Press Release **10 October 2006**

Ireland's economic fundamentals are still strong but rising costs and weakening productivity growth are a cause for concern

The National Competitiveness Council (NCC) today (Tuesday 10 October 2006) launched the first volume of its ninth Annual Competitiveness Report (ACR). Volume 1, entitled *Benchmarking Ireland's Performance*, contains a comprehensive analysis of Ireland's competitiveness performance, using more than 130 indicators. These cover a broad range of areas of Ireland's competitiveness, including economic growth, prices and costs, productivity, trade, employment, taxation, regulation, innovation, physical infrastructure and education and research.

Launching the report, Minister for Enterprise, Trade & Employment Micheál Martin, TD, noted that what counts ultimately is our ability to grow our economy, create jobs for our citizens and improve prosperity and general quality of life. As the report shows, Ireland has done this successfully over the past 15 years. Commenting on the report's findings, the Minister said "This report from the NCC paints an encouraging picture of our business performance, with Ireland ranked 1st in the EU for entrepreneurial activity and private capital investment and 1st in the OECD for attracting new greenfield FDI. This indicates healthy activity in both the indigenous and foreign-owned sectors of our economy.

"Of course there are challenges. Competitiveness has many dimensions. As the NCC point out, it is not possible to excel in every indicator. I want to reaffirm today that it is government policy to put competitiveness considerations at the heart of our day to day business and to inform our investment decisions for the future. In this context, I am confident that the forthcoming National Development Plan will address the physical infrastrustural deficits over the next 7 years and I am putting in place the essential knowledge infrastructure through the Strategy for Science, Technology and Innovation to take us into the next phase of our economic development," the Minister said.

The report confirms that, since 1995, Ireland's economy has grown, and continues to grow, at an exceptional rate by the standards of other advanced economies, allowing per capita incomes to converge with the OECD average. Despite the continuing strong headline performance, there are signs of deterioration in Ireland's underlying competitiveness performance which could threaten our future growth prospects:

- With imports growing faster than exports, Ireland's net exports are now a drag on economic growth, having driven Ireland's Celtic Tiger boom during the 1990s. Ireland's share of world trade peaked in 2002, and has been in decline since. World trade grew by an average of six percent per year between 2002 and 2005 in value terms, while the value of Ireland's exports grew by an average of just two per cent per annum over the same period. This loss of market share was most pronounced in manufacturing.
- Irish businesses and households are now spending more than they earn. The current account of Ireland's balance of payments with the rest of the world shifted from a surplus as recently as 1999 to a deficit of €4.2 billion in 2005 (3.0 per cent of GNP), and is forecast to deteriorate to €6.9 billion in 2007 (4.25 per cent of GNP).
- Productivity growth has slowed to its lowest rate since the early 1980s. Ireland's strong productivity growth during the 1990s was driven by a narrow base of modern manufacturing industries, while NCC figures would suggest little productivity growth in the services sectors, which account for the majority of employment in the economy.
- In the five years to March 2006, manufacturing industries lost over 32,000 jobs, declining as a share of total employment from 15 per cent to 11 per cent. Construction accounted for 13 per cent of those in employment in March 2006, twice the share of employment in Germany or the USA. The share of the public sector as a whole in total employment moved from 20 per cent to 23 per cent in five years to March 2006.

This year's benchmarking report shows that the underlying impetus to Ireland's continuing economic expansion has shifted from the broadly-based and export-led growth of the late 1990s to a growth pattern that by 2005-06 has become dependent on domestic consumption, residential construction investment and public spending.

The loss of momentum in the exporting sector in recent years has internal and external roots. The country is addressing its long-standing infrastructural deficit, including its housing needs, which has resulted in the construction boom, financed by increased public spending and a sharp rise in business and household indebtedness. This has brought about increased competition for scarce labour, capital and land resources, pushing up economy-wide costs in Ireland. At a time of intensifying external competition for trade and foreign direct investment (FDI), these rising costs have impeded the expansion of Ireland's exporting sectors.

Speaking at the launch, Dr Don Thornhill, Chairman of the NCC, said "As Ireland's infrastructure deficit is gradually addressed, construction's exceptionally high share of economic activity and employment will inevitably decline. As a small open economy, Ireland will need to rely more on growth in exports and the competitiveness of its exporting sector. National competitiveness will remain central to Ireland's success."

