Executive Summary

The National Competitiveness Council recognises that costs are an important basis of competition between enterprises. While competitiveness is made up of many factors, costs alone can make the difference between success and failure. This Report on Costs compares the main costs for Irish industry with those in competing countries. It highlights areas where costs are putting Irish enterprises at a competitive disadvantage. The analysis of costs is supported by information based on interviews with companies in the food, teleservices and software sectors.

Costs are a critical factor in Ireland because of the increased level of international competition, our peripheral location, and the importance of inward investment. The importance of individual cost elements varies across different sectors. Labour costs are particularly important for labour intensive, low margin sectors of industry. The recent Forfás Employment Survey found that job losses in 1998 were concentrated in the three sectors of metals/engineering, food and clothing/textiles – all labour intensive.

Based on the latest (1996) Census of Industrial Production data, individual costs vary in significance for different sectors of industry. In particular, wages and salary costs are by far the largest single item accounting for an average of 20 per cent of the net output of Irish industry. Labour costs do vary with size of firm, sector of operation and domestic/multinational ownership, from 9 per cent of net output for the chemical sector to 66 per cent for transport equipment. However, unit labour costs have been reduced significantly in Ireland in line with strong productivity growth, over the 1992 to 1998 period. Productivity of foreign-owned firms is, in general, significantly higher than in domestically-owned firms.

There are a number of areas where costs in Ireland place us at a competitive disadvantage. The main findings of the costs comparison analysis are:

- Labour costs in Ireland are below the average for the OECD area. However, they are significantly higher than in Greece, Portugal, S.E. Asia, Eastern Europe and Latin America, which besides competing in the global market, are alternative locations for international investment.

- At most wage levels up to £38,750 (749,202) per annum, employers' PRSI costs in Ireland are higher than corresponding National Insurance Contribution (NIC) costs in the UK, but lower than those in most other EU countries.

- Larger populations and economies of scale available to energy distributors in many European countries provide the opportunity for lower cost electricity and gas. Despite this gas prices in Ireland for large users are ranked among the lowest in Europe. Other energy costs are middle ranked.

- Telecommunications costs in Ireland remain relatively expensive, except for both business calls and leased lines to the UK and the US. This applies for the cost of calls and the cost/rental of equipment.

- The costs of industrial and office accommodation in Ireland are among the most expensive in Europe.

- Liability insurance costs are significantly greater than in the UK. The comparison is even more adverse with European countries that have state funding for industrial injury compensation. The level of awards in Ireland is a contributing factor to the higher cost of insurance.

- As a member of EMU, Ireland's wholesale interest rates are now defined by euro levels and are at present low. However, credit margins for small businesses remain large as they have not benefited, so far, from the intense international competition for lending to multinational companies. If this were to persist, alternative forms of finance for small business may be required.

A number of companies in the food, software and teleservices sectors were interviewed to ascertain specific plant cost comparisons with UK competitors. Wage and salary costs were significantly higher in food plants in Ireland than in similar plants in the UK, with employers' PRSI costs an important contributing factor. There was little difference in salary costs in the software and teleservices sectors, in 1998. However, availability of skilled personnel was a factor for all companies, particularly small and medium enterprises (SMEs), as larger companies can more easily attract graduates. The company interviews supported the findings that energy costs and insurance costs were uncompetitive in Ireland. The cost of telecommunications was an issue for the teleservices companies.

Transport is an important cost factor for Irish companies, especially for companies where virtually all raw materials have to be imported and end product exported. It is a particular issue for food companies exporting to the UK given specialised requirements such as refrigeration. Transport costs are a significant element in the cost differential between producing in Ireland as compared to similar plants in the UK. The Irish companies see little scope for reducing this cost differential due to the cost of crossing the Irish Sea. Express consignment and airfreight costs out of Ireland are comparable to rates in the UK. The Report on Costs identifies a number of responses to the findings of the cost analysis.

From a company perspective:

- There is a need for wage moderation coupled with alternative reward systems, and for continual improved productivity through (e.g.) increased flexibility, better working practices, training and upgrading of skills;

- The take-up of information and communications technology by companies needs to be accelerated; and

- Market re-orientation and company restructuring remain important ways of continuing to achieve competitiveness.

- From a policy perspective:

- The partnership approach to wage determination and social inclusion has been successful. However, future partnership agreements must be capable of accommodating the challenges posed by the rapid growth in the economy. They must provide greater flexibility through, for example, the identification of innovative reward mechanisms, such as, performance payment systems, skill based pay and gain sharing.

