

Review of Labour Cost Competitiveness

28 October 2010

Table of Contents

Executive Summary	5
1. Background and Introduction	13
2. National cost competitiveness and the implications for enterprise development 16	
3. Review of labour market costs	21
4. Review of the drivers of labour costs	32
5. Actions to improve wage competitiveness	59
Appendix 1: Hourly Earnings excluding Irregular Benefits (All Employees)	69
Appendix 2: Weekly Earnings including Irregular Benefits (All Employees)	69
Appendix 3: National Minimum Wage Rates	70
Appendix 4: Minimum Wage Scorecard	70
Appendix 5: List of ERO's	71
Appendix 6: Summary of Main Recommendations from Review of the JLC System	72
Appendix 7: Summary Cost Profiles for internationally trading manufacturing, services and R&D operations	73

Executive Summary

Introduction

Generating sustainable export-led growth is essential to rebuilding our economy. As a result of the single currency, Ireland cannot rely on a currency devaluation to restore competitiveness. In order for the economy to make the necessary transition from a reliance on domestic demand to sustainable broad based export-led growth, policies need to facilitate the convergence of Irish business costs towards the levels of our trading partners.

Despite recent significant improvements in Ireland's national cost competitiveness, Ireland has yet to achieve cost competitiveness relative to our key trading partners which is necessary to support a rapid improvement in employment and investment levels. Much of the improvement to date has occurred because of cyclical factors arising from the economic recession, as opposed to the type of structural reform required to underpin long term international competitiveness.

In order to better understand the challenges confronting Ireland, Forfás is undertaking assessments of our cost competitiveness across a range of key business inputs including labour, property, utilities and professional services. Given their contribution to total costs, the competitiveness of a country's labour costs significantly impact on overall cost competitiveness. The purpose of this paper therefore, is to examine the operation of the Irish labour market and to identify actions which can improve its efficiency. This paper provides policymakers with:

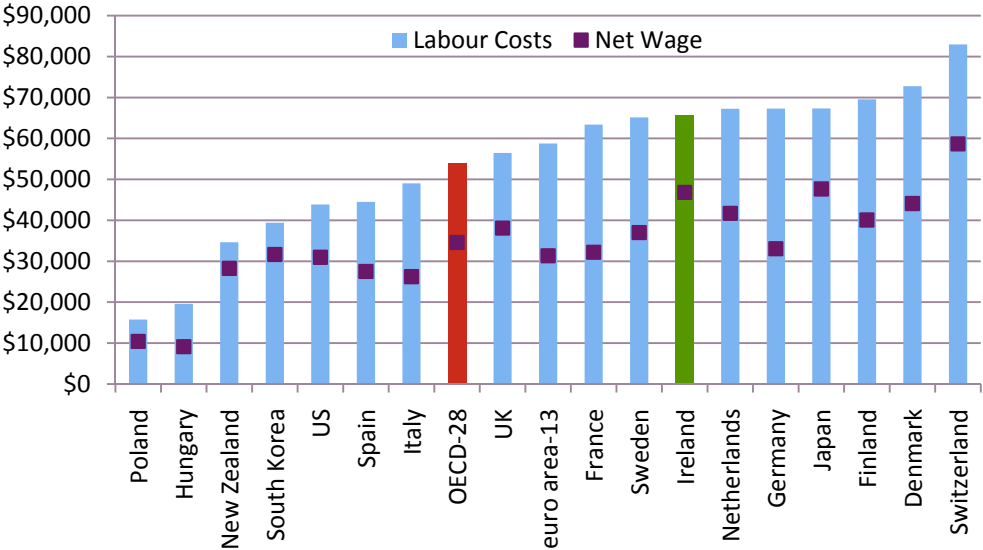
- An analysis of labour market costs and their drivers; and
- Policy recommendations to improve labour market efficiency, support enterprise development and encourage employment growth as the economy recovers. These recommendations:
 - Identify actions to incentivise increased labour supply (i.e. ensure individuals are willing to enter the labour market and offer their labour at the market rate); and
 - Identify actions to incentivise employer demand for labour (i.e. reductions in the cost to employers should increase their demand for labour).

Wage Developments to Date

Ireland had the tenth highest total labour cost level in the OECD-28 in 2009 (Figure E1)¹. When labour taxes are removed, OECD data indicates that Ireland has the fifth highest net wage level in the OECD-28, 39.5 percent above the OECD-28 average (excludes Turkey and Mexico). Analysis conducted by the Central Bank has found that compensation levels in the more sheltered sectors of the Irish economy are likely to be significantly higher than those in our main trading partners. The analysis finds that Irish salary levels in internationally trading businesses are broadly in line with the euro area average (although Irish salaries are higher than those in the US).

¹ Total labour costs include wages, taxes on income and employer and employee social security contributions.

Figure E1: Average Total Labour Costs and Net Wages, 2009



Source: Benchmarking Ireland’s Performance, 2010 based on data from OECD, Taxing Wages, 2009.

Over recent months, there have been anecdotal cases of significant downward adjustment in earnings and rates of pay. However, the observed decreases in hourly rates and weekly rates, based on CSO data, are relatively modest². At the aggregate level, hourly earnings excluding irregular bonuses have fallen by 1.3 percent in the year to Q2 2010. The corresponding figure including irregular earnings was an annual decrease of 1.0 percent. In weekly terms, average weekly earnings fell by 1.6 percent over the year to Q2 2010. The fall in weekly earnings is a result of a combination of changes in hours worked as well as changes in hourly earnings.

Instead of introducing cuts to wage rates, many employers have taken other measures to control labour costs. This is borne out by the available data on numbers employed and hours worked - many firms have continued to reduce numbers employed and/or contracted hours worked, more consistently and to a greater extent, than adjusting pay rates (Table E1).

Table E1: Summary of Earnings Data

	Hourly (Excluding Irregular)	Hourly (Including Irregular)	Weekly (Including Irregular)	Numbers Employed	Hours Worked
Annual Change to Q2 2010	-1.3%	-1.0%	-1.6%	-3.6%	-0.6%
Quarterly Change to Q2 2010	-0.6%	-1.4%	1.0	-0.1%	2.6%

Source: CSO Earnings, Hours & Employment Costs Survey (EHECS)

² CSO, Earnings and Labour Costs Survey, Q2 2010

Looking at unit labour costs (ULC), Ireland's ULC Real Effective Exchange Rate indicator appreciated between 2003 and 2008 by some 18 percent as wage growth remained high while productivity gains declined. European Commission research estimates a 5.9 percent improvement in 2009 versus the rest of the euro area and forecasts a further 3.6 percent improvement in 2010.

Given the dramatic increase in unemployment witnessed over the last 18 months, the relative stickiness of wage levels suggests that barriers exist in the Irish labour market that are preventing a more substantial adjustment.

Drivers of Labour Costs

- **National policy:** The evidence suggests that buoyancy in the broad economy drove labour costs over the past decade rather than national collective agreements and that the national agreement did not hinder decisions on wage cuts up to late 2007/early 2008. In the context of the recession, no national wage agreement is currently in place for private sector workers.
- **Inflation:** Whilst no binding indexation rule has ever been introduced as part of the Irish sequence of national agreements, wage increases have generally tended to be strongly influenced by the prevailing rate of inflation. ESRI research indicates a close upward correlation between consumer prices and wage demands. Relative to historical levels, the Irish consumer price index peaked in 2008. Since then the index has fallen and prices in September 2010 were 6.2 percent below the peak level. By contrast, based on CSO earnings data³, average weekly wages have declined by approximately 2 percent between Q1 2008 and Q2 2010, indicating that real wages have actually increased over the period in question⁴. House prices also affect wage expectations.
- **National minimum wage (NMW):** At first glance, relatively few workers in Ireland are earning the NMW rate - according to the CSO, in October 2007 4.9 percent of employees in Ireland (83,700) were earning €8.65 per hour or less. It is likely, however, that the presence of the minimum wage influences wage levels for those who earn close to the NMW rate - the earnings of another 26 percent of the labour force, for instance are within 1.5 times the NMW. The NMW impacts on sectors in different ways - sectors such as wholesale and retail, hotels and restaurants, construction and other services sectors tend to have significantly more NMW workers than internationally trading sectors. While the sectors and occupations where the greatest job losses have occurred generally coincide with the sectors where the NMW is most prevalent, these sectors have also experienced a major collapse in demand for their output. A majority of international studies surveyed by Neumark and Wascher (2007) give a relatively consistent (although not always statistically significant) indication of negative employment effects of minimum wages - of the studies which find a negative relationship between minimum wages and employment, a 10 percent increase in the minimum wage typically reduces employment in the cohort studied by between zero to five percent⁵.
- **Collective agreements:** It is estimated that between 170,000 and 300,000 workers are covered by either Employment Regulation Orders (ERO's) or Regulated Employment Agreements (REA's) regarding the terms and conditions of their employment. In many cases, those covered by ERO's and REA's overlap with those earning wage levels within 1.5 times the NMW. An examination of the hourly rates guaranteed by ERO's suggests that these agreements

³ CSO, Earnings and Labour Costs Survey, Online Database

⁴ This does not take account of the introduction of the income levy etc. which reduced take home pay.

⁵ Neumark, D. and Wascher, W., Minimum Wages and Employment, Institute for the Study of Labor, Discussion Paper Series IZA DP No. 2570, January 2007

are offering a premium of approximately nine percent over the NMW rate. REA's also provide for a wage rate in excess of the hourly minimum wage. REAs are predominantly related to the construction sector (others relate to the printing industry, for example) and guarantee hourly or weekly rates well in excess of the NMW. While many of these collective agreements have clauses requiring upward reviews of hourly rates upon any increase in the NMW, few include a similar clause to take account of a reduction of the NMW. Finally, the additional conditions of employment covered by ERO's and REA's (such as travel to work costs, Sunday working rates etc.) can have a significant impact on employment costs.

- **Social welfare and replacement rates:** Jobseekers' Benefit is designed to offer income maintenance during periods of frictional or cyclical unemployment, not to serve as an alternative long term source of income⁶. The replacement rate measures the proportion of out-of-work benefits received when unemployed against take home pay if in work. As such, it sets a de facto rather than legal minimum wage. In general, a replacement rate in excess of 70 percent is considered excessive, i.e. if an individual can receive more than 70 percent of un-work income in benefits, they will demand a higher wage in the market to retain a monetary incentive to work. At present, some individuals are receiving more by not participating in the labour market than taking up work depending on their individual circumstances. In particular, low income earners, families with children, long term unemployed and those in receipt of secondary allowances may have replacement rates in excess of 70 percent. It is estimated that between 15 and 20 percent of those on the Live Register have replacement rates in excess of 70 percent. It is important to note that replacement rates do not just act as a disincentive to work for low income earners, for example a one-earner-couple with two children on Average Industrial Earnings (€33,633) in receipt of the maximum rent allowance for the Dublin region receive 98.63 percent of their income if unemployed. This is based on in-work income consisting of gross wage less any taxes or levies due plus the greater of family income supplement or spouses jobseekers allowance (in this case spouses jobseekers allowance) plus child benefit versus out-of work income consisting of maximum jobseekers allowance including adult and child dependent allowances, plus fuel allowance, smokeless fuel allowance, maximum rent allowance for the Dublin region and child benefit. Replacement rates are lower for single workers with no families who comprise a significant component of the Live Register. Any move to cut wage levels, increase personal taxation or cut the NMW without corresponding changes to social welfare will lead to higher replacement rates which would not support adjustments in the labour market. In order to improve replacement rates, greater adjustments would be required in social welfare vis-à-vis the NMW and wage levels.
- **The taxation system:** The taxation system is broadly supportive of labour market efficiency but some issues of concern are emerging. The difference between the employers' cost of hiring an individual and the individual's actual take home pay, due to income and payroll taxes, is known as the tax wedge. A high tax wedge increases labour costs and has a negative influence on the employer's decision to retain or hire individuals. It also lowers take home pay and can affect an individual's participation decision as measured by replacement rates. Increases in personal taxes reduce take home pay for employees without any labour cost savings for the employer. Falls in take home pay arising from higher taxes may make it more difficult for employers to adjust gross pay (i.e. labour costs). In Ireland, the labour tax wedge

⁶ Jobseekers' Allowance (and other assistance payments) may serve as income support on a long-term basis - subject to satisfying scheme conditions.

has risen for all income categories assessed by the OECD since 2008 while the tax wedge in most OECD countries is unchanged or falling.

- **Firm level policies:** Despite economic theory suggesting that pay levels should fall to enable the labour market to clear, the available evidence in Ireland and internationally suggests that economy wide wage levels rarely fall. While it is easier for new enterprises and existing troubled enterprises to justify lower wage levels to their employees, the majority of businesses are reluctant to lower hourly wage rates. Detailed interview based research with firms suggests that firms prefer layoffs to pay cuts, do not favour wage reductions that merely take advantage of labour market conditions, and remain reluctant to hire overqualified people or new staff at significantly lower pay rates than existing staff⁷. The reasons given highlighted the role of internal wage structures and potential negative effects on productivity.

Context for Actions

Labour market reform is a prerequisite for Ireland's long term economic recovery. Regardless of the action taken, the nature of the labour market challenge means that it will take time to effect change. In some instances, the actions identified here will not have an immediate effect on lowering costs and increasing employment - some actions are about ensuring barriers to growth and employment creation are minimised once economic recovery is underway - the risk being that a nascent recovery could be choked off by a return to increasing costs. Other actions are intended to remove the causes of previous overheating that resulted in Irish wage levels growing at a rate not justified by productivity, undermining international competitiveness.

The labour market is complex and no single policy action can resolve all of the issues confronting us. Labour market expectations and wage demands are not divorced from happenings elsewhere in the economy. If employees genuinely believe that the cost of living in general is falling, this will be reflected in nominal wage demands. It is important, therefore, that appropriate and credible actions are taken to address all elements of the cost base in Ireland, for example, maximising competition and addressing professional fees. A long term opportunity arises for shifting negotiations on pay away from increases in living costs and focusing instead on improvements in productivity.

Principles Governing Intervention

The complex relationship between the various drivers of wage levels means that coordinated and complementary action is required - when interventions in one area of labour market policy are being considered, the impact of such action on other parts of the labour market must also be taken into account. To the greatest extent possible, the market should set wage levels, as opposed to state interventions determining pay rates, and interventions should be designed with this in mind. The bulk of the State's interventions in the labour market affect those who are either unemployed or on low or average incomes. The policy recommendations herein, therefore, largely focus on these areas.

