in recent years, as has funding from the State. However, Irish institutions remain under-funded relative to institutions internationally, which is damaging the reputation and perceived quality of education received. Improvement of quality standards at third level requires adequate resourcing and attention to efficiency and enhanced productivity. This in turn requires a continuous process of reform at institutional levels and the allocation of resources in such a way as provides the best value for money.

Graduates, who will benefit significantly from higher education in terms of increased earnings over the course of their life, should contribute a greater portion of the cost of their education. However, it would be important to ensure that such a measure does not act as a barrier to participation in third level education.

Recommendation: Undergraduates should contribute a greater portion of the cost of their education.
Responsibility: Department of Education and Skills

3.2 Up-skilling and Re-skilling

Activation is one of the most difficult and challenging public policy considerations confronting policy makers. Ireland will be confronted with very high levels of unemployment for some time – including high levels of youth and long term unemployment[37]. Structural imbalances in the labour market arising from the past dominance of the construction sector have exacerbated the situation in Ireland considerably[38]. In addition to a return to education, a strong focus on up-skilling and, of equal importance, the re-skilling of the labour market, are essential. Therefore, we must put in place labour market programmes which facilitate the ongoing adjustment in the shape of the labour market (i.e. ensuring that skills and experience of the labour force match the needs of the economy) and which equips unemployed workers with the necessary skills to gain employment.

[37] By Q2 2011, over 304,000 people (or 14.3 percent of the labour force) were unemployed. Because of the length of the recession, in Q2 2011 more than half of those unemployed were considered long term unemployed (i.e. over one year). Rising youth unemployment has also emerged as a significant concern – in Q2 2011, over 40 percent of the 15-19 year old cohort was unemployed, and 27.7 percent of 20-24 year olds were unemployed. CSO, Quarterly National Household Survey Q2 2011, September 2011

[38] According to CSO data, 17% of males were employed in construction in Q1 2004. Employment peaked at 21.3% of males in Q2 2007 before declining to 10.1% in Q2 2011. By way of comparison, 19.9% of male employment in Q1 2004 was in the industrial sector. Numbers have declined gradually but relatively steadily over time and by Q2 2011 industrial employment accounted for 17% of male employment.

Finally, while better management skills create business opportunities and support the development of best practices across organisations, many SMEs have relatively limited management capabilities, which need to be addressed.

Recommendation: More customised solutions are required to assist the unemployed. Activation measures should aim to improve employability by providing 'progression pathways' of relevant job search, training, education and employment opportunities for different target groups[39]. In addition, training and education programmes that incorporate traineeships/work placement should be prioritised. Flexible delivery that promotes access is essential also.

It is essential that activation and training 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.

Responsibility: Department of Social Protection / Department of Education and Skills

Recommendation: Public funding for management training should be targeted towards internationalisation skills (e.g. sales, marketing, languages, etc.)[40].

Responsibility: Department of Education and Skills / Department of Jobs, Enterprise and Innovation

3.3 Facilitate Labour Market Adjustment

In tandem with improving education (section 3.1) and training (section 3.2) outcomes, it is important that labour market rules and conditions support employment growth and incentives to work.

The EU/IMF Programme of Finance Support for Ireland requires Ireland to instigate reforms in relation to the labour market and the various regulated collective agreements[41] with a view to enhancing labour market efficiency. This goal has taken on increased impetus because of the 7th July 2011 High Court ruling which found that sections of the legislation governing wage-setting mechanisms contained in Employment Regulation Orders are unconstitutional. It is important that the reformed wage setting mechanisms promote employment growth, while at the same time protecting the interests and rights of workers.

The Council has also previously highlighted the need to ensure that the social welfare system does not create poverty traps and has emphasised the need to ensure that unemployed persons do not become disengaged from the workforce. A recent report from the ESRI[42] illustrated that approximately 18-19 percent of unemployed persons currently in receipt of jobseeker's benefit or assistance have a replacement rate of 70 percent or over. A high replacement rate of this nature is of particular concern as it can create a disincentive to work[43]. Secondary benefits, and specifically housing entitlements, are a major influencing factor on replacement rates. The preceding

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[39] Once established, the National Employment and Entitlement Service will have an important role in this regard also.

[40] At present the EGFSN are undertaking a study on Key Skills for Enterprise to Trade Internationally. In addition, the Royal Irish Academy recently highlighted the importance of international language skills for economic and social development. See Royal Irish Academy, National Languages Strategy, National Committee for Modern Language, Literary and Cultural Studies, August 2011

[41] The various agreements on pay and conditions made by Joint Labour Committees (JLCs) are known as Employment Regulation Orders (EROs). Agreements, which result from negotiations between trade unions and employers, are called Collective Agreements. If a Collective Agreement has been registered with the Labour Court, it is known as a Registered Employment Agreement (REA).

[42] Callan, T., et al , Tax, Welfare and Work Incentives, published in Budget Perspectives 2012, Dublin: ESRI, 2011

[43] While there is no pre-determined level of replacement rate which would influence every individual's decision to work, clearly the higher the replacement rate, the lower the incentive to work. A replacement rate in excess of 70% is considered excessive. It should also be noted that standard measures of replacement rates exclude a number of factors. For more information see: Department of Finance, Replacement Rates and Unemployment, 2009 and Department of Finance, Tax Strategy Group 10/04, Replacement Rates 2010, 2010

recommendation on the need for strong activation policies is also important in the context of overcoming the disincentive effect of high replacement rates.

Recommendation: Replacement rates should be monitored over time with a view to minimising the incidence of high replacement rates. In the longer term, replacement rates should not exceed 70 percent. Policymakers must also be cognisant of the impact of various policy changes on replacement rates (in particular the impact of changes to personal tax, social contributions and social welfare payments on replacement rates).

Responsibility: Department of Social Protection / Department of Finance / Department of Public Expenditure and Reform

Recommendation: The Council support suggestions that housing related entitlements are transferred out of the Social Welfare system, and into a separate dedicated housing stream where entitlement would depend on income levels rather than employment status (i.e. decoupling housing support from social welfare payments). This would substantially reduce replacement rates and allow for the retention of housing benefits for a period after take up of full time employment, depending on income levels.

Responsibility: Department of Social Protection / Department of Environment, Community and Local Government

3.4 Prioritise State Spending on R&D and Innovation

Investment in research and development, leading to improved product and process innovation, is one of the primary drivers of productivity. Ireland's recovery to date has relied on the production of high-value, knowledge intensive goods and services for export markets. In order to continue to develop such sectors in the context of increasing international competition, a stronger base in research and development is required.