- Enhancing infrastructure and eliminating bottlenecks have a key role in improving the environment for enterprise and in reducing costs. The key areas are the provision of skills, roads and other economic infrastructure and broadband telecommunications investment. The role of public private partnerships needs to be expanded in supplying the required infrastructure;

- A greater dispersion of economic activity throughout the country would reduce the pressure on infrastructure and costs;

- The focus of tax policy should remain on stimulating enterprise and encouraging innovation and investment, in a way which does not increase the cost base of enterprises. The reduction in the rate of corporation tax to 12.5 per cent by 2003 is a major benefit in this regard. The tax wedge has been reduced in recent years, but particularly at middle/higher incomes, remains above that in the UK for single employees. The employers' PRSI/NIC differential is a significant element of this. The National Competitiveness Council recommends that a more detailed review of the impact of employers' PRSI on competitiveness be undertaken, consistent also with the need to protect the integrity of the Social Insurance Fund;

- Deregulation of utilities, particularly electricity, gas and transport, should be accelerated in order to further reduce costs;

- A Compensation Board/Arbitration System, separate to the courts, for deciding on compensation in cases where parties agree to arbitration as an alternative to the courts, should be established with the aim of reducing liability insurance costs for enterprises.

Introduction

The National Competitiveness Council, in its statement “The Competitiveness Challenge ‘98” issued in March 1998, emphasised that costs are a fundamental basis of competition. The Council’s statement recognised that enterprises also compete on a range of other factors, including innovation, quality, marketing, skills, responsiveness and technology.

Costs have a key influence in determining prices and margins and can make the difference between the success or failure of an enterprise. While the control of costs is a prime responsibility of each business, Government policies and actions can influence success.

Global competition for investment means that Ireland must compete with locations having good technology and skills, where the costs of labour, services and utilities are lower.

Under EMU, some policy levers, such as the adjustment of exchange rates and interest rates, are no longer available to the Irish authorities to manage the economy.

This Report on Costs identifies the main cost factors for Irish industry and compares them with cost levels in key competitor countries. It analyses a sub-set of the competitiveness factors identified in the Annual Competitiveness Report, ’99. It highlights areas where costs in Ireland are putting Irish enterprises at a competitive disadvantage. The Report concludes by making a series of recommendations for action, at both the level of the firm and of the economy, to improve the relative cost position in Ireland.

The comparative analysis of costs is supported by interviews, conducted for this report, with selected firms in the food manufacturing, software and services sectors. These are presented as case studies in section 4. Cost competitiveness remains a key issue for many companies, particularly those operating in traditional, price sensitive market segments. Innovation, quality of service, niche positioning, flexibility and access to skills were also rated as important competitiveness factors by the companies surveyed.

The Relationship between Costs and Competitiveness

This Report focuses on costs, which are just one factor in overall competitiveness. Costs are particularly important for certain sectors of the economy, particularly those categorised as traditional and those competing with similar industries in the UK and Eastern Europe.

While focusing on individual costs, the Report is careful to emphasise that competitiveness depends on the complete set of factors that impact on the company's operations. Having a cost disadvantage in one area does not necessarily imply that an industry is uncompetitive. This is particularly true in the area of labour costs. In many industries Ireland can compete successfully with countries paying lower wages. In other industries, however, wage cost competitiveness alone can be a determining factor in the success or failure of the industry.

Costs are a critical issue in Ireland because of:

- Peripheral location and the distance to important markets. This results in firms having to incur a higher level of transport costs than competitors. The issue of excess transport costs was highlighted in interviews conducted with Irish exporters competing with UK firms on the British market (section 4.7) and in third markets;

- Foreign investment is critical for continued economic growth. Recently, investment has been concentrated in high technology sectors that are subject to constant innovation and change. If Ireland's costs are out of line with competing locations, there is a risk that projects will be lost;

- Maintaining cost competitiveness with our main trading partners is important. This is particularly relevant for firms operating in traditional sectors and competing with UK producers on both the home and export markets. Costs play a relatively important role in the competitiveness of these companies and in their ability to maintain market share; and

- Ireland needs to constantly improve productivity and thereby reduce unit labour costs in the face of competition from low cost locations in Asia, Eastern Europe and Africa. This is particularly relevant to Irish-owned firms competing in traditional/labour-intensive sectors. It is also important for foreign-owned firms in sub-sectors that are price sensitive, such as the production of some computer peripherals and motor vehicle components. The recent currency devaluations in East Asian countries (which may not continue) increase the competitiveness of exports from these countries and their attractiveness as investment locations. In addition, the current weakness of the euro may not persist, exposing Ireland to a risk of even greater competitive losses.

The Forfás Annual Employment Survey found that 65 per cent (11,495) of full-time job losses in 1998 arose in just three cost sensitive sectors: metals/engineering, food and clothing/textiles.