When deciding upon what action to take to lower costs, policymakers must be cognisant of a range of potentially conflicting principles:

⁷ Bewley, Truman F., *Why Wages Don't Fall During a Recession*, 1999, Harvard University Press, 527 pp. ISBN 0-674-95241-3

- The need to broaden the tax base (to bring lower paid workers into the tax net);
- The necessity to reduce public expenditure;
- The protection of those on low incomes; and
- The need to maintain good industrial relations.

The actions and recommendations are designed to ensure that the labour market is working efficiently so that wage levels adjust to support employment and economic growth and so that individuals are incentivised to work at market rates. A more competitive cost base will enhance our ability to attract and retain FDI, the ability of the indigenous sector to compete internationally, and can make marginal business opportunities profitable.

Recommendations and the Sequencing of Reform

The actions below are sequenced in an order designed to maximise impact.

In the context of likely budget cuts to social welfare rates, Forfás recommends that **replacement rates** be addressed as a matter of urgency, ensuring that all replacement rates move below the 100 percent mark and ultimately move towards the 70 percent benchmark. If taxes on employment or social contributions are increased in Budget 2011 without similar changes to social welfare, replacement rates will increase with negative implications for the labour market. At a minimum, replacement rates should not increase.

The issue of secondary benefits is quite complex and varies according to individual and household circumstances⁸. However, potential still exists to reform this area, for example:

- The Department of Social Protection have identified that replacement rates in excess of 70 percent which occur as a result of individuals receiving rent allowance may be addressed through a movement to the rental accommodation scheme;
- Potential may also exist to allow some secondary benefits to be retained for a period of time after take up of full time employment depending on income levels - this would reduce the impact from the loss of social welfare entitlements upon taking up employment.
- There is a need to reform the social welfare system so that benefits decline in line with the length of time a person is out of work - this would be in line with European approaches to social welfare. It is important to note, however, that the European model is predicated on relatively high contributions bestowing a relatively high post-employment income that generally declines over time.

In parallel with the replacement rate issue, Forfás recommend that **Employment Regulation Orders** be reformed to ensure that they contribute to labour market efficiency. In general ERO's have delivered a premium on top of the NMW to those workers covered by the agreements, adding to the cost of employment⁹. Additionally, because the wage rates contained in ERO's are legally enforceable, their continuation in their current form would negate the impact of any changes in the NMW. The secondary terms and conditions which are often determined by ERO's (e.g. travel costs, Sunday working rates etc.) place further costs on employers. Adjustments which reduce these costs would have a potentially significant impact on overall wage costs for some employers.

⁸ Moves to address replacement rates must also be cognisant of the impact that secondary entitlements can have - the Department of Social Protection is currently working on a paper relating to Child Income Support which addresses many of the relevant issues.

⁹ REA's, by contrast, are determined primarily from the top down and through national wage agreements.

- In the first instance, much of the power in relation to ERO's rests with the members of the Joint Labour Committees. Either side can request a meeting of the JLC to make proposals for variations in the terms and conditions - this approach has recently happened in the Hotels, Catering, Retail and Grocery, and Agriculture JLCs. Given the need to enhance labour market flexibility, employers could seek to renegotiate the various ERO's, reducing the premia paid above the minimum wage and/or reforming the additional terms and conditions (such as Sunday working rates). While such negotiations may be agreed by both parties, in the absence of an agreement the casting vote of the JLC Chairperson is required.
- It would also be useful to include a mechanism in future ERO's that would automatically reflect any variations to the national minimum wage - it appears that at present, many agreements do not contain any such provision that would allow for a reduction in hourly rates¹⁰.
- An alternative, more radical approach could be considered. It can be argued that the existence of a NMW and the introduction of extensive employment legislation render the JLC's irrelevant. Their abolition (as occurred in the UK) or suspension would not preclude employees and employers from engaging in local bargaining, and workers would still be protected by the NMW. This could be achieved through amendments to the Industrial Relations Acts¹¹.

Regulated Employment Agreements also provide for a wage rate in excess of the hourly minimum wage. REAs are predominantly related to the construction sector (others relate to the printing industry, for example) and guarantee hourly or weekly rates well in excess of the NMW (e.g. the REA for construction craftspeople has an agreed hourly rate of €18.60 while an electrician in their first year of work out of time earns €20.74 per hour). It would appear that wages in sectors covered by REA's are less directly influenced by the NMW than sectors covered by ERO's.

- As with ERO's, either employer or employee representatives can seek to renegotiate hourly rates and other terms and conditions, and to include provisions in future agreements that would mirror any reductions in the NMW and allow for reductions in hourly rates.
- An alternative approach would be to remove the clause making REA rates legally binding. Again, this would not preclude employees and employers from engaging in local bargaining, and workers would still be protected by the NMW.
- The abolition of the construction-related REA's could result in some non-national companies entering in the Irish market as they would now be able to compete on the basis of lower costs. While this would increase pressure on companies already trading here, it would also boost levels of competition.

¹⁰ The Minister for Labour Affairs has announced his intention to introduce an "inability to pay" provision into forthcoming Industrial Relations (Amendment) Bill, 2009 in relation to ERO's. Such a clause, however, could give rise to concerns about the impact on competition - for example, granting an exemption to an individual firm from ERO rates and allowing that same firm to compete for projects on the basis of lower labour costs confers an unfair advantage on them vis-à-vis competitor firms.

¹¹ Reform of ERO rates, however, may not yield the rewards anticipated. The National Employment Rights Authority (NERA) is tasked with ensuring that all aspects of employment law, including the terms and conditions set out in ERO's are fully complied with. According to their recent quarterly report, the main issues encountered by NERA when carrying out inspections of these agreements are in relation to the payment of the appropriate sectoral pay rate; overtime rates and Sunday premium; and trainee rates. This suggests that in some cases employees are receiving less than the agreed sectoral wage. This would, to some degree, negate the impact of reducing hourly ERO rates or abolishing JLCs. Statistics on discovered breaches of employment law can be found in NERA, Quarterly Update, June 2010

Thereafter, other measures such as changes to the **National Minimum Wage** can also be considered, though we believe that replacement rates and sectoral agreements represent the primary barriers to labour cost adjustments. For example, consideration should be given to:

- Cutting the headline NMW rate of €8.65 by a designated amount. A reduction in the NMW would result in an increase in employment in the medium term rather than the short term, although it is difficult to estimate how significant this increase might be.
- Extending the lower rate for younger workers. Currently a rate of €6.06 exists for workers less than 18 years of age. Consideration might be given to introducing a rate lower than €8.65 for all workers aged under 21 or 25 years of age.

All of these actions must be complemented by an efficient, effective and relevant activation and enforcement system that takes account of the needs of both employers and individuals. This will require collaboration and co-ordination between employment services, training and education providers and enterprise¹².

Finally, the issue of ensuring that part time workers are incentivised to take up full time employment was considered. Having examined the various types of part time work, it can be concluded that systematic short time working (SSTW) is not a particularly problematic issue. The numbers engaged in SSTW are relatively low and current procedures should be able to prevent workers rejecting offers to return to full time employment and retaining access to benefits. In relation to other part time workers, the priority should be the continued enforcement of the Genuinely Seeking Work (GSW) condition. Thereafter, a number of other options might be considered in order to incentivise part time workers to return to full time employment including changing the basis on calculating jobseekers benefit from a six to a five day week. A second option would involve extending certain entitlements for workers who move from part time into full time work for an initial period of employment thus temporarily cushioning the fall in their income.

¹² Forfás, Review of Labour Market Programmes, March 2010

1. Background and Introduction

Summary & Key Conclusions

- The purpose of this paper is to provide policy makers with an understanding of labour market costs and their drivers
- Policy recommendations designed to support enterprise development and employment growth as the economy recovers are also provided. These recommendations:
 - Identify actions to incentivise increased labour supply (i.e. ensure individuals are willing to enter the labour market and sell their labour at the market rate); and
 - Identify actions to incentivise employer demand for labour (i.e. reductions in the cost to employers should increase their demand for labour).
- Export-led growth is essential for the Irish economy
- A combination of improvements in cost competitiveness and productivity growth is required. Policies need to facilitate the convergence of Irish business costs towards the levels of our trading partners
- Enabling the price levels of key business inputs to adjust is essential to achieving swift improvements in competitiveness
- Labour costs are a significant factor for many enterprises and sectors

Generating sustainable export-led growth is essential to rebuilding our economy. In order for the economy to make the necessary transition from a reliance on domestic demand to sustainable broad based export-led growth, policies need to facilitate the convergence of Irish business costs towards the levels of our trading partners. This will require further improvements in cost competitiveness and productivity growth¹³. Enabling the price levels of key business inputs to adjust is essential to achieving swift improvements in competitiveness. While potentially painful in the short term, the alternative is a prolonged period of weak or negative growth, weak export growth, high unemployment and emigration.

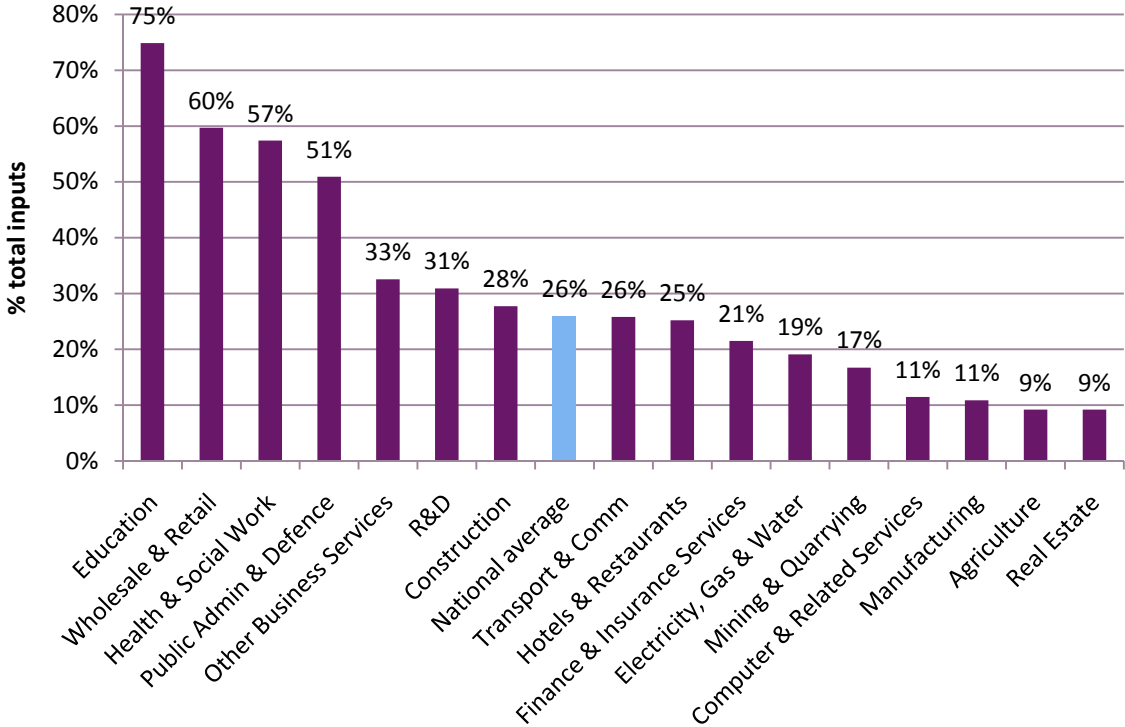
In the absence of a currency devaluation policy lever to improve cost competitiveness, the policy focus needs to be on achieving an internal devaluation through cost reductions in key business inputs and productivity growth. Figure 1 illustrates the contribution of labour costs as a percentage of total input costs for a range of economic sectors.

Forfás is undertaking assessments of our cost competitiveness across a range of key business inputs including labour, property, utilities, professional services and financing costs. The focus of this paper is on labour cost competitiveness.

¹³ Productivity growth is the preferred mechanism to improve competitiveness as it can support cost competitiveness in tandem with high and increasing wage levels. Many firms, however, may have limited opportunities to increase value added significantly in the short term. The more productive the labour force and the capital stock are, the higher the level of wages that is consistent with a state of “price and wage” competitiveness. This illustrates the importance of skills development, innovation, infrastructure, etc. in the longer term.

Figure 1 highlights that labour costs represent a relatively high proportion of total input costs across a range of locally trading sectors. In addition, within internationally trading sectors, work undertaken by Forfás for the National Competitiveness Council has found that labour costs are the largest location sensitive cost components for internationally trading manufacturing (52 percent), services (84 percent) and R&D operations (80 percent)¹⁴. In this context, labour costs are not only a significant input in to the cost of domestic services (which support our export sector) but also have significant influence on FDI decisions and our export potential.

Figure 1: Labour Costs as % of Total Input Costs by Sector, 2005



Source: CSO (March 2009) Supply and Use and Input-Output Tables Ireland 2005¹⁵

Our membership of a monetary union also necessitates urgent action in order to restore labour cost competitiveness - within currency unions, differences in wage rigidity within a monetary union may give rise to persistent inflation differentials and protracted changes in competitiveness across member countries¹⁶. In order to avoid future deteriorations in competitiveness, therefore,

¹⁴ Excludes location insensitive costs, i.e. goods and services produced on international markets where the price is determined by global supply and demand conditions. As these costs are internationally determined, they do not influence investment location decisions or the cost competitiveness of exports. Location insensitive costs account for 56 percent of total manufacturing costs, 11 percent of total services costs and 13 percent of total R&D costs.

¹⁵ This chart is derived from Input-Output Table 4. Inputs are composed of 'total consumption of goods and services at purchasers prices' plus 'compensation of employees'.

¹⁶ Lamo, A., and Smets, F., Wage dynamics in Europe: Some New Findings, European Central Bank, Research Bulletin No 10, June 2010

it is vital to maximise labour market flexibility. The purpose of this paper is to provide policy makers with:

- An analysis of labour market costs and their drivers; and
- Policy recommendations to improve labour market efficiency, support enterprise development and encourage employment growth as the economy recovers. These recommendations:
 - Identify actions to incentivise increased labour supply (i.e. ensure individuals are willing to enter the labour market and sell their labour at the market rate); and
 - Identify actions to incentivise employer demand for labour (i.e. reductions in the cost to employers should increase their demand for labour).