Ireland's ability to recover some of its lost export competitiveness and re-enter a more balanced phase of growth will depend on the attractiveness of the domestic business environment for a new generation of high value-added, knowledge-intensive exporting companies. At the end of this release are key statistics from this year's report. Some of the key issues identified are:

- **Prices and Costs:** Between 2000 and 2006, Ireland has experienced a significant loss of international price competitiveness, reflecting a combination of higher price inflation in Ireland and an appreciation of the euro against the currencies of many of our trading partners. A range of non-pay costs for business are relatively high, particularly office and industrial rents, electricity, waste and professional services. Pay costs have also been rising faster than in other EU-15 countries. If productivity continues to grow slowly, it will not be possible to sustain the level of wage increases experienced in recent years, without a further loss of cost competitiveness.
- **Productivity:** Productivity growth in 2004/05 slowed to its lowest levels since the early 1980s. Weak productivity growth is most apparent in those sectors of the economy, such as energy, that are sheltered from competition.
- **Taxation:** Direct personal and corporate tax rates in Ireland remain competitive, although the advantage of this for growing businesses is being offset by increasing local taxes and levies.
- **Regulation:** We rank well on regulation of product and labour markets in Ireland, which is not perceived by industry to significantly impede business operations, although the levels of regulation in the labour market are perceived to have increased since 2000.
- **Education:** Rates of secondary school completion and third level participation are rising and compare well with EU and OECD averages. On the other hand, pre-primary and post-graduate (4^{th} level) education remain under-developed in Ireland, and adult participation in life-long learning remains well below the leading countries.
- **Computers and ICT:** The ratio of computers to students in secondary schools remains low, too few businesses and households are connected to broadband, and the number of public services that are available online is limited, all of which may be explain the slow progress of domestic services firms in using ICT to accelerate productivity growth.
- **Infrastructure:** Road, air, seaports, energy, and communications infrastructures are all perceived to be deficient by the standards of other advanced economies, although industry perceptions have improved in recent years, reflecting high levels of public and private capital investment in these areas.
- **Business R&D:** Business expenditure on research and development, as a proportion of output, has remained static. The bulk of this R&D is also undertaken by a small number of foreign-owned firms.

Speaking at the launch, Mr Martin Cronin, CEO of Forfás and member of the NCC, said: "Overall, Ireland's business environment remains strong and Ireland's knowledge infrastructure is delivering huge improvements in the educational attainment of people entering the labour force. To maintain Ireland's competitiveness, we need a consistent focus on moderating price and cost increases, improving the physical infrastructure, developing pre-primary and fourth-level education and achieving a better innovation performance, particularly in the business sector."

Volume 2 of this year's ACR, *Ireland's Competitiveness Challenge*, to be published in December, will examine the internal and external challenges to address and will highlight the key policy directions needed to ensure that Ireland can continue to enjoy better standards of living over the coming years.

Sample Findings from ACR Volume 1, *Benchmarking Ireland's Performance*		
Area & Indicator	*Group Ranking*	*Change in Group Ranking*
Prices and Costs		
• Price Level, 2004	14th in the EU-15	Down 3 places since 2000
• Inflation	11th in the EU-15	Up 4 places since 2000
• Labour Cost Growth Rate, 2000-2005	13th in the EU-15	N/A
• Cost (per m^2) of Industrial and Office Space, 2005	Of 12: Dublin 11th, Cork 8th, Limerick 4th, Galway 5th	N/A
• Electricity Costs for Industrial Users, 2005	Of 9: 7th	N/A
Productivity Performance		
• Growth in Output per Hour Worked	GDP 7th in the OECD-28 GNP 9th in the OECD-28	Both down 6 places from 1995-2000 to 2000-2005
Tax Environment		
• Top Standard Tax Rate on Corporate Income	2nd in the EU-25	N/A
• Total Tax wedge, 2005	2nd in the OECD-28	Up 4 places since 2000
Regulation		
• Product Market Regulation, 2003	5th in the OECD-28	Up 2 places since 1998
• Labour Market Regulations, 2006	12th in the OECD-28	Down 3 places since 2000
Education		
• Percentage of 20-24 year olds with at Least Upper Secondary Education, 2005	6th in the EU-25	Up 4 places since 2000
• Percentage of 25-34 year olds with at Least Third Level	10th in the OECD-28	N/A
• Participation of Four Year Olds in Education, 2004	14th in the EU-15	No change since 2000
• PhD graduation Rates per 1000 population Aged 25-34, 2002	11th in the EU-15	Down 2 places since 2000
• Life Long Learning	10th in the EU-15	Down 3 places since 2000
Computers and ICT		
• Ratio of Students to Computers, 2003	20th in the OECD-28	Up 1 place since 2000
• Percentage of Enterprises with Broadband, 2005	14th in the EU-15	No change since 2003
• Broadband Subscribers per 100 Inhabitants, December 2005	23rd in the OECD-28	No change since 2003
• Public services Available Online, 2004	11th in the EU-15	Down 3 places since 2001
Infrastructure		
• Efficiency of Distribution Infrastructure, 2006	27th in the OECD-28	Down 1 place since 2000
• Government Fixed Capital Formation as a % of GDP, 2005	GDP 5th in the EU-15 GNP 2nd in the EU-15	No change since 2000 Down 1 place since 2000
Business R&D		
• Business Expenditure on R&D as a Percentage of GDP, 2004	GDP 20th in the OECD-28 GNP 17th in the OECD-28	Down 1 place since 2000 No change since 2000