2.1 Material Costs

The cost of materials is the single largest item of cost for most Irish firms. The latest Census of Industrial Production (1996) shows that materials account for the largest percentage (47 per cent) of the value of goods manufactured by firms in Ireland. For many firms, especially those in the intermediate stage of production, raw material costs are a given. For other firms, particularly those using domestically produced raw materials, material can be a major cost factor. It is essential, therefore, that the cost of materials is competitive, particularly in sectors exposed to international competition. Sourcing materials from the euro zone will make cost structures less sensitive to exchange rate fluctuations and provide a wider source of supply.

2.2 Wages and Salaries

The Census of Industrial Production showed that wages and salaries as a percentage of net output (value added) averaged 20 per cent for industrial operations, but were much higher in specific sectors such as the manufacture of transport equipment (66.4 per cent), clothing and textiles (55.5 per cent) and the manufacture of leather and leather products (58.2 per cent). The 1997 Forfás Irish Economy Expenditure (IEE) Survey shows that labour costs for manufacturing industry averaged 18 per cent of value added.

Wages/salary costs as a percentage of net output vary with size of firm, sector of operation and domestic/multinational ownership. As a percentage of net output, they are lowest in sectors dominated by multinational firms, i.e. chemicals, electrical/optical and publishing/printing (table 1). The food sector also has a low wages/net output ratio at 19.2 per cent. Notwithstanding this, there are subsectors within the categories below where wage costs may be the only real variable which the company can control.

Wages/salaries as a percentage of net output are relatively lower for larger firms than for smaller firms (table 2). This trend was more marked in hi-tech sectors, such as printing/publishing and electrical/optical equipment.

Wages/salary costs account for a far lower percentage of net output in foreign-owned firms than in their Irish-owned counterparts (table 3).

These divergences are partly explained by the degree of capital intensity of the firms. Technology transfer, modern plant and higher value-added processing are also factors.

Productivity growth in Ireland, measured on a GDP basis, has been the highest of all OECD countries since 1992 (table 4).

The good performance in Ireland is influenced by multinational firms in high tech sectors, where output per person is significantly higher than the overall national average (table 5).

Comparative Operating Costs in Ireland

This section compares key costs in Ireland to those in competing countries. The main data source is the Annual Competitiveness Report '99.

3.1 Labour Costs

As outlined in table 1 in the previous section, wages and salaries are the most important items of value added to industrial input and their importance varies significantly across sectors. Hourly labour costs in Ireland are below the average for the OECD area (table 6).

However, the cost of production workers in Ireland in 1997 was significantly higher than in countries, such as Greece, Singapore, Portugal, the Czech Republic, Korea, Hong Kong and Mexico, which are alternative locations for international investment, particularly labour intensive activities.

3.1.1 Ireland/UK Comparison

Maintaining competitiveness with the UK is of key importance to many sectors of Irish-owned industry and also in terms of competing and retaining foreign direct investment. Surveys conducted by Forfás show that 49 per cent of the exports of Irish-owned firms go to the UK market (Forfás Irish Economy Expenditure Survey, 1997). UK firms also compete strongly with Irish producers on the home and export markets.

The most recent year for which comparable UK and Irish labour cost statistics are available, in published form, is 1995. The source documents are the Irish Census of Industrial Production (CIP) and the UK Manufacturing Production and Construction Inquiry.

The statistics (which are somewhat dated) show that wages/salaries per employee, excluding PRSI/NIC, were reasonably similar across all industrial sectors (table 7). However, labour costs in regional locations may be significantly lower than the average. The exception was the Food, Drink and Tobacco sector where wage levels in Ireland were, on average, 14 per cent higher than in the UK. This is consistent with the results of the interviews, conducted for this report, with a number of major Irish-based food processors who submitted that wage levels in Ireland were up to 21 per cent higher than in comparable plants in the UK.

A further factor influencing cost competitiveness with the UK is the additional cost of employers' PRSI in Ireland. At most wage levels employers' PRSI costs are higher than employers' NIC costs in the UK, but lower than those in most other EU countries. In Ireland, a low rate of 8.5 per cent now applies on earnings up to IR£280 (7355) per week and the standard rate, reduced from 12.2 per cent to 12 per cent, applies up to a ceiling of £35,000 (744,440) per annum. In the UK, there is now a single rate of 12.2 per cent on all earnings in excess of STG£83 (7128) per week. Unlike Ireland, the UK has no ceiling on Employers' Social Insurance Contributions, making it more costly at higher earning levels. However, in the UK lower rates apply for employers who "contract out" their employees from the earning related part of the state pension scheme.

This results in lower employer social insurance costs in the UK compared to Ireland for almost all levels of salary up to £38,750 (749,202) per annum, with the exception of salaries in the narrow range of £14,250 - £14,559 (718,093 - 718,486) per annum, where Ireland is marginally cheaper.