As highlighted in Ireland's Competitiveness Scorecard, 2011, despite progress, Ireland's R&D and innovation performance is mixed in terms of expenditure and outcomes. In light of the severe contraction of the economy, funding for R&D and innovation is now running behind what was expected under the Strategy for Science, Technology and Innovation (SSTI) - the core STI programme budget in 2011 was €570 million compared with a projected spend of €940 million under the SSTI[44].

In the context of reduced resources, prioritisation is essential. Forfás has supported a National Research Prioritisation Exercise. This process has identified priority areas for the allocation of public funding of research and development over five years, and has produced an action plan for each priority area setting out specific goals. The exercise:

Takes account of fields of research activity where Ireland has built significant strength to date – identifying priority areas that have the greatest potential to deliver sustainable economic return through enterprise development, employment growth, job retention and tangible improvements to quality of life;

- Identifies a non exclusive list of supporting fields of research of relevance to each priority area.

As a small country with limited resources, Ireland must be strategic in terms of where it concentrates its reduced STI resources. In addition, the clear delivery of specific economic

[44] This figure refers to funding allocated on a competitive basis by SFI, HRB, etc. It excludes research funded out from the "block grant" to Higher Education Institutions.

outcomes from our investments is essential. Close evaluation of public expenditure in this area is of paramount importance to inform ongoing state support.

Recommendation: To accelerate the economic impact of publicly performed R&D, the recommendations of the National Research Prioritisation Exercise should be implemented.
It is important that implementation is progressed rapidly, based on clear objectives and metrics (including economic impact metrics) underpinning the priority areas. Performance against these metrics should be monitored on annual basis.
Responsibility: Whole of Government

3.5 Enhance Infrastructure

The availability of competitively priced world class infrastructure (e.g., energy, telecoms, transport, waste and water) and related services is critical to support competitiveness. While Ireland has made significant progress in recent years, deficiencies remain.

Investment in infrastructure is constrained by limited State resources. Almost €9 billion was invested in infrastructure in 2008, however just over half that amount will be invested in 2011. Capital investment is expected to fall to €3.3 billion per annum from 2014 to 2016[45]. However, it is an opportune time to invest given that the fall off in demand for construction related activities has led to significant cost reductions and improved value for money. It is also worth noting that as a result of the sharp correction in the property market, construction activity is below its long term equilibrium level[46].

Notwithstanding the challenges for the State in raising external finance, infrastructure investments offer a potentially attractive investment opportunity for private sector finance[47]. For example, the average group pension managed fund in Ireland returned an average of 0.7 percent per annum over a 10 year period to August 2011[48]. There is an opportunity, therefore, for the State to develop innovative approaches to encourage private sector investment in infrastructure where user charges can be applied[49,50]. Further potential also exists to reduce the costs of infrastructure delivery[51].

In terms of where to invest, the widespread availability of advanced broadband infrastructure and services is essential to realising future growth potential in existing and emerging sectors[52]. It will

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45 Department of Public Expenditure and Reform, Infrastructure and Capital Investment 2012-16: Medium Term Exchequer Framework, November 2011

46 According to IBEC, for example, in 2006, some 80,000 homes were bought by first-time buyers and mover-purchasers. In 2011, the corresponding number will be less than 10,000. This will not be a permanent state and normal transaction and investment activity will eventually return, most likely at a level somewhere between the current state and that experienced before the collapse. For further details see IBEC, Unlocking Domestic Demand - Initiatives to support Ireland's domestic economy, November 2011

47 According to *Ireland's Competitiveness Scorecard 2011*, the private sector in Ireland has experienced a dramatic decline in investment from over 26 percent of GDP in 2005 to 7.3 percent in 2010. This compares poorly with the euro area-16 average of almost 20 percent in 2010.

48 Mercer Investment Update, September 2011, available at: http://www.mercer.ie/articles/1425455

49 Potentially in tandem with the proposed 'Connecting Europe' infrastructure plan. The Connecting Europe Facility (CEF) is a proposal by the European Commission to fund a €50 billion investment to improve Europe's transport, energy and broadband infrastructure between 2014 and 2020; €9.2 billion is earmarked to support investment in fast broadband networks and pan-European digital services.

50 ICTU, for example, have set out a proposal in their pre-budget submission suggesting that pension funds which increase investment in the domestic economy by 5 percent of asset value should be exempted from the temporary stamp duty on the value of pension fund assets. For further details see: ICTU, Growth is the Key, Pre-Budget Submission, October 2011

51 Reductions in planning delays could yield potentially significant cost savings. The challenge is to make the approval system much more effective so that it can deliver greater certainty of outcome in a consistent, timely and transparent manner, while protecting rights to fair process. In this regard, a recent report from the Irish Academy of Engineers, which was partially sponsored by Forfás, sets out a series of practical solutions designed to reduce the cost of infrastructure delivery.

52 Advance broadband services offer download speeds of 100 Mbps or more, with significantly higher upload capability including the widespread availability of symmetric services for enterprise) and low latency (the speed of response of the system to the user). Forfás' advanced broadband vision for Ireland is to achieve, within five years, an advanced broadband infrastructure comparable with our key

also play a key role in supporting the growth of small business, capturing opportunities for productivity and innovation, supporting regional development, enabling greater public sector efficiency and marketing Ireland as a location for ICT-intensive FDI and R&D projects. Despite recent progress, Ireland still lags the EU and OECD in terms of high speed broadband availability[53].The optimal solution is that telecommunications market players undertake the necessary investment within the context of a supportive policy and regulatory framework with Government addressing areas of market failure. Given the weak telecommunications investment climate in Ireland, our dispersed population patterns and the recession, it is unlikely that the required investment will be made by the private sector within a timescale that will allow Ireland to catch up with competitor countries and to meet challenging EU targets for 2020[54]. If the market cannot deliver, the State will need to intervene.

The potential to use ICT in infrastructural services (i.e. intelligent infrastructure[55]) offers significant competitiveness benefits for the economy in terms of increasing productivity and reducing costs (e.g. reduced congestion, reduced investment requirements, increased energy/water efficiency, increased safety, etc.). For example, the projected cost of developing Grid 25 has been reduced from €4 billion to €3.2 billion largely through advances in smart technology. Smart technologies have already been applied to a range of infrastructures in Ireland[56]. However, potential exists to build on these advances given rapid advancements in sensor, communications and analytical technologies. In a recent report, Forfás highlighted the potential for the deployment of intelligent infrastructure in Ireland to optimise scarce resources, enhance competitiveness and create enterprise opportunities[57].

Ireland currently imports approximately 90 percent of its energy (electricity, heat and transport) needs. In the longer term, Ireland needs to adapt the fuel mix to ensure a cost-effective, secure and diverse fuel mix for electricity, heat and transport. Increasing interconnection to Great Britain and continental Europe will help diversify the electricity fuel mix. Notwithstanding this, alternative viable sources of energy need to be developed. Policy tools to incentivise investment which could be considered include the use of fiscal incentives (e.g. price supports) and/or the development of market rules (e.g. changing the capacity payment mechanism to incentivise investment in more flexible electricity generation plant).