Structure of Report

Looking at the structure of this report, Chapter 2 examines the scale of the competitiveness challenge facing Irish firms and considers the reasons for the deterioration in Ireland's cost base over recent years. The implications of this deterioration for both firms and the wider economy are also considered here. Chapter 3 summarises recent labour market developments in terms of employment trends and earnings trends. In particular, the trends in earnings are set against the international context and wage movements in key competitor locations. Having outlined Ireland's labour market story, Chapter 4 provides an overview of the key drivers of labour costs. The impact of a range of factors on Irish wage levels is assessed. Finally, Chapter 5 draws all of this analysis together to identify a set of actions designed to improve the efficiency of the labour market, facilitating employment creation and protecting real incomes.

2. National cost competitiveness and the implications for enterprise development

Summary & Key Conclusions

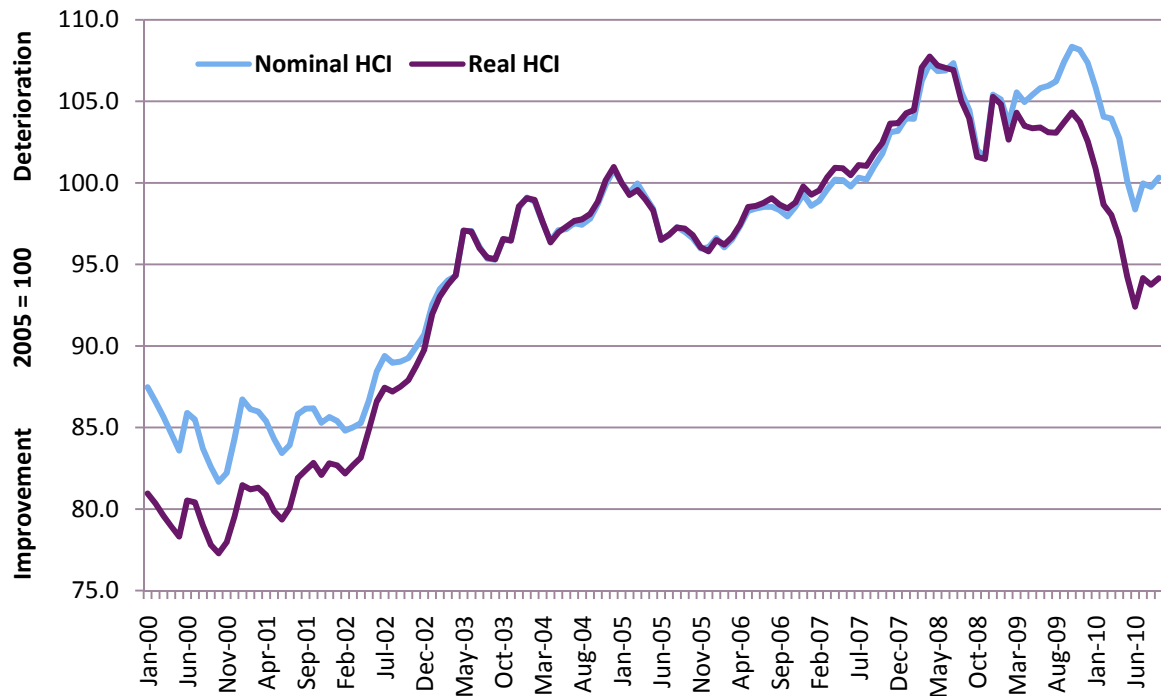
- The Irish Harmonised Competitiveness Indicator (a national measure of cost competitiveness) remains approximately six percent overvalued or overpriced
- Therefore, despite significant progress to date, Ireland still has some way to go to achieve relative cost competitiveness compared to our key trading partners
- Ireland's current lack of cost competitiveness is evident through high levels of unemployment and low levels of investment
- While some recent cyclical improvements have been recorded, structural reform is required if international competitiveness is to be restored
- A high cost environment impacts negatively on Ireland's ability to attract and retain FDI, the ability of the indigenous sector to compete internationally, the cost base for locally trading enterprises and the ability of companies to take advantage of marginal business opportunities

Defining national cost competitiveness is complex. An economy is under-competitive in cost terms, if the levels of prices and wages are sufficiently high to generate an increase in the unemployment rate and/or capital disinvestment¹⁷. Ireland has experienced a very sharp increase in unemployment and a collapse in investment across the broad economy. Various commentators (IMF, ESRI, etc.) do not expect strong recovery in the short term.

Nonetheless, Ireland's national cost competitiveness has improved in the past two and a half years - because of exchange rate movements and downward price adjustments within the Irish economy. As highlighted in Figure 2, since April 2008 Ireland has regained some of its lost cost competitiveness as a result of falls in relative prices and favourable exchange rate movements vis-à-vis our key trading partners. In September 2010, Ireland's real Harmonised Consumer Index (HCI) was more than 12 percent below the April 2008 value.

¹⁷ According to Lane, price and wage competitiveness can be defined as 'a state in which medium term full employment is achieved and the return on capital matches the global risk-adjusted cost of capital'. See Lane, P., Assessing Ireland's Price and Wage Competitiveness, National Competitiveness Council, 2004

Figure 2: Price Competitiveness Indicator for Ireland (Harmonised Competitiveness Indicators)¹⁸, 2000 - September 2010 (January 2005 = 100)



Source: Forfás calculations, Central Bank of Ireland

Research from the European Commission published in May 2010 acknowledges that Ireland has registered significant gains in cost competitiveness in 2008 and 2009¹⁹. The Commission highlights that Ireland is the only Eurozone country that provides clear evidence of 'competitiveness rebalancing'. Since the outbreak of the financial crisis in 2007, the intra-euro-area real effective exchange rate (or the HCI - a measure of national cost competitiveness) based on GDP deflators has depreciated by almost seven percent.

It is important to determine if progress to date is sufficient to restore competitiveness and whether further adjustments are necessary. European Commission research suggests that the Irish real effective exchange rate (REER) or HCI remains approximately six percent overvalued or overpriced - though it highlights that this figure should be treated as approximate²⁰. Similar assessments from the European Central Bank and the IMF estimate that Ireland's real exchange rate is overvalued by between four to fifteen percent²¹. Therefore, despite significant progress to date, Ireland would appear to still have some way to go to achieve cost competitiveness relative

¹⁸ The nominal HCI is a nominal effective exchange rate for the Irish economy that reflects, on a trade-weighted basis, movements in the exchange rates vis-à-vis 56 trading partners. The real HCI (deflated by consumer prices) takes into account relative price changes along with exchange rate movements.

¹⁹ European Commission, Surveillance of Intra-Euro-Area Competitiveness and Imbalances, 2010.

²⁰ European Commission, Surveillance of Intra-Euro-Area Competitiveness and Imbalances, 2010.

²¹ ECB, IMF 2009 Article IV Ireland Consultation and European Commission Quarterly Report on the Euro Area Volume 8, No.1 (2009)

to our key trading partners and to support a rapid improvement in employment and investment levels.

2.1 What drives costs and why can costs overshoot?²²

As a result of the long economic boom and credit fuelled bubble, costs have overshoot. Despite overshooting and the current recession, a range of barriers mean that prices are slow to adjust downwards. During a long economic boom, it can be expected that prices and costs will increase. Wealthy countries are generally expensive countries. The high rate of domestic price inflation in Ireland in recent years partly relates to convergence in average Irish and European price levels due to faster economic growth in Ireland. Higher inflation due to this 'convergence effect' is not, in itself, a major concern, reflecting a natural rise in the cost of domestic services justified by higher incomes and living standards²³.

Factors contributing to the rise in costs that are of greater concern from a competitiveness perspective are:

- Economic overheating caused by pro-cyclical fiscal policy (fast growth in public spending and tax cuts) while euro area interest rates were low;
- Rapid credit growth and the unsustainable boom in the construction industry;
- The circular impact of rapid house price inflation on wage growth; and
- Regulatory and private restrictions to competition as outlined in various Competition Authority reports.

Despite recent falls in the costs of doing business, there are concerns that prices and costs have overshoot and that readjustment is, in some cases, occurring too slowly. Prices can overshoot for three reasons which influence how fast they readjust to current economic realities:

- An unexpected boom creates shortages which drive prices upwards (e.g. raw materials such as oil that are in high demand, and wage rates of workers possessing scarce specialist skills). During a recession, it can be expected that these prices should self-correct as demand falls;
- The exercise of monopolistic power. Prices negotiations are set based on over optimistic expectations (e.g. public sector/semi-state sector wages, minimum wage, professional fees, and rates of return for utilities), which are then difficult to renegotiate; and
- Exchange rate developments that we have no control over.

²² This section is largely based on research conducted by Philip Lane, Trinity College Dublin for the National Competitiveness Council in 2004.

²³ In an economy catching up with its richer neighbours, labour productivity tends to rise faster in sectors producing internationally tradable goods (particularly in capital intensive manufacturing industry) than in those involved in the more labour intensive and generally non-traded service sector. Increases in labour productivity growth in traded manufacturing industries are usually followed by wage growth throughout the economy (both manufacturing and services compete for employees in the same labour market). Thus, a combination of wage growth across both traded and non-traded sectors, but lower labour productivity gains in the services sector, leads to more rapid increases in the cost of services. In this way, services inflation is often higher in those regions of a monetary union enjoying the most rapid growth in productivity and incomes. This is known as the 'Balassa-Samuelson effect'.

2.2 High costs damage enterprise development and growth?

A large increase in exports alone will not provide a panacea for the challenges facing the Irish economy or bring about an automatic reversal in our unemployment trends. However, improving Ireland's attractiveness as a location to do business and export from will be important for restoring the levels of confidence necessary to halt the decline in domestic consumption and investment seen since 2008²⁴. A high cost environment impacts on enterprise development across a range of areas:

- **FDI Enterprise Base:** A wide range of factors, including cost competitiveness contribute to our attractiveness in winning and retaining overseas investment. The intensification of competition from low cost locations for new FDI investment has coincided with, and exposed, the sharp rise in Ireland's cost base in recent years. Despite relatively strong productivity growth in these sectors and the containment of unit labour costs, the profile of FDI projects that Ireland has traditionally won has changed (e.g. the labour intensity of investment projects). For the existing FDI base, as some product markets are becoming increasingly commoditised (e.g. electronics in the past decade, pharmaceuticals as products are coming off patent), it is becoming more challenging to sustain value added (i.e. productivity) and cost competitiveness. However, given recent labour and property price development, Ireland is starting to win both manufacturing and services projects where Ireland would have been previously deemed uncompetitive by foreign investors. That fact that Ireland has priced itself back in the market for previously unattainable FDI projects is only in part a result of reductions in wage costs. Perhaps of more relevance to prospective employers is the confidence that they will not be facing significant earnings growth over the medium term. This more positive outline relating to future labour costs, allied to falling property costs, the large available population of young skilled workers, reductions in employee churn and the spill over effects resulting from the international economic recovery makes investment in Ireland a more attractive proposition.
- **Indigenous Enterprise Base:** The performance of our indigenous exports remains closely tied to the UK where labour costs are generally lower. For example, this is evidenced by a very strong trading relationship with Ireland exporting 44 percent of its estimated €7.12 billion²⁵ food and drink exports to the UK and importing €2.3 billion or 52 percent of its total food and live animal imports from the UK²⁶. Ireland's higher cost base and the appreciation of the euro against sterling in 2009 placed the food and drink sector under extreme pressure both at home, in the UK and in third markets where Irish produce competes with UK produce. The euro has since depreciated somewhat against sterling in 2010.
- **Sub-Supply Base to Exporters:** While internationally trading sectors account for a significant share of national value added, they represent a much smaller share of national employment. The more employment intensive locally trading sectors have generally faced a significant rise in unit labour costs - pay costs adjusted for improvements in productivity (see Chapter 3). Increases in the broader cost environment damage the costs competitiveness of exporting firms as they source essential goods and services. They also reduce the multiplier benefits of export driven growth if international trading firms are driven to source a higher proportion of

²⁴ Forfás, Making it Happen - Growing Enterprise for Ireland, October 2010

²⁵ Bord Bia, Performance and Prospects: Food and Horticulture Export 2009/2010

²⁶ CSO 2009 - compiled from preliminary monthly figures from External Trade publication. Includes live animals and excludes beverages and is therefore not a direct comparison with export figure in previous footnote.

their raw materials and services overseas because of high domestic costs²⁷. From 2000-2008, the share of raw material and services purchases by foreign owned manufacturing and international services firms in Ireland has fallen from 36 percent of purchases to 20 percent²⁸.

- At a firm level, high costs encourage companies to minimise the use of expensive resources such as labour. This can make marginal business opportunities unviable which results in lost output and employment. In cases where high prices are a genuine reflection of market demand and supply (e.g. scarcity), prices serve an important role in ensuring the best use of scarce resources. However, if prices remain high (despite the potential availability of resources - labour, property, etc), enterprise development and broader economic development (tackling unemployment, building vacancy rates, etc.) is impeded. If firms seek to reduce numbers employed and and/or hours worked as a means of managing high labour costs, the loss of human capital may impede their ability to compete for additional business when demand improves. From a broader economic development perspective, failure to improve the efficiency of the labour market now will have an adverse effect further down the road - for instance, labour market inflexibility could inhibit employment growth as the global economy recovers. Similarly, unless steps are taken now to address those factors preventing the labour market from operating in an optimum manner, a resumption of economic growth could quickly see labour costs escalate rapidly once again, negating recent cyclical competitiveness gains and cutting off the recovery.

²⁷ This could arise due to Ireland being too expensive or firm levels factors such as the centralisation of procurement and a lack of strong linkages to the local market and/or structural change towards sectors with a lower need for domestic inputs.