As a percentage of GDP, total social security contributions in Ireland (4.6 per cent of GDP) are one of the lowest in the EU and compare with the UK (6.7 per cent), Germany (19 per cent), France (19.3 per cent), Holland (18.9 per cent) and the EU-15 average of 15.1 per cent (Source: Eurostat 1998). These ratios include employers', employees' and state contributions to the Social Insurance Fund. However, in some of the company interviews conducted for this report, it emerged that employers' PRSI costs are a particular issue for competitiveness in labour intensive, low margin enterprises.

3.2 Energy Costs

Energy costs are a key component of industry and impact particularly on the chemicals/pharmaceuticals, minerals/metals, dairy and engineering sectors. In other sectors, such as traded services and information technology, the importance of energy costs is low. However, the cost of utilities and services is important for all sectors as these costs feed through into domestic prices and can thus effect wage bargaining.

Costs need to be compared for a number of different forms of energy as enterprises cannot easily switch from one energy source to another. It is also important to ensure that the prices used for purposes of comparison take account of discounts which are available to certain business customers.

3.2.1 Electricity

The large populations and economies of scale available to electricity distributors in large EU countries provide an environment for lower cost energy compared to Ireland (table 8). In figures compiled by Eurostat for 1998, Ireland was ranked 7th out of 15 European countries for large industrial users and 8th and 10th out of 17 countries for both medium and small users respectively.

In 1998, electricity prices in Ireland were higher than the average for 17 European countries for large, medium and small users (Eurostat). However, adjusting the average to exclude Norway, Sweden and Finland that have access to low cost hydro resources, Irish electricity prices were at or below the EU average for large and medium users and just 2.9 per cent above the average for smaller customers. Rebates based on particular patterns of usage, available both in Ireland and abroad, can further reduce the effective cost of electricity.

Under the EU Directive 96/92/EC, 28 per cent of the Irish electricity market must be opened to competition by February 2000. The Draft Electricity Regulation Bill 1998 is designed to achieve this. The Bill proposes to open the market to the 300 largest users of electricity. In the medium term, small and medium sized enterprises will also benefit from the opening of the electricity market to competition.

3.2.2 Gas

Based on published gas prices for small users, Ireland was ranked 7th out of 13 countries in the EU in 1998. Published gas prices for large users were the lowest of 13 EU countries (table 9). This represents a very substantial improvement in competitiveness from a middle ranking position in the previous year. This is due to the fact that some 50 per cent of Irish gas purchases came from the UK in 1998, resulting in Ireland benefiting from historically low gas prices in the UK wholesale market.

Interviews conducted for this report with a number of manufacturing companies showed that some firms in the UK have access to gas at lower prices than comparable plants in Ireland. This could be explained by the greater economies of scale and competition in the UK market.

Arrangements to allow third-party access to the Bord Gais transmission network are at an advanced stage of preparation. The Gas (Amendment) Bill 1998 is designed to ratify the competition requirements of the International Energy Charter Treaty and to develop an open and competitive market for energy. The Gas Directive, to be implemented in Ireland by 10 August 2000, requires an opening of the market of at least 20 per cent of the total gas consumption immediately, rising to 28 per cent in 2003 and 33 per cent in 2008.

3.3 Communications Costs

Costs of telecommunications affect the competitiveness of enterprises both as an input to the cost of production, as a cost of servicing export markets and as a potential constraint to the take up of new technology if entry costs, such as connection fees and rental charges, are high. In the case of certain business activities, notably telemarketing, telecommunication costs may be the highest variable cost, aside from labour. The telecommunications market in Ireland is undergoing rapid change in response to deregulation and increased competition. This is having a beneficial effect on costs and quality. Telecom Eireann has recently reduced the cost of calls and of leased lines for businesses.

Published tariff rates may not be the most accurate guide to the cost of telecommunications at firm level. In some countries discounts and special deals are available to major telecommunications users. In Ireland, as in other countries, firms involved in IT activities such as call centres and back-office processing for the global market take advantage of off-peak rates for the different time zones where their customers are located.

An analysis of published tariffs, produced in February 1999 by the UK telecommunications consultancy firm Eurodata, shows that the cost of local and national business calls in Ireland is considerably more expensive than in other OECD countries (table 10). The cost of business calls to the UK and the USA are competitive.

- Ireland is expensive in terms of the cost of peak time local business calls (US$0.046 for the first minute). This is 200 per cent above the average for the top performing quartile of OECD countries. Ireland is ranked 24th out of 29 countries compared;

- Based on the cost of a basket of national calls, Ireland was ranked 13th out of 29 OECD countries compared. The cost was 60 per cent above the average of the top performing quartile of OECD countries;

- In terms of fixed costs (equipment, rental/connection charges etc.), Ireland was ranked 22nd out of 29 countries and was 176 per cent above the average cost for the top performing quartile of OECD countries;

- Ireland is now competitive in the area of the peak cost of business calls to the UK and USA. To the UK, Ireland was ranked 3rd out of 28 countries. To the US, Ireland was ranked 6th out of 28 countries.