Recommendation: Where a priority infrastructure requirement is identified, innovative approaches (e.g. pension funds) to encourage private sector investments should be developed. Increased investment levels will require greater use of charges (road tolls, water charges, etc.).
Responsibility: Department of Public Expenditure / National Development Finance Agency

competitors in all towns with a population greater than 1,500, delivering download speeds of at least 100 Mbps, with significantly higher upload speeds (including the widespread availability of symmetric services for enterprise) and low latency.

53 The share of broadband lines in Ireland at 10 Mbps and above increased from 8.9 percent at the end of 2009 to 13.4 percent at the end of 2010; the EU average was 38.9 percent of subscriptions at 10 Mbps and above in 2010. Note, this does not include subscriptions to mobile broadband - Ireland has a relatively high rate of mobile broadband penetration (47.1 per cent), and is above the EU-15 average (43.4 per cent) and OECD average (41.6 per cent). Forfás, Ireland's Advance Broadband Performance and Policy Priorities, 2011

54 The Digital Agenda targets specify that by 2020, all EU citizens should have access to broadband speeds off 30 Mbps and that 50 percent of European households should be subscribed to services of 100 Mbps or higher.

55 "Intelligent" or "smart infrastructure" is the application of technology to deliver a more effective and efficient infrastructure service. Intelligent infrastructure can apply to a system wide application, for example, smart electricity grids. It can also be targeted at a specific element within the infrastructure chain, for example the use of sensors to detect the presence of a toxin at a landfill site.

56 For instance, a number of intelligent transport system initiatives have been established such as barrier-free tolling on the M50, real time passenger information in Dublin and the use of sensors to monitor traffic and to sequence traffic lights accordingly in some urban areas.

57 Forfás, Intelligent Infrastructure: Delivering the Competitiveness Benefits and Enterprise Opportunities, 2011

Recommendation: To support the rollout of advanced broadband, the State should:

- Improve the investment environment by amending the regulatory (e.g. enabling infrastructure sharing) and planning system (e.g. reforming local authority processes and fees, mandatory ducting in new infrastructure development such as roads, water network upgrade, new housing, etc.) to reduce investment costs and risks.
- Quickly assess how much the market can deliver by mapping existing telecommunications networks, assessing committed investment plans and identifying deficits. To address identified deficits, it is necessary for the State to make a firm commitment to providing or sourcing the funds required (through NewERA and coordinating infrastructure investment, leveraging existing State assets, EIB funding, the recently announced Connecting Europe Facility etc.) to achieve the goals set out in the Programme for Government;
- Stimulate demand for advanced telecoms services by using its position as a major purchaser of telecommunications services to support infrastructure investment, make better use of ICT across government (e-government; e-health; e-education) to improve the efficiency and effectiveness of public services. The State could also support businesses, particularly SMEs, to exploit the full benefits of greater ICT use, and foster an e-payment friendly environment through the rebalancing of stamp duty on cheques in favour of debit and credit cards and ensure that all State bodies' transactions are payable via electronic funds transfer.

Responsibility: Department of Communications, Energy and Natural Resources / Department of the Environment, Community and Local Government / Department of Public Expenditure and Reform / Department of Finance

Recommendation: The potential for intelligent infrastructure to substitute or complement traditional capital investment should be required as part of the capital appraisal process. Greater cooperation between infrastructure providers and enhanced coordination of infrastructure planning and roll out (across areas such as roads, telecoms, water, and energy) has the potential to deliver significant cost savings, particularly where projects are undertaken simultaneously.

Responsibility: Department of Transport, Tourism, and Sport / Department of Communications, Energy and Natural Resources / Department of the Environment, Community and Local Government / Department of Public Expenditure and Reform

Recommendation: To improve Ireland's fuel mix, develop alternative sources of heat energy such as Waste-to-Energy, CHP, district heating, solar and geothermal energy and incentivise investment in those with greatest potential in an Irish context.

Responsibility: Department of Communications, Energy and Natural Resources / Department of the Environment, Community and Local Government.

4. Restoring a Sound Macroeconomic Environment

Stable government finances and a functioning financial system are central to supporting competitiveness. It is essential that we implement credible and widely supported programmes to restore the sustainability of the public finances, to ensure that our taxation system continues to support enterprise development and job creation, and that adequate funding is available to support enterprise opportunities.

4.1 Fiscal Policy and Taxation

Despite progress, the EU Commission estimate that Ireland will have the largest deficit (% of GDP) among the euro area 17 countries in 2011[58]. In nominal terms, the underlying Exchequer deficit for 2011 – that is the deficit excluding the banking recapitalisation payments – is €17.9 billion. €12.4 billion of adjustment is planned for the 2012-2015 period [59]. The adjustment process will require both a curtailment of public expenditure and an increase in revenue. In seeking to reduce expenditure, the government should be cautious about cutting productivity and competitiveness enhancing investment as set out in section three, including:

- Education priorities include investment in maths, teacher training and focused labour market programmes.
- Infrastructure priorities include investment in advanced broadband and intelligent infrastructure projects.
- R&D priority areas as set out in the National Research Prioritisation Exercise.

Maintaining a pro-enterprise taxation system, while simultaneously broadening the tax base, is critical to maintaining employment levels and incomes in Ireland and repairing the public finances.

4.1.1 Broadening the Tax Base

The need to broaden our tax base as a matter of urgency is well recognised, however in doing so policy makers should be mindful of the impact on growth.

The Council strongly believes that a broadly based and equitable residential property tax should be implemented as a matter of priority. Such a tax will deliver a substantial tax yield to the State in a time when Exchequer finances are under significant pressure. The introduction of a household charge (of €100 levy on an estimated 1.6 million residential households) is an interim measure and heralds a move towards the implementation of a full residential property tax. Furthermore, there are benefits to economic growth in introducing such a tax. The OECD has noted that recurrent taxes on immovable property as the least harmful form of tax for growth[60], and as residential property taxes are placed on an immovable tax base, they are difficult to evade or avoid. Property tax revenue can be used to reduce the burden of other forms of direct taxation, and such taxes have less impact on investment, employment and consumption decisions than income taxes. A broad based and equitable residential property tax also represents a form of tax on wealth.

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[58] European Commission, DG EconFin, Spring 2011 Economic Forecasts. The estimated deficit for 2011 is -10.5 percent of GDP and -12.7 percent of GNP. 2011.

