

## **Strong Growth in Services and Construction Offsets Weaknesses in Manufacturing**

### **Annual Competitiveness Report 2005**

The National Competitiveness Council (NCC) today (Wednesday, 7th September) launched its eighth **Annual Competitiveness Report** (ACR). The ACR 2005 analyses Ireland's competitiveness using 171 indicators, drawing on data from bodies such as the OECD, IMD and Eurostat.

The report highlights the strong performance of the Irish economy over the past decade. Speaking at the launch of the report, Dr Don Thornhill, Council Chairman, said "*Ireland has performed remarkably well in comparison with other countries in terms of increasing employment levels and living standards*". More broadly, continued improvements in life expectancy and income per capita also supports Ireland's strong performance in the UN's Human Development Index, which is a good indicator of the general quality of life.

Ireland's strong economic growth rates over the past decade are likely to reflect a number of national strengths.

- Taxation. Despite competition from other countries, Ireland remains highly competitive in terms of both corporation tax (Ireland ranks first of the 16 countries benchmarked – 1st/16) and personal taxes (1st/15).
- Entrepreneurship. Ireland has a strong entrepreneurial culture. Ireland has an entrepreneurial activity rate of 7.7 per cent of the adult population, representing 193,000 individuals either actively planning or in the process of establishing an enterprise. Ireland is ranked second in the EU and 7th among the OECD countries for entrepreneurial activity.
- Labour market adaptability. Labour market regulations in Ireland are perceived to facilitate business activity (7<sup>th</sup>/16). Dr Thornhill noted that "*despite significant shocks to the economy in recent years, unemployment in Ireland remains low, less than half of the rate in some other eurozone countries*".
- Openness to trade and investment. Ireland continues to be one of the most open economies in the world in terms of trade in goods and services, and in foreign investment. Ireland continues to have the highest stock of foreign direct investment per capita amongst the benchmarked countries.

Ireland's performance is relatively weak in some areas that will be required to drive the knowledge economy.

- o Education. Ireland continues to enjoy relatively strong attainment levels despite lower levels of investment. While Irish investment rates in education at the tertiary level match the OECD average (7th/13), Ireland invests less in both primary (11th/14) and secondary level (11th/14) than the OECD average. Dr Thornhill noted that *'while Ireland has made significant progress in terms of increasing secondary and tertiary participation rates, 40% of the population aged 25-64 years does not have upper secondary level education. This is a legacy of past underinvestment in education and contrasts with the more favourable relative position of younger people who are now in the labour force'*. Adult participation in life long learning also remains relatively low in Ireland (6th/11).
- o Science and technology. While both public and business sector investment in R&D have increased substantially in recent years, they are below the levels pertaining in other advanced economies. Ireland is also behind other countries in the development of patents and the use of modern technologies (e.g. ICT).

### **Performance of the Manufacturing Sector**

Strong competitiveness pressures are facing internationally trading sectors, particularly manufacturing. The ACR notes that while Ireland's share of world goods trade increased sharply from the mid-1990s, it peaked in 2002. Industrial production has declined by over 3 per cent in the year to March 2005. However, Ireland's service exports continue to grow strongly. Ireland's total share of world services exports has grown from 0.5 per cent to 2 per cent since 1998. Dr Thornhill noted that *"reflecting the changing structure of the Irish economy, Ireland's share of world trade in services is now greater than our share of world trade in goods"*.

### **Prices and Costs**

Prices and costs remain a key competitiveness issue. In this respect, the ACR notes that:

- Over the past 12 months, Irish inflation has converged towards the EU average of 2 per cent. However, price levels in Ireland remain amongst the highest across the benchmark group of countries.
- With regards to pay costs, compensation per employee increased by over 5 per cent between 2003 and 2004 placing Ireland 4th highest among the 14 benchmark countries.
- With regard to non-pay business costs, energy (9th/10) and waste costs (8th/10) appear to be growing significantly, while insurance costs are moderating. Dr Thornhill noted that *"the improving situation in relation to insurance costs is a good example of how we can make progress through the sustained implementation of good policies"*.

- In response to higher costs, Irish firms need to increase productivity. One way is to ensure vigorous competition. However, the intensity of local competition (11<sup>th</sup>/16) and the efficiency of competition legislation are perceived as being relatively low (8<sup>th</sup>/16) in Ireland.