The analysis carried out by Eurodata shows that Ireland has a satisfactory competitive position for the annual rental cost of leased lines (table 11). As a result of price reductions implemented by Telecom Eireann, costs in Ireland are now the lowest of OECD countries for leased lines to the UK and are ranked 5th and 8th lowest respectively for 2 Mbit and 64 Kbit leased lines to the US.

In terms of Internet access, less than 11 per cent of the total population is estimated to be online. This compares to 16 per cent in the UK, 28 per cent in the US and 28 per cent in

Finland. This highlights the importance of the rapid introduction of a new flat rate cost structure for Internet usage to help Ireland make up for lost ground.

The derogation on voice telephony was lifted in December 1998. This will increase competition in the telecommunications market, with positive effects on prices and service delivery.

For call centre operations, the plant cost comparison surveys found that telecommunications costs accounted for up to 13 per cent of the total costs and were the second most significant cost after wages/salaries. Telecommunication costs were not a significant cost factor for the major food manufacturers surveyed.

3.4 Building and Construction Costs

Industrial and office occupancy (rental) costs in Ireland are amongst the highest in Europe. Figures produced by Hamilton Osborne King for 1997 show that Ireland was ranked 17th out of 20 European countries for the cost of renting industrial buildings and 16th for office buildings.

Ireland's position has disimproved considerably both as a percentage of the best performing country and in its international ranking.

Industrial building costs are high by European standards. Based on the Hamilton Osborne King data, Ireland has declined from 7th out of 14 EU countries to 14th out of 20 European countries compared between 1995 and 1997.

Office building costs are similarly very high. Ireland was ranked 17th out of 20 European countries in 1997[1].

The position for 1998 is likely to be even worse.

The objective should be to increase the supply of land for industrial development purposes and the provision of services, e.g. water, sewerage and access infrastructure, such as roads, transport etc. The public private partnership (PPP) approach, which has been adopted on a pilot basis by the Government, will facilitate the infrastructural investment aspects.

3.5 Insurance Costs

A Deloitte and Touche report in 1996 on insurance costs in Ireland, undertaken at the request of the Department of Enterprise, Trade and Employment, highlighted the fact that the cost of employers' liability and public liability insurance was relatively high in Ireland (table 12). The survey was based on comparative quotations received from insurers in 4 EU countries for 10 selected manufacturing firms with similar sectoral and employment characteristics.

Based on the quotations received, combined liability insurance premia in the UK were only 34 per cent of the cost in Ireland. Separately, employers' liability and public liability insurance premia in the UK were 27 per cent and 59 per cent respectively of the cost in Ireland. The comparisons for the EU countries are merely indicative, as the system of State funding for industrial injury compensation greatly reduces the significance of comparison with Ireland. In the Netherlands, total liability insurance costs amounted to just 14 per cent of the Irish levels.

---

[1] Source: Hamilton Osborne King, European Property Bulletin 1998. Occupancy and building costs are both measured in IR£ per square metre.

The Deloitte and Touche study found that motor insurance premia were on average 42 per cent lower in the UK. The report found that the motor insurance premia in Ireland represented a reasonable price for the level of service demanded in terms of comprehensive cover and the level of personal injury settlements.

The study also found that the cost burden was greatest in the case of very small firms. The consultants recommended that small firms join affinity or group insurance schemes to secure more competitive quotations. Affinity schemes have been successfully established by both the Small Firms Association (SFA) and the Irish Small and Medium Enterprises (ISME) Association. A second recommendation led to an increase in staffing of the Health and Safety Authority (HSA) from 98 to 119 people.

A workplace safety working group, comprised of representatives from the Irish Business and Employers Confederation (IBEC), the Irish Congress of Trade Unions (ICTU), HSA and the Department of Enterprise, Trade and Employment, reported in 1997 on occupational safety, health and the personal injury claims system in Ireland. The group made recommendations to improve the safety of employees and to reduce the number and cost of accidents. It recommended a voluntary code of practice at national and local level. This code was launched in 1998, by the Minister of State for Science, Technology and Commerce. This model provides an alternative to the courts route and addresses losses incurred by injured persons through mediation and arbitration.

It is recommended that Government should commission resources to assist the dissemination of this voluntary code.

Other recommendations in the Deloitte and Touche report to improve the efficiency of the courts in the processing of personal injury claims are being actively considered. These include:

- sharing of expert witness statements and case conferencing;
- establishing an independent courts' service;
- establishing a personal injuries tribunal as a means of reducing the legal cost component of claim settlements.

Since insurance costs are an ongoing issue for industry, the lack of progress on solutions identified, despite the high degree of consensus amongst the social partners, is a concern. The Council recommends that a system (Compensation Board/Arbitration) separate to the courts be introduced. It would decide on compensation in cases where the parties agree to arbitration as an alternative to the courts. Such a system should be easily accessible, remove the need for legal representation and be at zero or minimal cost to the parties.