[59] In terms of the €12.4 billion consolidation planned for the 2012-2015 period, it is intended that €7.75 billion will consist of expenditure reducing measures and €4.65 billion revenue raising measures. Department of Finance, Medium Term Fiscal Statement, November 2011.

[60] OECD, Going for Growth, 2009

In the past, property-based tax relief schemes were significant contributors to the development of the speculative property bubble. Virtually all of these historic property-based tax relief schemes have been abolished, subject to transitional arrangements for certain schemes. However, due to their nature, these reliefs continue to impose ongoing costs on the Exchequer in terms of tax foregone. The Department of Finance is currently carrying out an impact assessment of the potential effects of amending, curtailing and/or abolishing property-based "legacy" tax reliefs.

Recommendation: Any changes to broaden the tax base should be cognisant of the impact on growth. In this regard the introduction of a broadly based and equitable residential property tax[61], which would also provide a revenue stream for local authorities, and user charges (e.g. for treated water) should be a policy priority.
Responsibility: Department of Finance
Recommendation: The Council believes that tax incentives should promote investment in the productive sector of the economy rather than investment in property.
Responsibility: Department of Finance

4.1.2 Maintain a Competitive Tax Regime for Labour

A competitive tax regime is essential in attracting and retaining individuals in Ireland and more generally in terms of encouraging people to remain in or return to the labour market. Recent increases in personal taxation are eroding competitiveness and the incentive to work. Higher labour taxes raise the costs of labour, raise replacement rates (i.e. make work less attractive vis-à-vis social welfare), reduce take home pay and domestic demand and risk stimulating the informal economy.

In Ireland, the difference between the employers' cost of hiring an individual and the individual's actual take home pay, has widened for all income categories (in particular, as a result of changes to tax bands and credits and the introduction of the Universal Social Charge) while the tax wedge in most OECD countries is unchanged or falling[62]. The difference is wider for higher paid workers in Ireland, which is of concern as Ireland competes internationally for mobile talent. The level at which individuals start paying the higher rate of tax (€32,800 for single individuals) is low relative to other countries[63]. The higher rate of tax actually impacts on individuals earning less than the average wage[64]. This means that marginal rates (i.e. the tax paid on an individual's last euro of income) are now in excess of 50 percent for single individuals earning €32,800 per annum[65].

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61 Ireland generates a relatively low proportion of revenue using property taxes (5.6 percent of total tax revenue, compared with 10.3 percent in the UK and 12.8 percent in the US).

62 For a single person with no children on 167 percent of the average wage (€66,000 p.a.), the difference between what the employer pays and the employee receives has increased as a result of increased labour taxes. The difference in 2010 was 39.9 percent up from 34 percent in 2008. This differs from the trend reflected in the OECD 28, which experienced an average decrease in taxes on labour. Importantly the downward decrease on taxes on labour was evident amongst a number of our key competitors e.g. Poland, the Netherlands, and Switzerland.

63 For instance, in the case of the US, the threshold at which the marginal rate takes effect is at a much higher earnings level (approximately €310,000). In the case of Germany the marginal rate is lower than Ireland's at 47.5 percent and takes effect at a much higher wage level of approximately €253,000. All rates refer to 2009, OECD taxing wages 2009, Forfás calculations.

64 The CSO, Earnings and Labour Costs Survey for Q3 2011 show that average weekly earnings are €687.24. The average annual salary in the economy, therefore, is approximately €36,000.

65 The following example illustrates the effect of recent changes in taxation on individuals. For a single worker earning €40,000 per annum the average rate of tax has increased from 18.6 percent in 2008 to 24.2 percent in 2011, while the marginal rate has increased from 47 percent to 52 percent. At the higher income levels, a single worker earning €100,000 per annum, the average rate of tax has increased from 32.4 percent in 2008 to 38.8 percent in 2011, while the marginal income tax has increased 43 percent in 2008 to 52 percent in 2011. Department of Finance, Budget 2011, Annex

Recommendation: Marginal income tax rates are in excess of 50 percent for single individuals earning €32,800 or above. This position should not deteriorate further. When conditions improve, this issue should be reviewed.
Responsibility: Department of Finance

4.1.3 Ensure Ireland Remains Conducive to Developing Competitive Enterprises

As a trading economy, extension of Ireland's network of Double Taxation Agreements is important. As an ever increasing proportion of what we produce is service based, we need to ensure that our fiscal policy reflects this. In this regard, tangible and intangible assets should enjoy equal taxation treatment. In addition, R&D tax incentives have a key role to play in developing and attracting high value-added projects. Ireland must take steps to guarantee that its R&D incentives remain competitive, building on measures announced in Budget 2012[66]

Recommendation: Building on the significant advances made to date[67], and to ensure that Ireland remains an attractive operating base for global operations, Ireland should continue to extend its network of competitive Double Taxation Agreements (DTAs) as far and as rapidly as possible, with a focus on key emerging economies.
Responsibility: Department of Finance / Office of the Revenue Commissioners
Recommendation: Tangible and intangible assets should be treated equally in terms of taxation. This is an important issue in terms of the taxation treatment of withholding tax on royalties.
Responsibility: Department of Finance
Recommendation: Ireland must continue to remain attractive as a location for R&D activities. The Council recommends moving to a full volume based system for the R&D tax credit[68], subject to the results of a cost-benefit analysis.
Responsibility: Department of Finance

4.1.4 Improve Cash Flow

Given the difficulties companies are having in accessing finance, the Council believes there are taxation measures that government can undertake to improve companies' cash flow position. These relate to three specific areas; the R&D tax credit refund instalment, professional services withholding tax (PSWT) and a review of the qualifying threshold of the cash accounting method[69]. It

[66] Budget 2012 announced a series of changes to the R&D tax credit, specifically (1) that the first €100,000 of R&D expenditure of all companies will be allowed on a volume basis for the purpose of the R&D Tax Credit (2) the outsourcing arrangements for R&D purposes will be improved in a targeted manner to allow the greater of the existing percentage arrangement or €100,000 (3) companies will have the option to use some portion of the R&D credit to reward key employees who have been involved in the development of R&D. Further details on these will be published in the Finance Bill.

[67] Double taxation agreements represent an important measure to enhance Ireland's trade performance. Other trade policy measures, for example include Free Trade Agreements. A notable development in this area includes the recent signing of a free trade agreement between the EU and South Korea.

[68] For those companies with R&D expenditure in 2003, the R&D Tax Credit is calculated on the incremental R&D expenditure over the 2003 R&D spend. Those companies who commenced R&D expenditure or located in Ireland after 2003 currently get 25 percent credit on their full qualifying R&D spend (i.e. full volume base). Therefore, a move to a full volume based R&D tax credit would mean that for companies which had R&D expenditure in 2003, the credit would be calculated on the full volume of qualifying R&D expenditure within that claim period. An independent study by Mazars on the cost of global R&D initiatives after tax and other cost incentives has placed Ireland among the world's most competitive locations in this area. However, the Council believe that the R&D Tax Credit should not only be competitive, but market leading in order to attract further investment to increase the overall levels of R&D in the economy.