²⁸ Forfás, Annual Business Survey of Economic Impact (ABSEI), 2008

3. Review of labour market costs

Summary & Key Conclusions

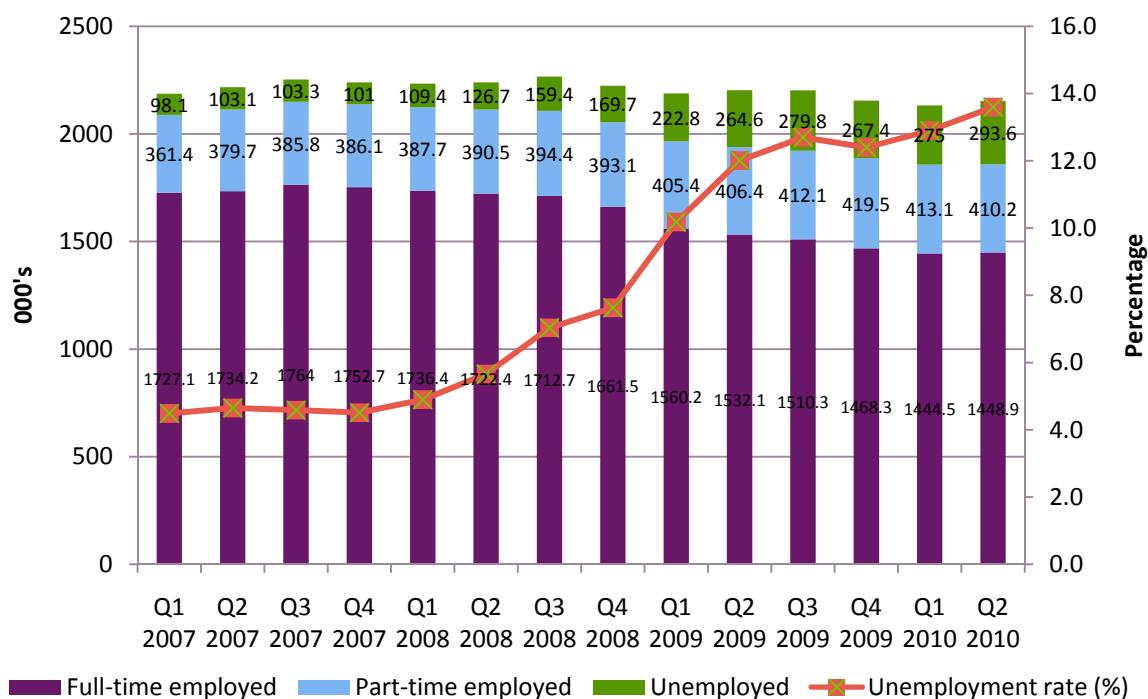
- Employment in Q2 2010 stood at 1,859,100, a decline of 79,400 on the previous year and a decline 253,700 compared to two years ago
- Unemployment has increased from 264,600 in Q2 2009 to 293,300 (13.6 percent) in Q2 2010
- Ireland had the tenth highest total labour cost level in the OECD-28 in 2009. When labour taxes are removed, OECD data indicates that Ireland has the fifth highest net wage level in the OECD-28
- When assessing compensation across the economy on an hourly basis, the Central Bank found that per hour economy wide compensation levels were 12.8 percent higher in Ireland than the euro area average in 2008
- Compensation levels in the more sheltered sectors of the Irish economy are significantly higher than those in our main trading partners
- For internationally trading manufacturing and services sectors, Irish salary levels in internationally trading businesses are broadly in line with the euro area average across the benchmarked occupations but are generally higher than those in the US and UK
- Ireland's ULC Real Effective Exchange Rate indicator appreciated between 2003 and 2008 by some 18 percent as wage growth remained high while productivity gains declined. European Commission research estimates a 5.9 percent improvement in 2009 versus the rest of the euro area and forecasts a further 3.6 percent improvement in 2010
- There is evidence of small decreases in both hourly and weekly rates of pay across most sectors up to Q1 2010. The observed decreases in hourly rates, however, are relatively modest
- Many firms have continued to adjust numbers employed and/or contracted hours worked, more consistently and to a greater extent, than adjusting pay rates

3.1 Overview of Labour Market

This section provides an overview of recent trends relating to employment and unemployment within the labour market and assesses the outlook for employment growth.

As illustrated in Figure 3, total employment in the Irish economy now stands at 1,859,100 (Q2 2010), a decline of 79,400 on the previous year and a decline 253,700 compared to two years ago. Unemployment has increased from 264,600 in Q2 2009 to 293,300 (13.6 percent) in Q2 2010. The Central Bank and ESRI estimate that the unemployment rate will be approximately 13.5 percent and 13.25 percent respectively in 2010, less than previously forecasted. This is partly due to a larger than expected reduction in the size of the labour force in the coming year.

Figure 3: Labour Market Trends, Q1 2007 - Q2 2010



Source: CSO, QNHS

While levels of employment overall have been declining in the past year, part-time employment is increasing. Part-time employment is growing as more people are placed on reduced working hours or have moved to shorter working weeks. People who have lost full-time employment are also moving into jobs of a more temporary nature in high turnover sectors (e.g. catering, care, sales, temporary clerical work, and security). This is reflected in the Live Register for September 2010, which shows that 76,879 people on the Live Register are casual/part-time employed, and in sectoral trends which show minor increases of males in employment over the past year in sectors such as human health and social work and financial, insurance and real estate activities.

Males have been affected much more than females in relation to employment declines. While some of this is to be expected due to higher participation rates, most is related to declines in sectors such as construction and agriculture, forestry and fishing, all of which are male dominated sectors. Another notable pattern is that the numbers of males in the labour force decreased in Q2 2010 by 78,200 compared to two years previously, while the number of females decreased by 8,700 over the same period.

Labour force participation has declined from 64.6 percent in Q3 2007 to 61.3 percent in Q2 2010. This is primarily driven by a decrease in participation rates by 15-24 year olds. This is a positive indicator as it most likely means that this cohort is reacting to current labour market conditions by staying in education longer. This trend is supported by HEA statistics which show record numbers of students currently enrolled in undergraduate education (new entrants plus those staying longer in education).

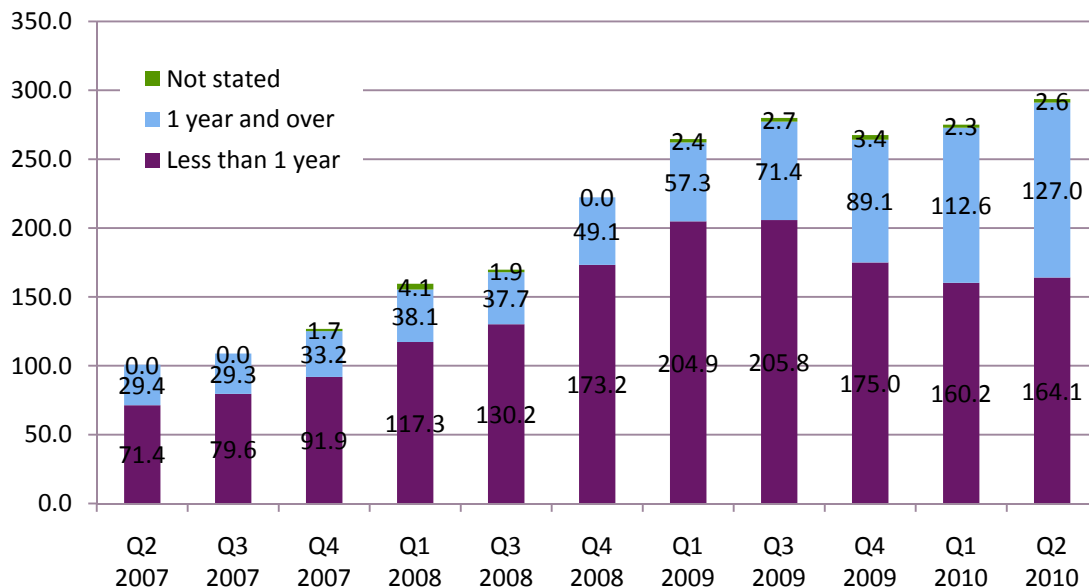
From a sectoral perspective, the sectors most affected in terms of declining employment from Q2 2009 to Q2 2010 are construction (-30,100, -19.4 percent), agriculture, forestry and fishing (-12,300, 12.7 percent), industry (including manufacturing) (-18,200, -7.0 percent) and wholesale

and retail trade (-8,600, -3.1 percent). Together, these sectors account approximately 87 percent of total employment declines. It is of particular concern that much of the employment declines in construction, industry (primarily traditional manufacturing) and some of retail (related to construction such as furniture and household goods) are likely to be permanent losses, which means structural unemployment is a pervasive feature of those that are unemployed. This trend is also reflected on an occupational basis which shows most employment declines in the groups of 'craft and related' (-27,300) and plant and machine operatives (-5,900) and 'other' occupations (-23,200, which includes labourers). This implies that many people will have to re-skill to other sectors/occupations to secure employment - otherwise they will remain locked out of the labour market.

3.1.1 Unemployment Trends

Given the scale of the challenge, it is worthwhile to examine in greater detail the trends specifically relating to unemployment. A primary concern must be that long term unemployment (more than 1 year) is increasing. Given that the majority of unemployment is due to employment declines in the past five quarters, long term unemployment will increase substantially in the short term (Figure 4).

Figure 4: Duration of Unemployment, Q2 2007-Q2 2010



Source: CSO

Those most vulnerable to long term unemployment have been profiled by the ESRI and are those with a recent history of long term unemployment, previous participation on the Community Employment (CE) scheme, advanced age, relatively high number of children, relatively low education²⁹, literacy/ numeracy problems, located in urban areas, lack of personal transport, and low rates of recent labour market engagement. Appropriate labour market interventions (for

²⁹ The unemployment rate for those with third level honours degrees and above was 6.7 percent in Q2 2010 compared to 13.6 percent on average. For those with below third level educational attainment, unemployment rates exceeded the national average.

example, up-skilling, literacy/numeracy interventions, job search supports, traineeships, work placements, specific skills training) are essential to ensuring that the long term unemployed remain an active part of the labour market.

Further analysis shows that the unemployment profile is more nuanced than single characteristics such as age, gender, or qualifications. Analysis previously published by Forfás clearly highlighted that those with highest unemployment rates are: older low-skilled workers, younger age cohorts, (under 25s, particularly those with low educational attainment³⁰) and those in 25-34 year old age cohort with PLC/upper secondary educational attainment or below³¹. Activation measures must be targeted at the most vulnerable cohorts and must align with current and future skills needs of enterprise.

3.1.2 Employment Outlook

At present, there are few areas of skills shortages. Any shortages are now confined to areas for persons with third-level qualifications and specific expertise and work experience. Thus, there is not a shortage of recent graduates, but rather persons with suitable experience. This complements the QNHS statistics which show a correlation between qualifications, age and likelihood of unemployment. Continued shortages, where identified, are confined to a small number of posts in specific sectors such as IT, sales, health, finance, engineering and management (production, marketing, finance) and generally relate to positions requiring experience. The Expert Group on Future Skills Needs identified the following current skills shortages in its most recent National Skills Bulletin³²:

- Specialists within an occupation (e.g. electrical engineers with an expertise in high voltage grids);
- Senior positions (e.g. IT project managers);
- Niche areas (e.g. telesales with fluency in foreign languages); and
- A specific skill mix (e.g. ICT professionals with business development skills).

The ESRI's recently published document, *Recovery Scenarios for Ireland: an Update*, suggests that by 2015, Ireland could have almost 2 million (1,994,000) people in employment, an increase from the 1.86 million working today. Job creation can be expected through a combination of ongoing replacement demand as older workers retire and exit the labour force and increasing demand for labour as the economy recovers.

Every year, across all occupations, a number of posts are vacated due to retirements, emigration, career change or other exits. While not all vacated posts will translate into employment opportunities, even during a recession, natural attrition creates some job opportunities for new entrants into employment. FÁS has estimated that up to 45,000 posts could be vacated annually, many of which will need to be filled by either unemployed people taking up employment or by new entrants to the labour market. Certain positions (such as those related to retail or clerical occupations) tend to have higher employment churn and so have higher levels of replacement demand. Conversely, many higher skills positions tend to have low replacement rates.

ESRI/FÁS forecasts indicate that by 2015:

³⁰ The under-25s represent 68,100 (23.2%) of total unemployment, even though this cohort only represents 11 percent of the total labour force.

³¹ Forfás, Profile of Employment and Unemployment, February 2010

³² Expert Group on Future Skills Needs, National Skills Bulletin, Forfás, July 2010

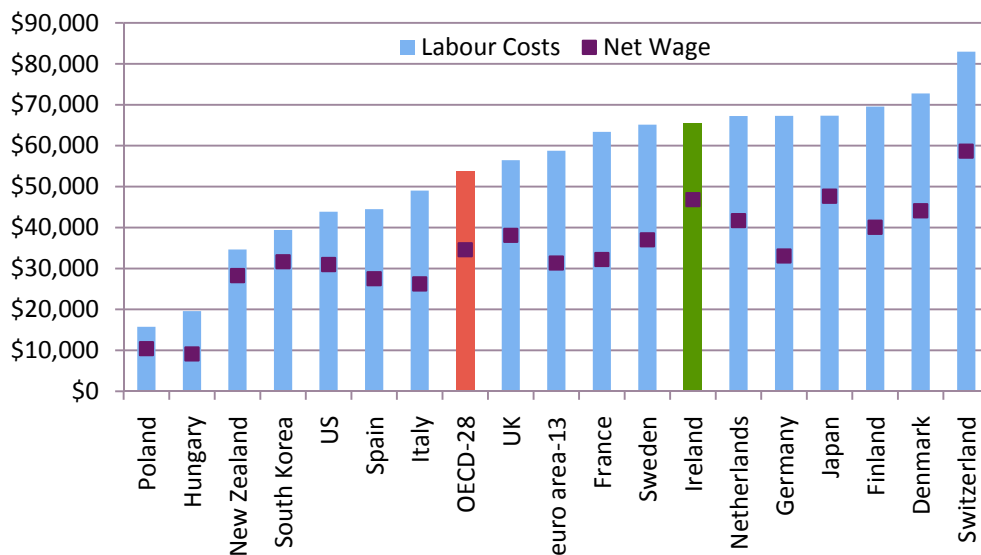
- Employment in a range of services activities, including communications, business, finance, insurance and other market services is forecast to surpass pre-recession levels, as is employment in high technology manufacturing and transport;
- More mature sectors including tourism and hospitality, agri-food, retail and distribution and construction are likely to resume growth but are unlikely to be fully restored to pre-recession levels;
- Employment in health, education and public administration and defence provides a significant contribution to employment and is likely to remain relatively unchanged, particularly as it relates to public sector provision;
- Sectors which are likely to continue to decline in employment terms include agriculture and low value added manufacturing.

3.2 Labour cost comparison with key trading partners

This section examines labour costs across countries, trends in labour costs and unit wage costs to determine whether Irish pay rates are out of line with pay rates in our key competitors³³.

Ireland had the tenth highest total labour cost level in the OECD-28 in 2009³⁴ (Figure 5). When labour taxes are removed, OECD data indicates that Ireland has the fifth highest net wage level in the OECD-28, 39.5 percent above the OECD-28 average (excludes Turkey and Mexico).