3.6 Borrowing Costs

In the last weeks of 1998, Irish pound short-term wholesale interest rates fell significantly (3 per cent) to converge to euro levels at the commencement of Economic and Monetary Union (EMU) on 1 January 1999. Irish long-term rates have also converged towards European levels because of EMU. A comparison of short term interest rates for the euro, US dollar and sterling is shown in table 13.

However, retail interest rates are unlikely to converge fully as these reflect local banking conditions. In May 1999, term loans and overdraft rates quoted by the major Irish Banks for large businesses (AAA) were close to wholesale rates but for smaller businesses (AA) and personal customers (A) were at a significant premium (between 4 and 7 percentage points) over wholesale rates (table 14). It is recognised that many enterprises can negotiate reductions on these margins and that other companies borrow at an agreed margin over wholesale rates. In contrast, rates quoted for mortgages (a more secure form of lending) were much lower, at 2.5 percentage points above wholesale rates. Increased banking competition, both domestic and international, is expected to reduce lending margins overall. However, the pressure of international competition may not reduce lending rates for small businesses to the same extent, due to the relationship nature of SME banking and the dominance of the leading Irish banks in this sector.

An additional factor is that long term loans at fixed rates of interest, lower than those available in Ireland, are more widely available to SMEs in some European countries such as Germany. In contrast, dependence on overdrafts and short-term loans at variable rates of interest is more prevalent in Ireland. This places Irish SMEs at a competitive disadvantage.

The information available on the cost of borrowing for Irish enterprises is limited. The National Competitiveness Council requests the Central Bank consider publishing regular information on the average retail lending rates (both fixed and variable) by loan size for different size of enterprises. This information would facilitate improved analysis of the impact of the banking system on the competitiveness of the economy.

3.7 Conclusion

The comparative data has identified areas where costs in Ireland are higher than in competing countries. While individual cost differences may be small in relation to the total operations of the enterprise, their cumulative impact can be significant, particularly for low margin enterprises. Given Ireland's peripheral location and dependence on exports, these cost disadvantages can have a significant impact on the overall competitiveness of the economy. The data also indicated that different costs were of different importance to various industries. In particular, there are significant variations, depending on the size of industry, its sector of operation and whether it is multinational or domestically-owned.

Case Studies On Plant Cost Comparisons

As an input into the Report on Costs, an assessment of key competitiveness issues vis-a-vis the UK affecting individual firms was undertaken, based on responses to questionnaires and on one to one interviews conducted with a number of companies in the food processing, teleservices and software services sectors.

This facilitated:

- cost comparisons with similar firms in the UK; and
- a detailed analysis of transport costs for competing Irish and UK firms.

Every effort was made to identify Irish and UK firms with similar operations. It proved difficult at times to obtain objective and comparable cost data where the UK plant performed different functions, was structured differently to its Irish counterpart or data could not be obtained for competitive reasons. Most comparable UK cost data was provided by senior executives of the Irish plants based on their best estimates.

The main cost/competitiveness issues raised by the firms were wages, employers' PRSI costs, skill shortages, transport costs and the costs of utilities and services such as energy, insurance and telecommunications (table 15). The impact of these costs bears most heavily on Irish-based manufacturers in sectors where profit margins are low. The skills shortage was highlighted by all companies, particularly software operations where it is perceived as a bigger issue than costs.

4.1 Total Costs at Plant Level

The most comprehensive cost comparison data was submitted by two major food manufacturers based in Ireland, both part of multinational groups and exporting 70 per cent-80 per cent of their output to the UK.

- One company submitted detailed costings in respect of its manufactured food range. The costs of the Irish plant were 9.7 per cent higher than for comparable plants in the UK. The cost differential was even higher compared to some regional locations in Britain, where wage levels are lower than average. The cost differential was accounted for by additional transport and delivery costs to and from the UK (48 per cent), higher employers' PRSI (21 per cent) and wages/salaries (17 per cent), and additional energy (10 per cent) and insurance (2.6 per cent) costs.
- The second food company, a manufacturer of prepared consumer foods, submitted comprehensive cost data in respect of exports to the UK. The costs of the Irish plant were estimated to be 12.5 per cent higher than a comparable plant in the UK. Delivery costs to the UK (38 per cent), wages/salaries/employers' PRSI (30 per cent), material costs (19 per cent), energy (6 per cent), insurance (1 per cent) and sales and travel costs (6 per cent) accounted for all of the cost differential.