[69] By allowing the R&D tax credit instalment to be available from January 1st, it would allow business to use this refund to pay other tax liabilities. PSWT is a deduction made at the point of payment, which represents an advance payment of tax liability of the professional service provider and is charged at 20 percent. Potential exists to allow tax compliant professional services businesses to pay their tax liabilities under the normal preliminary tax payment rules and rates. For corporate entities, PSWT is currently withheld at 20 percent on a gross figure, which is in excess of the current corporation tax rate of 12.5 percent on a net figure. Finally, under existing measures businesses with a turnover of less than €1 million can account for VAT on sales on the basis of monies received, rather than invoices issued to their customers, consideration should be given to increasing this threshold subject to a cost-benefit analysis.

is important to note that businesses benefiting from these proposed initiatives would still be required to pay their full tax liabilities, but these measures would affect the timing of the payments, thus improving their cash flow position.

Recommendation: Improve enterprise cash flow by carrying out the following measures:
Where an R&D tax credit instalment refund arises, companies should be permitted to use the year 2 and year 3 instalment of the refund as a credit to offset against other (non-payroll) tax liabilities from January 1st.[70]

- Where evidence tax clearance certificate has been obtained, Professional Service Withholding Tax should be removed for service providers.
- Subject to the results of a cost-benefit analysis, consideration should be given to increasing the qualifying threshold for companies to avail of the cash accounting method. This would allow companies to account for VAT on sales on the basis of monies received, rather than on invoices issued to their customers.

Responsibility: Department of Finance

4.2 Improve Access to Funding for Enterprise

The availability of external funding impacts on enterprises ability to trade, increase employment, and contribute to the growth of the overall economy. International experience suggests that there is a significant probability that our recovery could be 'creditless' (i.e., the economy could recover while there would be a continuing real fall in credit or zero credit growth). The IMF[71] has found that average output growth in creditless recoveries is nearly a third lower as new investment is constrained.

In terms of bank lending, the total amount of credit outstanding to Irish private-sector enterprises was €40.4 billion in June 2011, down from €59.6 billion at its peak in December 2008[72]. A recent CSO survey on access to finance indicates that enterprises that applied for bank finance had a success rate of 95 percent in 2007, compared with 55 percent in 2010[73]. While we do not wish to return to the credit bubble of the past, it is notable that many SMEs are undercapitalised following three very difficult years of trading in which losses have eroded capital and reserves. Some businesses have also tied their reserves up in property based assets which have been decimated. The Council believes the key challenges are to:

- Restore bank lending; and
- Promote investment in enterprise.

4.2.1 Restore Bank Lending

It is worth stressing that both the banking system and enterprise themselves have a role to play in enabling the credit market. In the era of easy access to credit, banks had strong incentives to move

[70] This recommendation relates to the second and third R&D tax credit refund instalment. Currently, the first R&D tax credit refund instalment cannot be made in advance of the claim in the corporation tax return by an enterprise in the ninth month of the accounting period after the qualifying R&D expenditure was incurred. The subsequent second and third refund instalment occurs on the annual anniversary of the first refund.

[71] Creditless recoveries are defined as episodes where real credit growth is negative in the first three years following a recession. A recovery can be creditless because either credit is not required, or because credit is not available. IMF Working Paper, Creditless Recoveries, March 2011

[72] These are the figures on the balance sheet of resident credit institutions and excluding property-related and financial sectors. Source: Central Bank, Business Credit and Deposit Statistics, Table A.14 Credit Advanced to Irish Resident Private-Sector Enterprises

[73] When successful and partially successful applications are added together, the comparable totals are 98 percent in 2007 and 74 percent in 2010. This is similar to international norms.

from real economy projects, yielding a profit, towards lending against rising asset prices, yielding a capital gain[74]. Realignment is underway. In this regard, building on advances already made, banks need to continue to up-skill staff to enable them to commercially assess credit applications from productive, cashflow based viable businesses. As banks refocus on lending to the real economy, there needs to be complementary up-skilling of the financial skills in businesses. Banks are increasingly returning to undertaking commercial assessment based on prudent cash flow rather than on collateral. This enhances the requirement for businesses to prepare strong business plans with realistic cash flow forecasts in order to establish future viability[75].

The Council welcomes measures introduced to improve the access to finance[76] and the delivery of a partial credit guarantee and microfinance initiative. There is a need to assess whether the range of measures introduced have achieved their objectives of aiding the supply of credit to viable firms. In this regard, there have been a number of improvements made in official credit supply data. However, more improvement is required to separate new from old lending and to understand where credit is flowing. In addition, while a lending survey is underway, it is important that this is carried out on a periodic basis to alleviate uncertainty and provide timely evidence for further potential action.

During the credit boom, the construction sector experienced a significant increase in the supply of credit from the banking sector. From March 2003 to June 2008, the outstanding credit in the construction sector grew by 227 percent[77]. Given the reliance on the construction sector over the past decade and likely staff reductions in the banking system, there is a need to up-skill and mentor front-line and lending staff to focus on understanding key export sectors, exporters' business models and their key exporting markets. This needs to be complemented by a simultaneous up-skilling of the chief financial officers in businesses to ensure they understand the requirements of the banking system.

There is a need to ensure that credit products and their conditions (i.e. availability of products and the cost of these products) are supporting the ability of businesses to compete. Prior to the current crises, many exporters felt that the banking system did not fully serve their needs by providing relevant banking products and developing pro-active overseas networks. In particular, concerns have been raised about the availability of products such as international invoice discounting, performance bonds and specialised leasing, amongst others.

Finally, choice and competition in the credit market is also a concern given the small number of operators remaining in the market (both AIB and Bank of Ireland hold approximately 60 percent of the market in lending to SMEs in Ireland[78]). It is also notable that in a reversal of past trends, the current financial crisis is resulting in EU banking systems that are more national and fragmented. This fragmentation leads to higher costs and risks, particularly for SMEs, which are more dependent on the domestic banking system[79]. A pan-European financial system would improve competition and stability in the credit market. In addition there is potential to introduce a State bank as outlined in the Programme for Government. To support a pan European financial system, an integrated

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74 Bezemer, D., Lending must support the real economy, Financial Times, November 4th 2009

75 These issues have also been raised by the Credit Review Office. See Credit Review Office, August 2011, Fifth Quarterly Report from John Trethowan, Credit Reviewer available at http://www.creditreview.ie/docs/FifthReportfromJohnTrethowanAug2011.pdf

76 The range of initiatives includes lending targets, the credit review office, the recapitalisation of financial institutions, and the code of conduct in lending to SMEs. Business customers of participating banks (those engaging with NAMA) are eligible to avail of the services of Credit Review Office. Business customers outside this cohort would not be eligible.