Figure 5: Average Total Labour Costs and Net Wages, Selected OECD Countries, 2009



Source: Benchmarking Ireland’s Performance, 2010 based on data from OECD, Taxing Wages, 2009.

³³ For a more detail examination of these issues, see the Costs of Doing Business in Ireland, 2010. It should be noted that comparing labour costs across countries is challenging due to a variety of methodological, definitional and data collection challenges.

³⁴ Total labour costs include wages, taxes on income and employer and employee social security contributions.

When assessing compensation across the economy on an hourly basis, the Central Bank found that per hour economy wide compensation levels were 12.8 percent higher in Ireland than the euro area average in 2008³⁵. Looking specifically at the industrial sector, however, labour costs on a per hourly basis were 13.4 percent below the euro area average in 2007. This indicates that compensation levels in the more sheltered sectors of the Irish economy are likely to be significantly higher than those in our main trading partners.

For internationally trading manufacturing and services sectors, Forfás analysis undertaken for the NCC has compared salary levels across a range of sectoral occupations in Ireland with those in a number of international locations and the euro area average³⁶. The analysis finds that Irish salary levels in internationally trading businesses are broadly in line with the euro area average across the benchmarked occupations. However, Irish salaries are higher than those in the US (a key source of FDI) for comparable positions and for most comparable positions in the UK (a key competitor for trade and investment). While Irish salary levels remain significantly below those in the most expensive countries (such as Denmark, Germany and Japan), they are generally a multiple of those available in Eastern Europe (Poland and Hungary) and India - countries that we are increasingly competing with for trade and investment.

Turning to labour cost growth rates, between 2000 and 2006, the average annual increase in total compensation per employee was significantly higher in Ireland (6.2 percent) than the euro area (2.3 percent). However, the rate of increase in average compensation began to slow in Ireland in 2007. In 2009, average employee compensation continued to grow in the euro area (1.4 percent) while it fell in Ireland (-2.2 percent)³⁷.

3.2.1 Unit Labour Costs (ULC)

Figure two highlighted that after many years of weakening price competitiveness's, Ireland has regained some of it lost price competitiveness since January 2008. A European Commission ULC-based real effective exchange rate (REER) indicator highlights similar trends to the CPI based trends in Figure 2. While the ULC REER indicator was relatively stable between 1997 and 2003, it appreciated thereafter until 2008 by some 18 percent as wage growth remained high while productivity gains declined to rates more comparable with those in the euro area. European Commission research estimates a 5.9 percent improvement from 2008 to 2009 versus the rest of the euro area and forecasts an additional 3.6 percent improvement in 2010³⁸.

Comparing euro area economies, Ireland stands out as the only country to record falls in nominal unit labour cost (-2.7 percent from 2008 to 2009). This was driven by both falls in compensation per employee and growth in labour productivity. However, it is not clear to the degree to which

³⁵ The Central Bank highlight a number of caveats to be aware of when using compensation levels to review international labour cost comparisons (compensation levels are not adjusted for differences across countries in age, educational attainment and sectoral composition) and advised that such comparisons should be viewed as crude and treated with caution. Derry O'Brien, Central Bank, "Measuring Ireland's Price and Labour Cost Competitiveness", Quarterly Economic Commentary, January 2010

³⁶ The data for this section is compiled using the Global 50 Remuneration Survey report, published by Towers Watson Wyatt. The salary data represents 12 months' gross salary plus any guaranteed bonuses such as legal holiday pay, extra contractual months, etc. The salary data does not include other non-wage costs such as employers' social welfare contributions.

³⁷ Forfás, Costs of Doing Business in Ireland 2010 Volume 1, 2010

³⁸ European Commission, Surveillance of Intra-Euro-Area Competitiveness and Imbalances, 2010 - See table 3A http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-1_en.pdf

these improvements are sustainable – productivity fell in most euro area countries as employment levels fell by less than the decline in GDP. While full sectoral data is not yet available for 2009, the available evidence suggests that industry (excluding construction) achieved a 9.6 percent quarterly fall in unit labour cost in the third quarter of 2009³⁹.

3.3 Labour market payroll response

Accepting that wage levels in Ireland must adjust downwards to restore competitiveness, this section examines recent earnings trends. Over recent months, there has been anecdotal evidence of significant downward adjustment in earnings and rates of pay. However, the observed decreases in hourly rates and weekly rates, based on CSO data are relatively modest⁴⁰.

At the aggregate level, hourly earnings excluding irregular bonuses have fallen by 1.3 percent in the year to Q2 2010. The corresponding figure including irregular earnings was an annual decrease of 1.0 percent. In weekly terms, average weekly earnings fell by 1.6 percent over the year to Q2 2010. Since Q1, the reductions in public sector wages announced in the 2010 budget have been captured for the first time. The main data is summarised in Table 1 below.

Table 1: Summary of Earnings Data

	Hourly (Excluding Irregular)	Hourly (Including Irregular)	Weekly (Including Irregular)
Annual Change to Q1 2010	-1.3%	1.0%	-1.6%
Quarterly Change to Q1 2010	-0.6%	-1.4%	-1.0%

Source: CSO Earnings, Hours & Employment Costs Survey (EHECS)

As well as weekly and hourly measurements, it is possible to examine earnings data according to economic sector, occupational grouping, and firm size, as well as differentiating between public and private sector earnings. The main hourly and weekly trends are summarised below.

3.3.1 Hourly Earnings Trends

- Earnings by Sector: Most economic sectors saw quarterly and annual decreases in hourly earnings. On an annual basis, hourly earnings including irregular benefits decreased in 9 of the 13 sectors measured. The largest annual falls were recorded in health (-6.1%), public administration (-6.1%), education (-5.1%) and transportation (-4.1%). On the other hand, hourly increases were recorded in four sectors, most notably in financial, insurance and real estate activities (+3.3%), and professional, scientific and technical activities (+2.0%).
- Earnings by Occupational Group: Occupational data is only available up until Q1 2010. All occupational groups experienced a decrease in quarterly and annual earnings, excluding

³⁹ European Commission, Labour Market and Wage Developments in 2009, European Economy 5, 2010

⁴⁰ CSO, Earnings and Labour Costs Survey, Q1 2010. EHECS has replaced the four-yearly Labour Cost Survey. From 2008 Q1 onwards all enterprises with 50 or more employees and a sample of the 3 to 49 employees are surveyed to compile EHECS data

irregular payments. The largest annual reductions in hourly earnings were recorded for clerical, sales and service workers (-2.5%) and for production, transport, craft and manual workers (-2.3%).

- **Public & Private Sector Earnings:** For the first time, the Q1 2010 data captured the impact of the public sector pay cuts announced in December 2009. As a result, public sector, hourly earnings excluding irregular payments fell significantly and this trend continued into Q2 2010 with an annual fall of 4.2 percent being recorded. In the private sector, hourly earnings increased by just 0.1 percent on an annual basis.
- **Earnings by Company Size:** In enterprises with less than 50 employees, hourly earnings increased by 0.5 percent on an annual basis. Earnings were reduced by 0.9 percent in companies employing 50-250 employees and by 1.3 percent in large companies with more than 250 employees.

3.3.2 Weekly Earnings Trends

- **Earnings by Sector:** average weekly earnings fell in 10 of the 13 sectors with the largest annual decreases in the education (-8.3 percent) and transportation and storage (-7.3 percent) sectors. Increases were recorded in financial, insurance and real estate activities (+3.8%) and industry (+2.3%).
- **Earnings by Occupational Group:** Again relying on Q1 occupational data, weekly earnings of clerical, sales and service employees fell by 5.9 percent in the year to Q1 2010. Relatively lower decreases were recorded for the managers, professionals and associated professionals and production, transport, craft and other manual workers occupational groups (-3.9 percent and -3.5 percent respectively).
- **Public & Private Sector Earnings:** Comparing developments in the public and private sector, it is clear that the public sector wage cuts announced in December 2009 have had a significant impact. Weekly earnings fell by 4.4 percent in the public sector compared with a fall of 0.7 percent in the private sector. This reverses recent trends where private sector reductions generally outstripped public sector reductions. Compared with weekly wage levels in Q1 2008, private sector earnings have fallen by 4.5 percent whereas public sector wages are virtually unchanged over this extended period⁴¹. While these salary levels reflect the impact of recent public sector pay cuts, they do not capture the impact of the public sector pension levy.
- **Earnings by Company Size:** Enterprises with less than 50 employees recorded a fall in weekly earnings of 1.4 percent, while enterprises with more than 250 employees recorded a fall in weekly earnings of 1.2 percent. A lesser decrease of 0.8 percent was recorded for enterprises with between 50 and 250 employees.

From an employer perspective, it is important to realise that labour costs can be adjusted not just through the hourly or weekly rate of pay, but also through the number of hours worked and the number of employees on the payroll, both of which are analysed below.

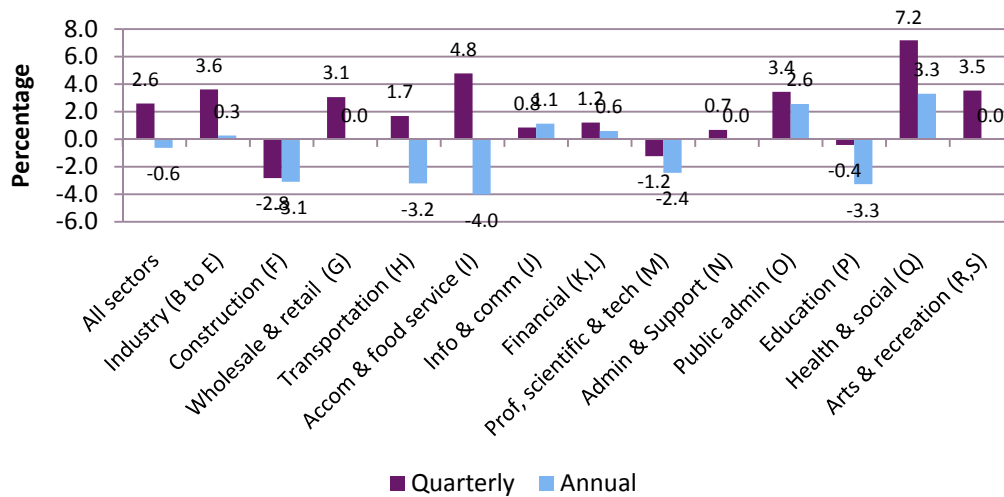
⁴¹ Private sector wages appear to have adjusted downwards earlier than public sector wages before rebounding in Q4 in both 2008 and 2009. The public sector adjustment, however, while delayed was significant in terms of the scale of the reduction.

3.3.3 Hours Worked and Numbers Employed

CSO data shows a slight annual fall in paid hours worked. Average weekly paid hours fell to 31.7 in Q2 2010, a fall of 0.2 hours or 0.6 percent over the year (Figure 6). For the first time, there appears to be some positive news in relation to hours worked, with many sectors showing an increase on a quarterly basis in Q2 - in Q1, by comparison, all sectors experienced reductions in hours on both a quarterly and annual basis. It is important to note, however, that it is too early to determine whether this is a permanent or temporary development.

In the private sector, average weekly paid hours fell by 0.6 percent over the year from 32.0 hours to 31.8 hours, while a decrease of 0.3 percent was recorded in average weekly paid hours in the public sector.

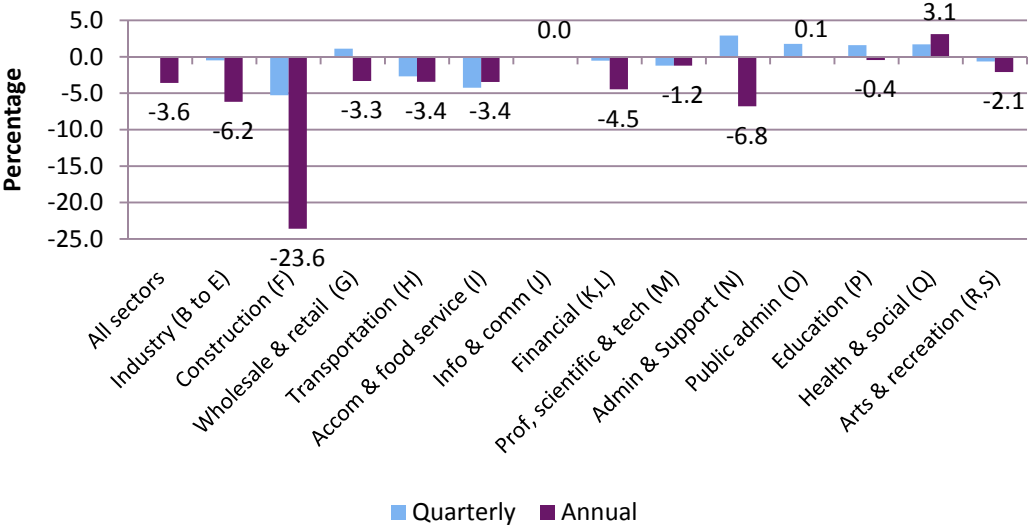
Figure 6: Change in Average Weekly Paid Hours (%), by Economic Sector, Q2 2010



Source: CSO, Earnings, Hours & Employment Costs Survey (EHECS)

In terms of employment trends, on both a quarterly and annual basis, numbers employed have fallen across economic sectors and occupational groups, with only a few minor exceptions (Figure 7). Notably, employment in Construction experienced an annual fall of more than 23 percent. As noted previously, however, even in situations where employment in a particular sector is falling, there will still be demand for new labour because of replacement demand.

Figure 7: Change in Numbers Employment by Sector, Q2 2010



Source: CSO, Earnings, Hours & Employment Costs Survey (EHECS)

3.3.4 Other Labour Costs

Other labour costs (e.g. statutory employers’ PRSI, redundancy payments etc.) decreased from €3.65 per hour to €3.03 per hour in the year to Q1 2010 (-17%). Reductions in other labour costs were recorded in all 13 economic sectors. When other labour costs are added to earnings overall average labour costs decreased by 3.3 percent from €25.66 per hour in Q2 2009 to €24.82 per hour in Q2 2010.

3.3.5 Conclusions on Wage Movements

There is evidence of small decreases in both hourly and weekly rates of pay across most sectors up to Q2 2010. The observed decreases in hourly rates, however, are relatively modest. Instead, many firms have continued to reduce numbers employed and/or contracted hours worked, more consistently and to a greater extent, than adjusting pay rates. This is reflected by the annual reductions in hours worked and numbers employed (summarised in Table 2).