4.2 Wages and Salaries Costs

Wages/salaries costs (excluding employers' PRSI) as a percentage of turnover constituted a major item of cost competitiveness for most firms interviewed (table 16)

Food Manufacturers

- The major company involved in exporting food products to the UK stated that, taking account of productivity levels, wages/salaries costs were on average 2.7 per cent higher in Ireland than in the UK. Employers' PRSI costs were 48 per cent higher in Ireland, taking account of the increase to £35,000 (744,440) per annum in the ceiling for employers' PRSI payments, since 6th of April 1999.

- Data submitted by the prepared consumer food manufacturer showed that wages/salaries costs in their main Irish plant were c.21 per cent higher and employers' PRSI payments 44 per cent higher, compared with a similar operation in the UK. This company has particular difficulty in obtaining skilled administrative and senior production staff at competitive wage rates. Salary expectations are higher in Ireland than in the UK. Higher income tax, particularly for single persons and house price inflation were contributory factors. However, productivity is higher in the group's Irish plants and a major expansion is planned.

- The issue of the higher cost of employers' PRSI in Ireland compared with employers' NIC in the UK was highlighted. Wages/PRSI costs are a particular issue for the food industry where profit margins are generally tight and there is high dependence on the very competitive UK export market

Teleservices/Software Companies

- Salaries for Irish telesales staff are marginally lower than in equivalent UK operations according to the two companies interviewed. One company expressed concern that the rapid growth of the market, skills shortages and wage increases may make Ireland uncompetitive in this sector.

- In the software sector, companies stated that basic salaries are in line with the UK but marginally cheaper than in Northern Ireland for technical staff, e.g. trainees, programmers, programmer/analysts, project managers and sales staff (table 17).

- Management executives and project managers' costs depend on experience and vary from firm to firm. One software company desired to pay more of the overall remuneration package by way of commissions and bonuses, which decrease costs when sales are low. However, employees want commissions and bonuses built into the basic salary to maximise the scope for mortgage borrowing, as banks lend on a multiple of salary, excluding bonuses.

4.3 Skills Shortage

Skills shortages and difficulties in recruiting staff were raised by a number of companies. This is a particular difficulty for small companies, as larger multinationals can more easily attract graduates. For software companies, particularly those in the high tech sector, the issue was the availability rather than the cost of skilled resources. Companies with access to skilled resources can deliver the product/service 'first to market,' giving them a competitive advantage. This also holds true for their UK operations, where skills are also in short supply. In the software sector, particularly at the lower end of the value added chain, sub-contracting projects and setting up operations in overseas locations where software staff are available is occurring. Alternative locations include the Czech Republic, India and Malaysia.

One multinational software company spoke of the high quality of software staff in India and referred to the fact that the Indian staff were directly supporting the group's high level R&D facility in the US. As a result of the skills shortage, a leading Irish-based software company has announced the establishment of a new software and support centre in India.

Skills shortages are also affecting certain categories of staff in the food sector, particularly chemists, engineers, and sales/marketing personnel. This is not the case in comparable UK plants.

4.4 Energy Costs (Electricity, Gas, Oil)

Electricity costs were a key concern of the companies surveyed but varied in significance (table 18). Electricity costs were not of significance for software, distribution companies or call centre operations.

For the multinational companies in the food sector, electricity costs in Ireland were stated to be 17 to 20 per cent higher than for UK-based operations. This varies with currency levels. The companies put the cost differential for electricity down to economies of scale in the UK market and the fact that UK companies can negotiate with private sector energy providers to obtain discounts.

One of the companies interviewed stated that gas prices were significantly more expensive in Ireland than in the UK. However, the cost of industrial gas only amounted to 0.25 per cent of total sales in this company. Gas prices for large users are generally competitive by EU standards.

Oil costs were 28 per cent higher than in an equivalent UK plant in the same company. However, oil costs amounted to just 0.26 per cent of the firm's sales.

The gas and oil cost differential is more important for energy intensive industries.

4.5 Insurance Costs

The companies interviewed for this report stated that the insurance environment in Ireland has always been more expensive than in the UK. A major contributory factor is the high level of settlements paid to claimants.

One of the food companies stated that, over a six-year period (1991/96), the average cost of claims in Ireland was higher than comparable claims in the UK by:

- up to 56 per cent for employers liability;
- up to 126 per cent for motor; and,
- 5.4 per cent for public/product liability.

In this company, insurance costs accounted for 0.6 per cent of sales and were 19 per cent higher than in a comparable UK plant.

The second food company experienced an overall insurance cost differential of 15 per cent between its comparable Irish and UK plants. In 1998, the premia were:

- 63 per cent higher for employers liability;
- 42 per cent higher for motor insurance; and
- No different for product liability insurance.

Insurance costs accounted for a relatively small proportion of overall sales in this company.

In software companies insurance costs constitute a higher percentage of turnover, amounting to 0.75 per cent of sales in one company. However, because of high profit margins, the companies did not rate insurance costs as an issue.