77 Central Bank, Business Credit and Deposit Statistics Table A.14 Credit Advanced to Irish Resident Private-Sector Enterprises

78 Credit Review Office, Quarterly Report from John Trethowan, Credit Reviewer, June 2010

79 Barrell, Fic, FitzGerald, Orazgani and Whitworth, The Banking Sector and Recovery in the EU Economy, ESRI Research Bulletin 2011/2/2

framework for crisis prevention, management and resolution is essential[80]. Mirroring the US system, stronger EU wide regulation and more diversified banks (in terms of product offerings, and geographic/ sectoral exposure) would reduce costs and the impacts of national shocks[81].

Recommendation: Ensure that the efficacy of the range of measures put in place to improve credit flows can be assessed and action taken if required. This will require a periodic survey of credit demand and supply. We also need to isolate new lending from refinancing, to provide more detailed data by firm size and sector[82], and to classify the supply of credit by the principle purpose of the credit.
Recommendation: Internationally benchmark the availability and cost of bank finance products that are of particular importance to exporters and encourage banks to match offerings available to exporters in other countries.
Recommendation: Up-skill front-line and lending banking staff to understand key export sectors, export business models and their key exporting markets. To complement this action, an initiative is required to up-skill chief finance officers to equip them with the knowledge to understand the requirements of the banking system.
Recommendation: Ireland should support the development of a pan European financial system.
Responsibility: Department of Finance/Central Bank / Department of Jobs, Enterprise and Innovation / Business and banking representatives

4.2.2 Promote Investment in Enterprise

As noted above, three years of very difficult trading conditions have left many enterprises undercapitalised. Even in the presence of relatively healthy banks, the existence of previous debts may inhibit the private sector from accessing credit for potentially profitable investments. In any case, increased lending will not address the financial constraints (i.e. excessive debt) facing these enterprises.

Equity investment represents a mechanism to help over-indebted but viable businesses to rebalance their balance sheets. It is notable that venture capital firms are experiencing greater difficulty now in raising new funds as investors have become more risk-averse post the global financial crisis. Other investors (e.g. business angels and private investors) also face considerable challenges. It is important as we eliminate incentives to invest in the property sector, that we support investment in productive enterprise.

In addition, where businesses which can demonstrate future viability through a recovery plan – possibly by separating performing and non-performing assets (e.g. property investment), the Credit Review Office has highlighted the potential to develop a process that results in debt/ equity swaps or debt write-off and restructuring. These measures need to be considered[83].

[80] Ajai Chopra, Deputy Director, European Department, International Monetary Fund “Strengthening the Financial Stability Framework of the EU,” address to the 2011 Dublin Economic Workshop – Kenmare Conference, October 15th 2011.
[81] Barrell, Fic, FitzGerald, Orazgani and Whitworth, The Banking Sector and Recovery in the EU Economy, ESRI Research Bulletin 2011/2/2
[82] That is to provide details on credit for the three SME categories (micro, small and medium) and to provide a further sectoral breakdown of credit supply data (at NACE 2 level).
[83] Credit Review Office, Fourth Quarterly Report from John Trethowan, Credit Reviewer, 2011

Recommendation: Taxation policies should continue to encourage equity investment into productive areas of the economy.

Responsibility: Department of Finance

Recommendation: Investigate the possibility of debt/equity swaps or debt write-off and restructuring for business, which can demonstrate future viability through a recovery plan.

Responsibility: Department of Finance / Financial sector

5. Ensuring Delivery of World Class Performance Standards

5.1 Reform of the Public Sector

The public sector reform agenda since 2008 has largely focused on reducing the cost of running the public sector by reducing employment numbers. There is a need, however, to move beyond relying almost exclusively on cuts as a vehicle to drive reform. We must embed structural reform that will deliver sustainable productivity improvements, which cannot be quickly eroded once the economy returns to growth.

5.1.1 Adopt a Stronger Output and Outcomes Focus

The public sector needs to continuously monitor its performance against predefined targets and outcomes. This would ensure that departments and agencies work towards specific goals and objectives and public sector reform encompasses a results focus. To build on recent advances, the Council believes that greater emphasis should be placed on developing output and outcome targets. Equally, improved measurement and monitoring of progress towards these targets is required, and the results should be published periodically.

To ensure a focus on outputs and outcomes, budgetary processes need to change. The Council has previously recommended that zero based budgeting be introduced – this would require a more rigorous analysis of expenditure by all government departments and the use of verifiable metrics to assess the outcomes of investments. While ex- ante evaluations of expenditure programmes have become more common, the requirement to carry out such evaluations should be formalised.

Periodic independent external scrutiny has been a largely absent feature of public sector reform. The OECD has previously recommended that independent five year reviews of the public sector be conducted[84]. The Council believes that this should be taken a step further and include an international exercise to examine whether Ireland can learn from public sectors in other countries. Independent international five year comparative reviews of the performance of government departments would greatly enhance the reform process. The Council recommends that regulators are also periodically assessed to determine if they are meeting their objectives effectively, including competitiveness objectives, where applicable.

Recommendation: Departments and agencies should develop key output and outcome indicators that are measured, monitored and published over time.
Responsibility: All government departments and agencies

Recommendation: Introduce zero based budgeting, to require a more rigorous analysis of expenditure by all government departments and the use of verifiable metrics to assess the outcomes of investments. It is also necessary to ensure that a rigorous system of ex-ante evaluation of expenditure programmes is implemented on a formal basis.
Responsibility: Department of Public Expenditure and Reform

[84] OECD, Public Management Reviews: Ireland – Towards an Integrated Public Service, 2008

Recommendation: Mandatory, independent international five year comparative reviews of the performance of government departments should be introduced. In addition, periodic reviews to assess if regulators are meeting their objectives (including competitiveness objectives, where applicable) effectively should be undertaken.
Responsibility: Department of Public Expenditure and Reform

5.1.2 Improve the Allocation of Public Sector Resources

Further cuts in public expenditure, while painful, are planned to address our fiscal challenges. Such cuts, however, need to be achieved in a manner that enhances public sector productivity, and delivers the best outcomes for citizens and businesses. As previously noted, the reduction in the public sector headcount has been the primary avenue to achieving cost savings in the public sector pay bill. The Council believes that this approach is sub-optimal.