Table 2: Summary of Employment Numbers & Hours Worked

	Numbers Employed	Hours Worked
Annual Change to Q2 2010	-3.6%	-0.6%
Quarterly Change to Q2 2010	-0.1%	2.6%

Source: CSO Earnings, Hours & Employment Costs Survey (EHECS)

Finally, it is necessary to note that the changing composition of the labour market impacts on wage data - at the moment, relatively more low-paid workers are losing their jobs than high paid workers. This would serve to force average wage levels up.

Using Q3 2009 data⁴², the CSO have estimated the standardised average weekly paid hours and standardised average hourly earnings. In essence these estimates represent the average weekly paid hours and average hourly earnings which would have resulted had employment composition within the enterprise not changed over the period, in this case a year. Allowing for all of the difficulties inherent in attempting such an exercise, the CSO concluded that given data limitations, it was not possible to fully deal with the effect of a compositional change on earnings with the available data. As far as corrections can be made, they concluded that the compositional effect is relatively low, but varies in magnitude depending on the sector in question.

⁴² As the most recent supplementary report examining the compositional effect and its effect on earnings data was published approximately 10 months following the period Q3 2009, a similar report for Q1 2010 would not be expected to be published until late 2010 or early 2011.

4. Review of the drivers of labour costs

Summary & Key Conclusions

- The State has a relatively limited role in directly setting wage levels - except for those workers who are employed by the State and those who receive the legal minimum wage. The State can influence labour costs and trends through policies on wage bargaining, labour market regulation, migration, social welfare, taxation and broad economic policy
- Buoyancy in the broad economy drove labour costs over the course of the Celtic Tiger period rather than national collective agreements
- There is a bi-directional relationship between public and private wages in Ireland - rather than public pay leading private pay or vice versa
- There is a close correlation between consumer prices and wage demands
- Ireland has the second highest monthly minimum wage (€1,462) rate in the EU. Relative to average industrial and services earnings, Ireland's NMW is the seventh highest within the EU
- The NMW stands at €8.65 per hour, with certain exemptions. In October 2007, 4.9 percent of employees in Ireland (83,700) were earning €8.65 per hour or less. Another 26 percent were earning within 1.5 times the NMW
- The NMW is most prevalent in the hotels and restaurants, other services, wholesale and retail and construction sectors
- Exporting sectors such as food and beverages, pharmaceuticals, medical devices, ICT, and financial services are not impacted directly by the NMW
- A majority of international studies surveyed give a relatively consistent (although not always statistically significant) indication of negative employment effects of minimum wages. Of the studies which find a negative relationship between minimum wages and employment, a 10 percent increase in the minimum wage typically reduces employment in the cohort studied by between zero to five percent
- The sectors and occupations where the greatest job losses have occurred generally coincide with the sectors where the minimum wage is most prevalent. Nevertheless, the inference cannot be drawn that these job losses are a direct result of the NMW rate being too high. In the short term, the lack of demand in many sectors may be of more significance
- While there is no official collection of data on Employment Regulation Orders (EROs) or Registered Employment Agreements (REAs), it is estimated that between 170,000 and 300,000 workers are covered by either ERO's and REA's
- ERO's and REA's set out minimum wage rates for specific categories of employees as well as defining other conditions of employment. In general, wage rates negotiated as part of an ERO offer a premium of approximately 9 percent above the NMW
- ERO's would limit the actual impact of any potential cut in the NMW
- The clauses determining working conditions may be imposing more serious costs on employers than the hourly rate
- Jobseekers' Benefit is designed to offer income maintenance during periods of frictional or cyclical unemployment, not to serve as an alternative long term source of income

- Replacement rates in excess of 70 percent act as a disincentive to search for a job - a number of cohorts have been identified as experiencing a disincentive to work as a result of excessively high replacement rates
- It is estimated that between 15 and 20 percent of those on the Live Register have replacement rates in excess of 70 percent
- Part time workers are already close to the labour market and are not the priority for activation policy and may be more amenable to a directive/control approach
- Relatively low numbers engage in systematic short time working (SSTW) and current arrangements (if implemented) appear sufficient to incentivise SSTW workers back into full time employment
- High replacement rates may discourage other part time workers from taking full time employment
- At the firm level, firms do not favour wage reductions to adjust labour costs, as they can be seen as counterproductive. Instead, they prefer layoffs. They remain reluctant to hire overqualified people or staff at lower rates

In Ireland, as in most countries, the State plays a relatively limited role in directly setting wage levels - except for those workers who are employed by the State (16.4 percent of the labour force in Q3 2009) and those who receive the legal minimum wage (4.9 percent in October 2007⁴³). Nonetheless, the State through policies on wage bargaining, labour market regulation, migration, social welfare, taxation and broad economic policy (e.g. inflation targets) influence labour costs and trends. This section elaborates briefly on some of the key factors that influence labour costs and their likely effect.

National Wage Agreements

4.1 Role of national policy in setting labour costs

Since in 1980s, the social partnership process has played a role in guiding wage levels across the economy. The Central Bank and Financial Services Authority of Ireland carried out a major survey of wage setting in almost 1,000 manufacturing, construction and services Irish firms in late 2007 and early 2008 and the results should be interpreted in the context of the stronger economic climate at that time⁴⁴. The survey contained questions on wage-setting practices and the role of wage-bargaining processes. As Towards 2016 was the National Wage Agreement in place at the time of the survey, they enquired specifically about the role and application of that agreement. They found that approximately one-third of firms followed this agreement in full, whilst a further one-third applied some elements agreed⁴⁵. They suggest that a significant part of the remaining third may have set a wage premium over and above the wage increases agreed collectively, given the tight labour market at that time. In addition, the Central Bank found that when firms were asked about the reasons for avoiding wage cuts, Irish firms were the least likely to rank collective

⁴³ CSO, National Employment Survey 2007, July 2009. This is the most up-to-date and comprehensive source.

⁴⁴ The average number of employees per firm in the sample was 23.

⁴⁵ Keeney, M., and Lawless, M., Wage Setting and Wage Flexibility in Ireland - Results from a Firm-level Survey, European Central Bank, Working Paper Series No 1181, April 2010

bargaining arrangements (and regulations) compared to the survey results for other countries while concerns about reductions in employee effort and losing talent were the most relevant reasons.

Views on the importance of the social partnership process in setting wage levels vary significantly. The available evidence suggests that buoyancy in the broad economy drove labour costs over the course of the Celtic tiger rather than national collective agreements and that the national agreement did not hinder decision on wage in late 2007/ early 2008. In light of the recession, no national wage agreement is in place for private sector workers in Ireland.

Public wage setting can have an important effect on a country's cost competitiveness through its effects on private wage setting. Strong growth in public and private sector employment over the past decade helped to bid up labour costs in Ireland. Since the beginning of EMU, Ireland has seen significantly faster public wage growth than private wage growth, and to a greater extent than all other euro area countries. Between 1999 and 2008, the ratio of public wages per employee to private wages per employee increased by 31 percent in Ireland⁴⁶. Public wage setting also affects the price level as the costs of a range of public and administered services continue to negatively affect Irish cost competitiveness. Given the personalised nature of many of these services, labour costs comprise a significant proportion of the cost base. Forfás research for the NCC highlights that pay levels for a range of public sector professions (teachers, nurses, hospital consultants) are high in Ireland relative to other developed countries⁴⁷. From a public policy perspective, the ECB suggests that 'public wage restraint could be a crucial factor in maintaining a country's competitiveness'⁴⁸.

4.2 Role of inflation in setting labour costs

It is generally accepted that there is a close correlation between consumer prices and wage demands. As noted previously, despite recent cost and price reductions, Ireland remains expensive in comparison with many of our competitors for a range of business inputs and consumer goods. Whilst no binding indexation rule has ever been introduced as part of the Irish sequence of national agreements, wage increases have generally tended to be strongly influenced by the prevailing rate of inflation. A Central Bank study on Irish wage dynamics found that while 71 percent of Irish firms do not have a policy of automatically adapting base wage rates to inflation, wage changes are much more likely to take account of the general cost of living changes without a formal or automatic rule⁴⁹. In an era of easy credit, falling taxes rates and a booming property market, increasing wages costs quickly fed into increasing consumer prices and so the process continued.

Relative to historical levels, the Irish consumer price index peaked in 2008 when prices were 28 percent above 2001 prices. Since then the index has fallen and prices in September 2010 were 6.2 percent below the peak level. By contrast, looking at CSO earnings data⁵⁰, average weekly wages have declined by approximately 2 percent between Q1 2008 and Q2 2010 - suggesting that real

⁴⁶ Holm-Hadulla, F., Kamath, K., Lamo, A., Pérez, J., & Schuknecht, L., Public Wages in the Euro Area - Towards Securing Stability and Competitiveness, European Central Bank, Occasional Paper Series No 112, June 2010

⁴⁷ National Competitiveness Council, Costs of Doing Business in Ireland 2010 Volume 1, July 2010

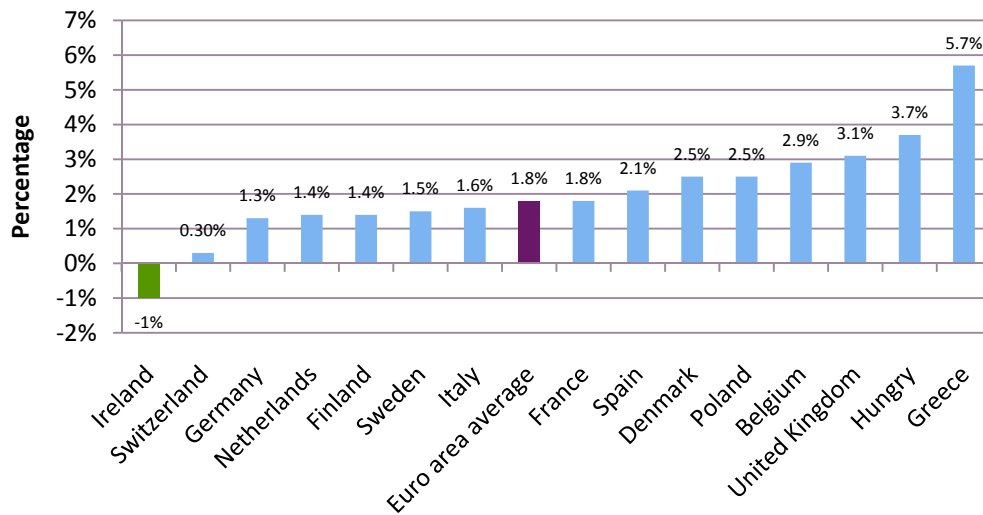
⁴⁸ Holm-Hadulla et al. (2010)

⁴⁹ Keeney, M., and Lawless, M., Wage Setting and Wage Flexibility in Ireland - Results from a Firm-level Survey, European Central Bank, Working Paper Series No 1181, April 2010

⁵⁰ CSO, Earnings and Labour Costs Survey, Online Database

wages have actually increased over the period in question⁵¹. Recent data from the CSO, however, suggests that deflationary trends are ending; the CPI was 0.5 percent higher in September 2010 when compared with September 2009. This mirrors ESRI inflation forecasts.

Figure 8: Harmonised Index of Consumer Prices, Annual % Change, September 2010



Source: Eurostat Harmonised Index of Consumer Prices (HICP) for all EU Member States

From a competitiveness perspective, it is important to place these trends in an international context. The first thing to note is that price levels for consumer goods and services differ widely across countries - even within the EU. In 2008 Irish price levels were the second highest in the EU-27 at 27 percent above the EU average⁵². This average hides significant sectoral variations - food and non-alcoholic beverages (+27 percent above the EU-27 average), alcoholic beverages and tobacco (+84 percent), clothing (-9 percent), consumer electronics (+11 percent), personal transport equipment (+25 percent) and restaurants and hotels (+37 percent).

Since this data was published, we know from Figure 8 and the supporting text that prices in Ireland have fallen as a result of the recession. It is the differential between Irish inflation and inflation in our key competitors that really matters for international competitiveness. Between September 2009 and September 2010, Ireland experienced a 1.0 percent decrease in the

⁵¹ This does not take account of the introduction of the income levy introduced in January 2009 which reduced take home pay.

⁵² In 2008, Denmark (141% of the EU-27 average) had the highest price level in the EU, followed by Ireland (127%) and Finland (125%). Price levels of 10% to 20% above the EU-27 average were found in Sweden (114%), Belgium and France (both 111%), while Italy (105%), Germany (104%) and the Netherlands (103%) were just above the average. The United Kingdom (99% of the EU-27 average), Spain (96%) and Greece (94%) were just below the average. Price levels between 20% and 30% below the average were observed in Estonia (77%), Latvia (75%), the Czech Republic (72%), Hungary and Slovakia (both 70%). The lowest price levels were found in Bulgaria (51%), Romania (62%), Lithuania (67%) and Poland (69%). Eurostat News Release "Price levels varied by one to three across the EU27 Member States" July 2009

harmonised index of consumer prices (HICP), the largest decrease in the European Union. During the same period the euro area HICP increased by 1.8 percent⁵³.

House prices also affect wage expectations. In 2007, the average nationwide price for a house peaked at nearly €300,000 or more than eight times average industrial earnings. The average national house price fell by 35 percent between Q1 2007 and the Q2 2010. As a result, housing affordability for those in employment has returned to levels last experienced in the year 2000 at approximately 6 times earnings. However, in 1995-1996, average house prices were approximately 3.5 times average industrial earnings⁵⁴.

As real wages (nominal wages adjusted for inflation) determine living standards, the challenge for Ireland is to engineer a situation where both wage competitiveness and consumer prices continue to improve in order to protect real living standards.

Labour Market Regulation

4.3 Role of the national minimum wage (NMW) in setting labour costs

The minimum wage is intended to deliver a socially preferable distribution of income than would occur through a free market solution. In general, therefore, the success or otherwise of minimum wage policy is usually measured against its impact on poverty levels. It is important to note that the imposition of a minimum wage has significant impacts on income as well as poverty, and impacts on both firm level and national competitiveness.