Finally, the weaker performance of the export-driven manufacturing sector and its impact on the economy is to some extent being compensated by strong growth in demand for domestic goods and services, as in the construction sector. Household spending is being supported by record levels of private sector borrowing, which may not be sustainable in the long run. Private sector credit increased from 78 per cent of GNP in 1995 to 163 per cent of GNP in 2004, and is continuing to grow strongly. Dr. Thornhill noted that "*while the domestic economy is performing strongly, in the long run, in a small regional economy like Ireland, economic prosperity ultimately depends on our ability to sell goods and services abroad and therefore on our international competitiveness*".

This report seeks to compare various aspects of Ireland's competitiveness relative to other countries. The Council's next publication, the Competitiveness Challenge (to be released in the Autumn) will examine these issues in more detail, and will highlight the key policy directions that the Council considers are needed to ensure that Ireland can continue to be successful and competitive over the next decade.

The full report can be downloaded from the Forfás website at [www.forfas.ie](http://www.forfas.ie)

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## **Key Statistics in the ACR 2005**

### **Sustainable Growth**

Ireland continued to perform remarkably well in terms of growing national incomes. Continued improvements in life expectancy and income per capita also support Ireland's strong performance in the UN's Human Development Index.

*Rankings:* GDP per capita 2<sup>nd</sup>/16; Annual average real GDP growth rates; 1999-2004 1<sup>st</sup>/16; Human Development Index 5<sup>th</sup>/16

### **Essential Conditions**

A strong aggregate productivity performance masked large differentials between indigenous and foreign owned firms. Irish consumer inflation has dipped below the EU average; however Ireland still remains the second most expensive country in the EU15. Ireland continues to be one of the most open economies in the world. Ireland's share of world services trade has overtaken its share of world merchandise trade in recent years.

*Rankings:* Projected labour force growth 3<sup>rd</sup>/15; Hourly productivity 8<sup>th</sup>/13; Comparative private consumption price levels 14<sup>th</sup>/15; Exports of goods and services 2<sup>nd</sup>/16

## **Policy Inputs**

### **Taxation and Regulation**

Ireland remains highly competitive in terms of corporation tax and personal tax. Labour market regulations in Ireland are perceived to facilitate business activity. The intensity of local competition and the efficiency of competition legislation are perceived as being relatively lower.

*Rankings:* Standard corporate tax rate 1<sup>st</sup>/16; Effective income tax rate 1<sup>st</sup>/16; Indirect tax 7<sup>th</sup>/8; Labour market regulations 7<sup>th</sup>/16; Intensity of competition 11<sup>th</sup>/16; Competition legislation 8<sup>th</sup>/16

### **Economic and Technological Infrastructure**

Overall performance has been weak despite continued high levels of investment. Irish business people still rank Ireland poorly for transport and energy infrastructure, while Ireland also continues to perform poorly with respect to broadband usage

*Rankings:* General government gross fixed capital formation (% GDP) 2<sup>nd</sup>/11; Efficiency of distribution infrastructure 14<sup>th</sup>/16; Energy infrastructure 14<sup>th</sup>/16; Broadband usage 14<sup>th</sup>/15

### **Education and Training**

A high proportion of the Irish population in the 25-34 age group has a third level education. While Ireland continues to perform strongly in terms of science and engineering graduates per population, the ACR notes that Ireland's advantage is

deteriorating. Adult participation in life long learning remains relatively low in Ireland. Irish spending on third level education ranks 7th among the 14 countries benchmarked in the ACR

*Rankings:* Spending in primary level 11<sup>th</sup>/14, Spending in tertiary level 7<sup>th</sup>/13, Percentage of population (aged 25-24) that has at last third level education 6<sup>th</sup>/15; Science and engineering graduates (aged 20-29) 1<sup>st</sup>/13.

### ***Entrepreneurship and Innovation***

Ireland continues to have high levels of entrepreneurship; innovation performance is mixed, while in terms of clusters and networks, Ireland is perceived as being relatively well developed.

*Rankings:* Total entrepreneurial activity rate 5<sup>th</sup>/16; Gross domestic expenditure on R&D 7<sup>th</sup>/11; New to market products 3<sup>rd</sup>/9; European patent office patents granted 10<sup>th</sup>/11; State of cluster development 6<sup>th</sup>/16; Local availability of specialised research and training services 11<sup>th</sup>/16