The current approach is focused on reducing headcount, and is not designed to save a specified proportion of the pay bill. Public sector wages differ considerably across grades. The current headcount approach, however, does not differentiate for example, between the savings achieved by a reduction in the number of lower paid administrative staff and the savings achieved by a comparable reduction in the number of higher paid senior managers. Retirement incentives[85] have meant that up to now, many of those who have left the public service have been those with the longest service (and are likely to have been at more senior levels). Going forward, as these schemes expire, it is doubtful whether the headcount approach will achieve the desired cost savings.

While the overarching objective of addressing the cost of the public sector pay bill is necessary, we also need to enhance public sector productivity. A public sector with a lower pay bill but also reduced productivity leads to higher costs elsewhere in the economy. A more effective method of achieving cost reductions, while maintaining a focus on productivity would be to allocate a (reduced) pay budget to each state entity and a series of output targets, which must be met. It would be up to each entity to determine how to allocate and use resources to best meet these targets. Commensurate with greater responsibility would come clearer accountability to meet agreed targets and manage budgets appropriately (e.g. balanced budgets, appropriate organisational structures, etc).

Recommendation: In order to reduce the public sector pay bill, each government department and agency should be provided with a pay budget within which they must operate, rather than the current headcount target approach.
Responsibility: Department of Public Expenditure and Reform

5.1.3 Incentivise Good Practice

Consideration should be given to making service provision to or on behalf of the State more open to aspects of competitive behaviour. The threat of competitors entering a market can enforce good conduct upon incumbents or the threat of losing market share can also promote more efficient behaviour[86]. The health sector, for example, may benefit from such an approach. The introduction of systems where funding followed the user, as is currently the case in education, is likely to result in improved health service delivery: if funding follows the user, hospitals and health care providers

[85] For example, the Incentivised Scheme for Early Retirement and changes in the taxation treatment of public service pension.
[86] See Thornhill, D., Internal Competition is in the National Interest: Stop the rents!, Speech to the Competition Authority, 13th June 2011

would be incentivised to manage resources in a more efficient manner, while achieving service standards demanded by users. This process would reward good resource management by assigning budgets based on best practise in public service provision.

Recommendation: Introduce funding procedures (and other competitive mechanisms) to the provision of public services that reflect performance and encourage an output focus.
Responsibility: Department of Public Expenditure and Reform

5.2 Reform of Corporate Governance

Restoring public trust at home and rebuilding our reputation internationally are two of the major challenges facing Ireland. The current crisis revealed severe shortcomings in corporate governance, particularly in relation to the financial services sector, which is of systematic importance to the wellbeing of an economy. Reforms to corporate governance must be central to enhancing public trust and our international reputation, as they are important aspects of competitiveness. There are direct benefits for the corporate sector also. The more ingrained the system of corporate governance in a business community, the less the need for detailed regulation to ensure effective compliance with good standards of business behaviour[87]. Strong corporate governance should also reduce the cost of capital as perceived corporate risks fall.

A range of initiatives are underway at EU and national level. At EU level, work is progressing to reform corporate governance[88], to improve the disclosure of non-financial information by companies[89] and to examine how the audit function can be enhanced[90]. At a national level, a single modern Companies Act is expected to come before the Oireachtas in 2012. The new act will consolidate existing Irish company legislation, some of it dating from 1963 and introduce several company law reforms. In terms of corporate governance measures, it will introduce the "directors' compliance statement" (section 222 of the Bill). The Bill will also bring together and give a statutory footing to all the existing directors' duties. While these duties already exist, putting these into statute will enhance clarity. The Department of Justice and Law Reform is also engaged in an review of white collar crime[91] which is highlighting stakeholder concerns regarding: the apparent lack of parity of treatment by the criminal justice system between white collar criminals and other criminals; equipping the various regulatory and enforcement agencies with a range of effective investigative and prosecutorial powers to deal with white collar crime; and comprehensive protections for whistleblowers. A Criminal Justice Act 2011 was enacted in August 2011, which aims to address delays in the prosecution and investigation of complex crime by improving certain important procedural matters and strengthening Garda investigative powers. Conclusion of these work streams is essential. In proposing reform of Irish corporate governance, the Council have focused on two issues.

[87] Financial Reporting Council, The UK Approach to Corporate Governance, 2010

[88] EU Commission, Green Paper- The EU Corporate Governance Framework, 2011

[89] EU Commission, “Public consultation on disclosure of non-financial information by companies, Directorate General for Internal Market Services, 2010. A Commission proposal is planned for the first half of 2012.

[90] EU Commission, Green Paper - Audit Policy: Lessons from the Crisis, 2010

[91] The discussion document highlights challenge around detecting and prosecuting white collar crime, white collar crime trials and juries, and the sanctions for white collar crime.

- Companies listed on the Irish Stock Exchange's main market are legally obliged to comply with the Corporate Governance Code (formerly the Combined Code)[92]. A listed company choosing to depart from the Corporate Governance Code has to explain which parts of the code it has departed from and the reasons for doing so. Mirroring the sentiments expressed in the EU green paper on corporate governance, the Council believes there is a need to introduce more stringent requirements upon companies departing from the code. Companies should be required to explain not only the reasons for departure from a given recommendation, but also a detailed description of the solution applied instead[93].
- Boards and audits also need to be more effective. The board of directors is the highest governing authority within the management structure of any publicly traded company or organisation. Accordingly, the composition and activities of the board of directors need to be re-examined. A number of guidelines are in existence (or are being developed) and should inform any further action in this area, notably the expected output from the EU's consultation on the corporate governance framework.

The Office of the Director of Corporate Enforcement has noted that there are grounds for questioning the consistency and quality of audit work within the auditing profession[94]. Following a recent consultative process, the indications from the European Commission are that it will issue proposals to address many of the issues connected to quality and consistency. In the meantime, in Ireland implementation of the Commission's Audit Quality Assurance Recommendation[95] which will confer the quality assurance of audits of public interest entities function on the Irish Auditing and Accounting Supervisory Authority will be a welcome development. This will bring Ireland into line with best practice operating in the majority of fellow EU member states.

Recommendation: Recognising the need to enhance corporate governance in Ireland, the Council recommends that companies be required to provide more transparent and detailed information justifying any departure from the Corporate Governance Code (where applicable).

In the context of the European Commission's ongoing work on corporate governance, there is a need to examine the role of Board's of Directors and of Auditors. It will also be important that any reforms of Corporate Governance in Ireland progress in parallel with reform at EU level.

Measures to reform Ireland's corporate governance regime, however, must also be cognisant of the need to maintain a pro-enterprise regulatory regime and avoid the imposition of unnecessary administrative burdens on firms.