A National Minimum Wage (NMW) was first introduced in Ireland in 2000 through the National Minimum Wage Act, 2000. The current NMW stands at €8.65 per hour, with certain exemptions. These exemptions provide for lower rates of hourly pay for certain categories of workers (including trainees and inexperienced employees). According to Eurostat data, in 2010 Ireland has the second highest monthly minimum wage (€1,462) rate in the EU⁵⁵. Relative to average industrial and services earnings, the minimum wage in Ireland is the seventh highest within the EU. This data does not capture recent increases in the UK's minimum wage rates⁵⁶.

In determining the rate at which the minimum wage is set, the Minister for Enterprise, Trade and Innovation must be cognisant of a number of factors, namely:

- Economic factors, including the requirements of economic development, levels of productivity and the level of employment;
- The needs of workers and their families;

⁵³ Eurostat Harmonized Indices of Consumer Prices

⁵⁴ Source: Benchmarking Ireland's Performance, 2010, Figure 4.35

⁵⁵ For most countries, the minimum wage is agreed in terms of a monthly rate. For some countries (e.g. France, Ireland, United Kingdom,) the minimum wage is fixed at an hourly rate. For purposes of comparison, the hourly rates for these countries have been converted to a monthly rate, using the following factors (supplied directly by the Member States concerned): France: 35 hours x 52 weeks divided by 12; Ireland: 39 hours x 52 weeks divided by 12; United Kingdom: 37.9 hours x 52 weeks divided by 12.

<http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&plugin=0&language=en&pcode=tps00155>

⁵⁶ From October 2010, UK NMW rates increased by approximately 2 percent from £5.80 to £5.93 an hour for workers aged 21 and over; from £4.83 to £4.92 an hour for workers aged 18 to 20; and from £3.57 to £3.64 an hour for workers aged 16 to 17. While this does not change the overall rankings, it does narrow the gap between the Irish and UK NMW rates.

- The general level of wages within the country;
- The cost of living and changes therein;
- Social security benefits; and
- The relative standard of living of other socio-economic groups.

The CSO's National Employment Survey 2007⁵⁷ provides the most comprehensive overview of earnings in Ireland. According to this data, in October 2007, 4.9 percent of employees in Ireland (83,700) were earning €8.65 per hour or less (Table 3). Due to methodological difficulties, it is not possible to estimate precisely the number earning exactly the €8.65 rate.

Table 3: Earnings per Hour by Sector (%), 2007

NACE Sector	Less than €8.66	€8.66- <€10.00	€10.01- <€12.97	€12.98- €17.29	€17.30 or more
Manufacturing, Mining and Quarrying	2.7	6.9	20.2	27.5	42.7
Electricity, Gas and Water Supply	0.1	0.2	0.6	6.8	92.4
Construction	6.0	4.3	12.9	26.3	50.4
Wholesale and Retail	8.7	19.4	27.6	22.2	22.0
Hotels and Restaurants	11.1	31.8	26.0	15.5	15.5
Trans, Storage and Communications	4.8	5.8	13.4	22.6	53.3
Financial Intermediation	0.9	1.8	10.7	23.0	63.6
Business Services	3.9	12.6	20.9	22.9	39.7
Public Administration and Defence	2.2	1.3	4.7	17.0	74.8
Education	1.8	2.6	5.2	17.1	73.2
Health and Social Work	1.9	4.1	8.3	33.1	52.7
Other Services	10.6	14.7	21.9	23.3	29.5
Total	4.9	9.8	16.5	23.7	45.2

Source: CSO, National Employment Survey, 2007

The data tells us that the NMW is most prevalent (in terms of the number of employees earning €8.65 or less) in a number of specific sectors, notably:

- Wholesale and retail - 23,600 employees;
- Hotels and restaurants - 13,100 employees;
- Construction - 12,000 employees; and,

⁵⁷ The National Employment Survey (NES) is a major workplace survey conducted by the CSO. The survey captures earnings data by sector, occupation, educational attainment, age group, nationality as well as other factors that go to explain differences in rates of hourly earnings. The survey covers both the public and private sectors using the same methodology.

- Other services - 8,200 employees.

In addition to the information that the 2007 National Employment Survey provides about earnings by sector, it also demonstrates that those earning €8.65 per hour or less are more likely to be employed in sales, craft, personal service or other occupations; are most likely to be between the ages of 15 and 24 years; tend to be female; have relatively low levels of educational attainment (i.e. less than upper secondary); and are more likely to be nationals from the EU Accession States.

A range of employers note that while they do not employ staff on the minimum wages, it sets a baseline for wage negotiations. For the purpose of this work, we assume that wages up to 1.5 times the NMW (€12.97) are impacted by changes in the NMW rate. Forfás believe that the 31 percent of employees whose wage rates may be affected by a change in the NMW is an outer-bound⁵⁸. From a competitiveness perspective:

- On the basis of the proportion of employees earning less than 1.5 times the NMW and the proportion of their output which relates to labour costs, the wholesale and retail, hotels and restaurants, other services, and traditional manufacturing sectors are the most impacted by the existence of the NMW.
- On the basis of reliance on NMW sectors for intermediary goods and services, the hotels and restaurants, business services, and other services sectors are most impacted.
- Exporting sectors such as food and beverages, pharmaceuticals, medical devices, ICT, and financial services are not impacted directly by the national minimum wage given relatively high average salaries in these sectors. However, it affects the broader costs of doing businesses as exporter's source goods and services in the local economy.

Faced with a minimum wage, firms must control their payroll costs by either adjusting numbers employed or hours worked. In employment terms, determining the impact that the minimum wage has on employment levels is notoriously difficult. Economic theory suggests that the lower the price for labour, the greater the quantity that will be demanded.

There is a large body of theoretical and empirical studies examining the impact of minimum wages on employment levels. The international evidence indicates that there is a wide range of estimates and, accordingly, a lack of consensus about the overall effects on low-wage employment of the minimum wage. Neumark and Wascher (2007) reviewed evidence from 33 different studies on minimum wages from around the world. While a sizable majority of the studies surveyed give a relatively consistent (although not always statistically significant) indication of negative employment effects of minimum wages - particularly for the least-skilled groups, there were conflicting views⁵⁹. However, in their review of individual studies, Neumark and Wascher are not convinced by those studies which suggest evidence of positive employment effects of a minimum wage. It should be noted that the 33 studies primarily focused on the implications of an increase in the minimum wage or variations in minimum wages across states/countries rather than specifically the effects of cutting the minimum wage.

⁵⁸ As illustrated in Table 3, 14.7 percent of employees earn less than €10.00 per hour or within approximately 15 percent of the NMW.

⁵⁹ Neumark, D. and Wascher, W., Minimum Wages and Employment, Institute for the Study of Labor, Discussion Paper Series IZA DP No. 2570, January 2007

Based on Neumark and Wascher's research, it is difficult to provide a consensus estimate of the elasticity of labour demand as these studies vary in terms of methodology and, of course, the individual cases will differ across states (US), countries and over time. The scope of the studies also varies significantly from assessing the impact on the entire labour market to focusing on certain groups (e.g. age - teenagers and young adults, income - those on the minimum wage and those marginally above them, education level, and sectors - low wage sectors and specific sectors such as retail, construction, etc.) Of the studies which find a negative relationship between the minimum wage and employment, they typically find that a 10 percent increase in the minimum wage would reduce employment in the cohort studied by between zero to five percent.

Limited Irish data is available. However, it is interesting to note, that the sectors and occupations where the greatest job losses have occurred generally coincide with the sectors where the minimum wage is most prevalent. Nevertheless, the inference cannot be drawn that these job losses are a direct result of the NMW rate being too high. In the short term, the lack of demand in many sectors may be of more significance.

4.4 Collective Agreements and Labour Costs

It is estimated that anywhere between 170,000⁶⁰ and 300,000⁶¹ workers are covered by either Employment Regulation Orders or Registered Employment Agreements regarding their employment. These agreements deal with the pay and working conditions of the employees concerned and may be included in an employee's contract of employment.

- 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).

Employers of workers covered by EROs and REAs are obliged to pay the wage rates and provide the conditions of employment prescribed by the collective agreement. They must also display details of the current agreement in the workplace and keep records of wages. The full list of ERO's is contained in Appendix 5.

A 2005 review of the JLC system conducted by researchers in the University of Limerick on behalf of DETE concluded that in general, employers wanted JLC's abolished while employee bodies wanted them retained⁶². In the end, modernisation and reform was recommended (Appendix 6).

⁶⁰ According to William Fry, ERO's alone determine the pay and conditions of approximately 170,000 workers. See William Fry, Overview of Employment Regulation Orders and Registered Employment Agreements, 2010

⁶¹ SIPTU, Liberty - Special Supplement on the Proposals for Towards 2016 Transitional Agreement, New Series Vol 7.2, October 2008

⁶² O'Sullivan, M. & Wallace, J., Review of the Joint Labour Committee System, Kemmy School of Business, University of Limerick, 2005

4.4.1 Relationship with NMW

As well, as defining other conditions of employment (such as hours worked, Sunday working etc.), both EROs and REAs set out minimum wage rates on either an hourly or a weekly basis for specific categories of employees. In general, wage rates negotiated as part of an ERO or REA offer a premium over the minimum wage rate.

Forfás has examined the agreed wage rates for 139 occupations covered by the various EROs. This analysis reveals that 65.5 percent of occupations are earning between 100-110 percent of the rate to which they would be entitled under the provisions of the National Minimum Wage Act, 2000. Those occupations earning in excess of 110 percent (27.3% of occupations) are predominantly related to the legal profession (i.e. law clerks etc.) and/or require significant experience (i.e. managerial and supervisory roles). A very small number of occupations had wage rates below the legal minimum wage - these were confined to trainee-type positions.

Excluding the various categories of trainee, apprentices and other defined workers to whom different rates apply, the average hourly rate agreed under the EROs is €9.42, or 108.8 percent of the NMW. These facts combined would suggest that the NMW is used as a floor for ERO wage setting, and that the ERO process delivers a premium of approximately 9 percent over the NMW.

While a reduction in the NMW, might over time be expected to lead to a reduction in wage levels governed by ERO's the actual impact may be limited: although ERO's appear to use the minimum wage as a floor and deliver a premium to workers covered, most agreements only include upward review mechanisms (i.e. an increase in the NMW may trigger an upward review in hourly wage rates. Few agreements contain clauses dealing with reductions in the NMW). Any reduction in the NMW may not, therefore, lead to a reduction in hourly ERO rates. Similarly, many employees' wage rate may be built into employment contracts and so would not automatically adjust downwards upon a reduction in the NMW.

The REAs also provide for a wage rate in excess of the hourly minimum wage. The sectoral REAs, however, are predominantly related to the construction sector and guarantee hourly or weekly rates well in excess of the NMW (e.g. the REA for construction craftspeople has an agreed hourly rate of €18.60 while an electrician in their first year of work out of time earns €20.74 per hour). It would appear that wages in sectors covered by REA's are less directly influenced by the NMW than sectors covered by ERO's. Wage levels appear to be influenced more by national agreements and specific market conditions than by the NMW.

Despite 144,000 job losses in construction being recorded between Q2 2007 and Q2 2010, wage rates in the construction sector have remained quite sticky - recently, the Labour Court recommended that the basic rate for Craft Workers in the construction REA should be reduced by 7.5 percent.

Finally, it is important to note that ERO's and REA's cover more than rates of pay. In many cases, certain conditions of employment are also governed by these agreements. As well as pay related issues such as overtime and Sunday working rates, certain agreements also include clauses relating to travel expenses, annual leave, dispute resolution, and board and lodging. In many cases, these additional clauses may be imposing further rigidities on the labour market. In many cases, these clauses may no longer serve any necessary purpose as they have been superseded by economy-wide employment legislation.

4.5 Role of horizontal regulation in setting labour costs

While horizontal regulations (i.e. regulations imposed across the entire economy, rather than those targeted at specific sectors) on employment can provide important social protections for employees, they can increase the costs of employment and affect the workings of the labour market. World Bank research highlights that analysis across economies shows that while employment regulation generally increases the tenure and wages of incumbent workers, overly rigid regulations may have undesirable side effects⁶³. These include less job creation, smaller company size, less investment in research and development, longer spells of unemployment and thus the obsolescence of skills, all of which can reduce productivity growth.

Ireland ranks 27th globally in terms of the ease of employing workers and 8th in the OECD⁶⁴ which specifically measures the regulation of employment as it affects the hiring and redundancy of workers and the rigidity of working hours. Ireland's score, while significantly weaker than our aggregate score (7th in the world in terms of the ease of doing business), suggests that regulations around the hiring of workers, the number and nature of their working hours and the costs of redundancy impact have not significantly affected the performance of the labour market and wage rates. The Central Bank and Financial Services Authority of Ireland's survey of wage setting in 1,000 firms in late 2007 and early 2008, found that when they asked firms about reasons for avoiding wage cuts, Irish firms are the least likely to rank regulations (and collective bargaining arrangements) compared to the survey results for other countries⁶⁵.

Broader National Policies

4.6 Role of the social welfare system in setting labour costs

4.6.1 Incentives to work

The 'insider - outsider' theory of unemployment proposes that wage levels are determined by 'insiders' (those employed) as a result of the power they hold (the turnover costs involved in hiring external workers). This makes it costly for firms to replace incumbent employees with outsiders. These turnover costs include hiring and redundancy costs, the effects of excessive turnover on staff morale, and the ability of 'insiders' to exercise some discretion over the level of cooperation they extend to new employees in the process of training and working with them. According to this theory, wages are determined by the 'insider', and do not reflect the true availability of labour to the market⁶⁶. This results in higher wages being set than if the full labour market was considered.

⁶³ Based on indices that track the ease of starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business.

⁶⁴ <http://doingbusiness.org/economyrankings/?direction=Asc&sort=4>

⁶⁵ Keeney, M., and Lawless, M., Wage Setting and Wage Flexibility in Ireland - Results from a Firm-level Survey, European Central Bank, Working Paper Series No 1181, April 2010

⁶⁶ Report of the Expert Working Group on the Integration of the Tax and Social Welfare Systems, Dublin, Stationery Office, p.174, 1996

Another theory, the 'outsider ineffectiveness hypothesis' highlights how insiders are shielded from the competition of the external labour market. In this case, the external market is assumed to consist, at least in part, of the long term unemployed who have suffered a loss of skills due to the duration of unemployment. This loss of skills increases the difficulty for finding a job at an 'acceptable wage' leading to the opt-out of some workers from the labour force, while remaining unemployed. These 'discouraged workers' are unemployed workers who no longer actively seek employment. They are available to work, and have looked for employment sometime in the past year, but are no longer job hunting because they believe that there are no jobs available⁶⁷. The implications of this behaviour for employment and unemployment is that there is an absence of wage underbidding even when many unemployed workers are willing to work for wages lower than existing insider wages (normalized for productivity differences). Given the increase in long term unemployment to 127,000 in Q2 2010, this may potentially have a significant impact on competitiveness. Furthermore, the OECD examined the relationship between benefit entitlements and unemployment rates in 21 countries and found that replacement rates and the duration of benefits have an adverse impact on unemployment rates⁶⁸.