4.6 Telecommunications Costs

Telecommunications costs are particularly significant for the services sector, both in terms of cost and infrastructure.

Telecommunication costs amounted to 13 per cent of the total costs of some call centres and are the second largest cost after salaries. Companies in the teleservices sector called for faster deregulation of telecommunications to achieve cheaper costs.

They were not a significant cost factor for the major manufacturers interviewed.

4.7 Transport Costs

Costs of transport from Ireland to third country destinations are comparable with the costs of transporting goods from the UK to the same destinations. However, Ireland's peripheral location puts Irish exporters at a disadvantage. The cost of transport was a key concern expressed by the Irish-based food manufacturers competing on the UK market.

The interviewees were of the view that the freight costs of Irish exports will always be dearer than competing UK producers' domestic freight charges, because of the cost of crossing the Irish sea.

- In the case of the manufacturer of food products, outbound transport costs amounted to 2 per cent of sales. Some 44 per cent of the additional costs of production in Ireland were due to additional freight costs incurred by the Irish plant shipping its products into the UK market.

- Data provided by the Irish manufacturer of prepared consumer foods showed that transport costs were 122 per cent higher than for an equivalent UK manufacturer.

The Irish companies see little scope for reducing the cost differentials in transport and, as a result, some food companies have set up production facilities in the UK and others have moved further up the value added chain to reduce the impact of transport costs in the final sales price. A key issue is the very competitive nature of the UK food market and the dominance of the major supermarket chains, leading to tight margins for Irish food manufacturers. It has been proposed that establishing regional cross-docking facilities on a multi-supplier, multi-retailer basis could contribute to improved competitiveness for the food sector both on the domestic and export side.

A Deloitte and Touche/Institute of Logistics (UK) 1998 European Logistics Survey found that reduced lead time was the most important target for 600 respondents. Customers are demanding quicker response times and increased customisation of products at all levels of the supply chain. Traceability, reliability of delivery and a proactive approach by the carrier were key concerns for clients.

Whilst freight cost on outbound traffic accounted for, on average, only 1.4 per cent of the value of sales of Irish Industry (Census of Industrial Production 1996), this disguises a number of underlying factors.

I. It deals with export freight charges only and excludes the cost of inward shipment of raw materials and maintenance supplies, which are included in the cost of materials; and
II. Sectors, such as the food industry, incur significant transport costs. For one company interviewed, freight out costs amounted to 3.5 per cent of sales.

The most comprehensive cost comparison data was submitted by two major food manufacturers based in Ireland, both part of multinational groups and exporting 70 per cent-80 per cent of their output to the UK.

The most recent year for which comparable UK and Irish labour cost statistics are available, in published form, is 1995. The source documents are the Irish Census of Industrial Production (CIP) and the UK Manufacturing Production and Construction Inquiry.

The statistics (which are somewhat dated) show that wages/salaries per employee, excluding PRSI/NIC, were reasonably similar across all industrial sectors (table 7). However, labour costs in regional locations may be significantly lower than the average. The exception was the Food, Drink and Tobacco sector where wage levels in Ireland were, on average, 14 per cent higher than in the UK. This is consistent with the results of the interviews, conducted for this report, with a number of major Irish-based food processors who submitted that wage levels in Ireland were up to 21 per cent higher than in comparable plants in the UK.

A further factor influencing cost competitiveness with the UK is the additional cost of employers' PRSI in Ireland. At most wage levels employers' PRSI costs are higher than employers' NIC costs in the UK, but lower than those in most other EU countries. In Ireland, a low rate of 8.5 per cent now applies on earnings up to IR£280 (7355) per week and the standard rate, reduced from 12.2 per cent to 12 per cent, applies up to a ceiling of £35,000 (744,440) per annum. In the UK, there is now a single rate of 12.2 per cent on all earnings in excess of STG£83 (7128) per week. Unlike Ireland, the UK has no ceiling on Employers' Social Insurance Contributions, making it more costly at higher earning levels. However, in the UK lower rates apply for employers who "contract out" their employees from the earning related part of the state pension scheme.

This results in lower employer social insurance costs in the UK compared to Ireland for almost all levels of salary up to £38,750 (749,202) per annum, with the exception of salaries in the narrow range of £14,250 - £14,559 (718,093 - 718,486) per annum, where Ireland is marginally cheaper.

As a percentage of GDP, total social security contributions in Ireland (4.6 per cent of GDP) are one of the lowest in the EU and compare with the UK (6.7 per cent), Germany (19 per cent), France (19.3 per cent), Holland (18.9 per cent) and the EU-15 average of 15.1 per cent (Source: Eurostat 1998). These ratios include employers', employees' and state contributions to the Social Insurance Fund. However, in some of the company interviews conducted for this report, it emerged that employers' PRSI costs are a particular issue for competitiveness in labour intensive, low margin enterprises.