Responsibility: Department of Jobs, Enterprise and Innovation / Central Bank / Financial Regulator / Department of Finance / Irish Auditing and Accounting Supervisory Authority

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[92] Currently companies listed on the Irish Stock Exchange's main market are legally obliged to comply with the Combined Code on Corporate Governance. As for other "listed companies" (i.e. on Irish markets other than the main market, such as IEX), Stock Exchange rules require all companies to report on how they have implemented the provisions of the Combined Code on a comply or explain basis.

[93] A 2009 study showed that in over 60 percent of cases throughout the EU where companies chose not to comply with a corporate governance recommendation, they did not provide a sufficient explanation. RiskMetrics on behalf of the EU Commission, Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, 2009

[94] ODCE, (2010), Submission to the European Commission on Audit Policy, referenced by the ODCE, (2011) Annual Report 2010, available at http://www.odce.ie/GetAttachment.aspx?id=2ddbc174-072a-4e93-ab7a-50786599ab0c

[95] The effect of the decision will mean that the responsibility for quality assurance of audits of public interest entities will rest with the Irish Auditing and Accounting Supervisory Authority (IAASA) and will no longer be the responsibility of the particular professional accountancy body subject to oversight by IAASA.

Appendix 1: A Set of Principles to Guide National Competitiveness in the Global Economy

The Global Federation of Competitiveness Councils (GFCC) is a global network of leaders from competitiveness organizations around the world. The GFCC was created to bring leaders from the private and public sector together to:

- Strengthen national competitiveness;
- Stimulate economic growth, and;
- Foster innovation.

Acting globally is now a prerequisite to economic competitiveness nationally. The GFCC have identified 10 principles to guide national competitiveness, and these are set out in the table below.

	GFCC Principle	Ireland's Performance
1	Significant private sector involvement is critical in developing national public policy initiatives to address short- and long-term competitiveness issues. These public-private partnerships are essential in creating new industries and jobs, as well as enhancing social responsibility, by leveraging the knowledge, expertise and resources of both sectors.	Ireland is a mature, democratic and open society with a free press. According to the IMD, for instance, Ireland is one of the countries most open to foreign ideas (ranked 8th out of 59), and the value system amongst citizens supports competitiveness (6th out of 59). Similarly, Ireland scores highly according to the WEF in terms of the transparency of the policymaking process (25th out of 142).
2	As the driving force of innovation, greater investment in research and development, new technologies—and the deployment thereof—will stimulate productivity, standards of living and leadership in global markets. Long-term strategic investment in these areas is predicated upon fiscal responsibility; sustainable budgets; and access to capital.	In terms of business expenditure on R&D, Ireland was ranked 15th out of 28 OECD countries in 2009; in terms of higher education sector spend on R&D, Ireland was ranked 12th; and Ireland was ranked 27th in terms of Government spend. While Irish firms are generally considered actively engaged in innovation, there is a need to ensure that this activity translates into tangible outcomes.
3	21st century workforce skills should be the baseline for every citizen in order to reach their full potential while fuelling wealth creation and profits. All nations should strive to educate and train the best and the brightest skilled talent within their borders and from around the world without regard for gender, race, religion, age, nationality or economic status.	Overall, average educational attainment in Ireland has improved significantly in the last two decades; for example, the proportion of the working age population with tertiary level education has increased from 26% in 2003 to 33% in 2008. Challenges persist at all levels of the education system, however. The impact of the recession on the labour market has reinforced the need to upskill and reskill many cohorts of the population.

4	Economic competitiveness is dependent on the success of regions and metropolitan areas, which are fast becoming the true engines of creativity and innovation. These regions, which leverage their assets through collaborative leadership, must be defined by economic factors and the real dynamics of development and growth, which in many cases does not follow the strict limits of formal/administrative borders.	As Ireland has targeted high-tech, high-value internationally trading sectors, Irish cities have developed sectoral specialisms - for example, medical technology in Galway, software and financial services in Dublin, pharmaceutical and chemicals in Cork. Irish cities perform relatively well in terms of international benchmarks of quality of life, while improvements are still required in terms of connectivity and sustainability.
5	Strong intellectual property rights—consistent with international standards—are a prerequisite to attract high-value investment and innovation and drive the creation of next-generation products and services.	Ireland is a strong performer in relation to the protection of intellectual property rights – according to the WEF's *Executive Opinion Survey*, Ireland is ranked 10th out of 142 competitor locations in this regard.
6	A modern, well-maintained infrastructure, be it transportation, energy, information technology networks or communications is critical to encourage national and foreign investment and to support modern business activity and economic growth	Ireland has made great strides in terms of the quality of physical infrastructure over the last decade. Despite sustained investment over recent National Development Plans, perceptions about quality remain poor. According to the IMD, while Ireland's score in terms of air and water transport has improved, Ireland's perceived performance in relation to road, rail, air and sea transport is weak. Perceptions about the quality of energy infrastructure remain particularly poor. Similarly, perceptions about the adequacy of communications technology and connectivity remain poor.
7	Open, transparent and fair trade is necessary to expand global trade and investment and drive sustainable economic growth globally, nationally and regionally. A well-defined set of international standards is essential to the facilitation of trade and commerce.	As a small open economy, Ireland has long recognised the importance of trade facilitation. Ireland's openness to both trade and investment is demonstrated, by a range of indicators: inward investment levels, for example, remain among the highest in the OECD, while exports as a percentage of GDP exceed 100%.
8	Sustainable growth and responsible development through increased natural resource productivity, energy efficiency and access to or development of critical materials will foster innovation, increase standard of living, and enhance national security.	According to the Environment Protection Index, Ireland's performance is marginally below the OECD average. Improvements are being made, however: Ireland's share of energy derived from renewable resources is growing, while the proportion of waste recycled in Ireland (32%) exceeds the euro area-16 average (22%).

9	Transparency, efficiency, a fair and equitable tariff and regulatory system, and a lack of corruption in government and in the interactions between the public and private sector provide a more stable environment for business and investment, thereby increasing economic growth.	Ireland is generally considered a good place to do business, as evidenced by strong scores in both the IMD and WEF competitiveness reports across a range of aspects relating to property rights, corruption, the judicial system and the body of regulation governing the establishment and running of a business. Ireland also scores highly in the IMD's assessment of tariff barriers (ranked 12th out of 59).
10	Benchmarking national competitiveness across a set of established and forward-looking metrics—measuring both inputs such as education, research and development spending, patents and outputs such as job creation, new industries and products, GDP growth and quality of life, including culture, arts and community—is necessary to drive the successful development and implementation of appropriate competitiveness policies.	Every year the National Competitiveness Council's *Competitiveness Scorecard* publication benchmarks Ireland's competitiveness across a range of 125 indicators against other countries. The report endeavours to provide a clear, authoritative, thorough, accurate and up-to-date assessment of Ireland's competitive performance.

The publications of the National Competitiveness Council (NCC) are available at www.competitiveness.ie

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