From an enterprise perspective, the smaller the unemployed cohort, the tighter the labour market, and this is consequently reflected in wage demands. In this regard, it is important to assess the impact of social welfare on the cost of labour as the social welfare rates impact upon an individual's incentive to work. The replacement rate measures the proportion of out-of-work benefits received when unemployed against take home pay if in work. The Department of Finance has noted that while there is no pre-determined level of replacement rate which would influence every individual's decision to work, a replacement rate in excess of 70 percent is considered excessive⁶⁹.

Currently the social welfare system in Ireland comprises a contributory element and a social solidarity element. This means that individuals build up an entitlement to certain out-of-work benefits through payment of PRSI, while also sharing the costs of social benefits by paying into a fund which covers individuals who have not built up full entitlement to benefits⁷⁰. At present, when an individual becomes unemployed, if they have sufficient PRSI contributions made, they are entitled to jobseekers benefit, which is paid for a maximum of 12 months. If a person does not qualify for jobseekers benefit or has used up their entitlement to jobseekers benefit, they may claim jobseekers allowance, which is means tested. The maximum rate of jobseekers allowance is paid at the same rate as jobseekers benefit. This maximum rate has been used in the calculation of replacement rates in this paper. A number of secondary benefits are also available depending on individual circumstances. These include:

- Fuel allowance (includes fuel allowance and smokeless fuel allowance);
- Medical card;
- Doctor only/GP visit card;
- Basic supplementary welfare allowance;
- Rental allowance;
- Mortgage interest supplement;
- Exceptional needs payment; and

⁶⁷ Dobbie, M., Hysteresis and Insider-Outsider Theory: A Literature Review, 2004

⁶⁸ OECD, Jobs Study, 1994

⁶⁹ Department of Finance, Replacement Rates and Unemployment, 2009

⁷⁰ Commission on Taxation, 2009

- Urgent needs payment.

Department of Social Protection data indicates that in 2009 there were 319,000 claims for fuel allowance - this figure refers to all claims for fuel allowance and not just those on the live register. The scheme operates for 32 weeks from September to the end of April and is €20 per week, which equates to approximately €12.30 per week if spread across 12 months. In some cases, an additional allowance is provided to cover the cost of smokeless fuel, which is paid at a rate of €3.90 per week for 32 weeks, equating to €2.40 per week over 12 months. Given the widespread use of this secondary benefit, the fuel allowance and smokeless fuel allowance have been used in calculating basic replacement rates by the Department of Social Protection in their Live Register analysis and in this paper. Another prominent secondary benefit is rent allowance. The replacement rate for a person in receipt of a rent allowance is unfortunately, too complex to calculate because this payment varies on a case by case basis, depending on household composition, location of property, and local authority administration of the payment. The replacement rates including rent allowance that have been calculated in this paper are based on the maximum thresholds for Dublin and family type less minimum contribution of €24. Therefore the examples including rent allowance are the maximum that would be possible when rent allowance is included.

In-work benefits are available to provide financial support to those on low pay. These include the Family Income Supplement (FIS). In some cases, families have an entitlement to both FIS and spousal Jobseekers Allowance (JA). Where this occurs, only one entitlement is granted to the family. However, this entitlement is selected on the basis of which one is more beneficial to the family once they have been calculated. The greater of these two benefits have been included where appropriate in this paper.

It is important to highlight the fact that replacement rates actually increase (that is the disincentive to work increases) the longer a person is unemployed in Ireland due to the entitlement to additional secondary benefits such as those mentioned above. It is worth highlighting at the outset that replacement rates have increased significantly since 2000. In addition, it is important to note that the replacement rates examined below do not factor in expenses incurred as a result of working such as transport costs and childcare costs. Replacement rates may increase also for those in employment when an increase in an employed person's gross income results in a reduction in net income. This may be caused by a loss of entitlements if gross income exceeds a certain threshold or if hours worked exceed a certain number (e.g. rent allowance is not payable if a worker is employed on a full time basis - 30 hours or more a week). This creates a disincentive to work for higher earnings or work increased hours. This may result in individuals seeking greater increases in wages to compensate for this net reduction.

Current Replacement Rates for One-Earner Household Including Fuel Allowance

Table 4 below sets out current replacement rates based on five different wage levels and five different family types⁷¹. For each family type, a replacement rate was calculated based on the maximum jobseekers benefit and basic fuel and smokeless fuel allowance. It is important to note that where a one earner couple is referred to, the replacement rate is the difference between having one spouse working and having no spouse working.

⁷¹ Some of these wage levels may be supplemented by in-work benefits.

Table 4: Current Replacement Rates one earner household including fuel allowance⁷²

	NMW	67% AIE	AIE	150% AIE	200% AIE
Single	63.73%	53.19%	39.89%	30.19%	24.61%
Couple, 1 earner, No children	69.51%	65.30%	60.27%	44.30%	36.73%
Couple, 1 earner, 1 child	73.05%	69.12%	62.62%	49.34%	41.36%
Couple, 1 earner, 2 children	75.86%	72.17%	66.00%	54.87%	46.30%
Couple, 1 earner, 4 children	78.70%	75.62%	69.85%	64.03%	55.97%

Source: Department of Social Protection, 2010

Based on these replacement rates and using the 70 percent replacement rate as a benchmark in terms of acting as a disincentive to work, the following cohorts, which are shaded in the above table, may be identified as experiencing a disincentive to work:

- One earner couples in receipt of fuel allowance with children on the National Minimum Wage (NMW)
- One earners couples in receipt of fuel allowance with two or more children on 67 percent of Average Industrial Earnings (AIE)

Current Replacement Rates including fuel allowance and maximum rent allowance for Dublin

Table 5 sets out current replacement rates based on five different wage levels and five different family types. For each family type a replacement rate was calculated. These calculations are based on one-earner couples with entitlement to fuel and smokeless fuel allowance and maximum rent allowance in the Dublin region.

⁷² In-work income for a single individual consists of gross wage less any taxes or levies due compared with out-of-work income consisting of maximum jobseekers allowance, fuel allowance and smokeless fuel allowance; In-work income for a couple with no children consists of gross wage less any taxes or levies due plus spouses JA compared with out-of-work income of maximum jobseekers allowance plus relevant adult dependant allowances plus fuel allowance and smokeless fuel allowance; In-work income for a couple with children consists of gross wage less any taxes or levies due plus the greater of FIS or spouses JA, plus child benefit compared with out-of-work income of maximum jobseekers allowance plus relevant adult and child dependant allowances plus fuel allowance, smokeless fuel allowance and child benefit.

Table 5: Current Replacement Rates including fuel allowance and maximum rent allowance for Dublin⁷³

	NMW (Rent Allowance - Dublin)	67% AIE (Rent Allowance - Dublin)	AIE (Rent Allowance - Dublin)	150% AIE (Rent Allowance - Dublin)	200% AIE (Rent Allowance - Dublin)
Single	93.38%	77.93%	58.44%	44.24%	36.05%
Couple, 1 earner, No children	102.55%	96.35%	88.92%	65.35%	54.19%
Couple, 1 earner, 1 child	107.41%	101.63%	92.07%	72.55%	60.81%
Couple, 1 earner, 2 children	113.35%	107.85%	98.63%	81.99%	69.18%
Couple, 1 earner, 4 children	105.23%	101.00%	93.30%	88.18%	77.08%

Source: Department of Social Protection, 2010

Based on the replacement rates set out in Table 5 above and using the 70 percent replacement rate as a benchmark in terms of acting as a disincentive to work, the following cohorts, shaded in the table above, may be identified as experiencing a disincentive to work:

- Those on the NMW and 67 percent of the AIE in receipt of fuel allowance and maximum rent allowance in the Dublin region
- One earner couples with and without children on AIE in receipt of fuel allowance and maximum rent allowance in the Dublin region
- One earner couples with children on 150 percent of AIE in receipt of fuel allowance and maximum rent allowance in the Dublin region
- One earner couples with 4 or more children on 200 percent of AIE in receipt of fuel allowance and maximum rent allowance in the Dublin region

⁷³ In-work income for a single individual consists of gross wage less any taxes or levies due compared with out-of-work income consisting of maximum jobseekers allowance, fuel allowance and smokeless fuel allowance plus maximum rent allowance for the Dublin region; In-work income for a couple with no children consists of gross wage less any taxes or levies due plus spouses JA compared with out-of-work income of maximum jobseekers allowance plus relevant adult dependant allowances plus fuel allowance and smokeless fuel allowance plus maximum rent allowance for the Dublin region; In-work income for a couple with children consists of gross wage less any taxes or levies due plus the greater of FIS or spouses JA, plus child benefit compared with out-of-work income of maximum jobseekers allowance plus relevant adult and child dependant allowances plus fuel allowance, smokeless fuel allowance and child benefit plus maximum rent allowance for the Dublin region.

It is important to note that replacement rates do not just act as a disincentive to work for low income earners, for example a one-earner-couple with two children on Average Industrial Earnings (€33,633) in receipt of the maximum rent allowance for the Dublin region could receive 98.63 percent of their income if unemployed.

Current Replacement Rates for One Parent Family including fuel allowance

Table 6 below sets out current replacement rates based on five different wage levels and two different family types. For each family type a replacement rate was calculated based on whether the individual was on the Community Employment Scheme or not. These calculations are based on a one-parent family with entitlement to fuel and smokeless fuel allowance.

Table 6: Current Replacement Rates for One Parent Family including fuel allowance

	NMW	67% AIE	AIE	150% AIE	200% AIE
One Parent Family 1 child	44.50%	47.80%	40.22%	30.68%	25.52%
One Parent Family 3 children	55.15%	59.00%	54.31%	47.88%	40.44%
One Parent Family 1 child on Community Employment Scheme	87.66%	94.16%	79.23%	60.45%	50.28%
One Parent Family 3 children on Community Employment Scheme	87.98%	94.13%	86.64%	76.38%	64.51%

Source: Department of Social Protection, 2010

Based on these replacement rates, the following cohorts experience a disincentive to work:

- One parent families in receipt of fuel allowance with one or more children on the community employment scheme up to AIE
- One parent families in receipt of fuel allowance with 3 or more children on the community employment scheme up to 150 percent of AIE.

Current Replacement Rates for two earner household where second earner receives NMW including fuel allowance

Table 7 below sets out current replacement rates for two-earner households, whereby the first earner earns a wage level as outlined across the top of the table and the second earner receives the national minimum wage. The replacement rate relates to the second earner - that is, the worker on the national minimum wage being out of work.

Table 7: Current Replacement Rates for two earner household where second earner receives NMW including fuel allowance

	NMW	67% AIE	AIE	150% AIE	200% AIE
Couple, 2 earner	74%	72%	66%	72%	76%
Couple, 2 earner, 1 child	80%	77%	72%	74%	78%
Couple, 2 earner, 2 children	85%	82%	77%	75%	78%
Couple, 2 earner, 4 children	86%	86%	87%	79%	80%

Source: Department of Social Protection, 2010

Based on the above table, for two-earner households (where the second earner is on the NMW), the following cohorts experience a disincentive to work:

- Two earner couples in receipt of fuel allowance with or without children at wage levels up to 200 percent of AIE.

Analysis of cohorts on live register

The Department of Finance analysed the 279,058 JA/JB claims on the Live Register for September 2009 and found the following:

- 58 percent (161,773) of cases are single:
 - Of these, 51 percent (83,226) have children (One Parent Families)
 - Based on the replacement rates set out in Table 6 above, it is thought that some of the 5,000 One Parent Families on the CE scheme may have replacement rates in excess of 70 percent.
 - Of these 49 percent (78,547) have no children
 - Based on replacement rates set out in Table 4 above, it is not thought that this cohort experience a disincentive to work.
- 42 percent (117,285) are married/co-habiting
 - 57 percent (66,852) of this cohort have no children
 - Based on the analysis of one earner couples in Table 4 above, it is not thought that this cohort experiences a disincentive to work, some disincentive may exist for two earner couples, as set out in Table 7 above though the numbers impacted have not been quantified.
 - 30 percent (35,185) of this cohort have 1-2 children

- Again, examining Table 4 and Table 7 above, the evidence points to the fact that one earner couples on the NMW and one earner couples on 67 percent AIE (€22,535) with two children may experience a disincentive to work. Two earner couples examined above may experience a disincentive to work. The exact numbers impacted have not been quantified.
 - 13 percent (15,248) of this cohort have 3 or more children
 - For one earner couples, replacement rates are an issue for those with earnings up to 67 percent of AIE as set out in Table 4. For two earner couples examined in Table 7, replacement rates experienced may act as a disincentive to work. The exact numbers impacted have not been quantified.
 - Looking at the 42 percent married/cohabiting another way
 - 42 percent (49,260) are one-earner households
 - As set out in Table 4 above, those one earner households that may experience a disincentive to work and shaded in the table include those on NMW with children and those on 67 percent of AIE with 2 or more children. The exact numbers impacted have not been quantified.
 - 58 percent (68,025) are two-earner households
 - As can be seen from Table 7 above, where the second earner is on the NMW and becomes unemployed replacement rates are an issue for two earner couples regardless of whether they have children or not. The exact number of two earner couples that would fall into this category has not been quantified.
 - Of the 279,058 total claims
 - 12 percent (33,273) are in receipt of rent supplement
 - Taking the example of the Dublin region, where one earner couples are in receipt of the maximum rent supplement, it is evident that from Table 5 above that a disincentive to work may exist for one earner couples with children up to 150 percent of AIE (€50,450)
 - Extending the example to single individuals, single people up to 67 percent AIE (€22,535) experience a disincentive to work.
 - 2.5 percent (7,006) are in receipt of Mortgage Interest Supplement
 - DSP say this is an issue but replacement rates differ on a case by case basis, and will be an acute issue in some cases.

4.6.2 Tax and Welfare Related Employment Incentives

Social security schemes/supports can have an impact on labour costs in the following scenarios:

- Incentive to work: The OECD has found that “a highly progressive income tax system normally reduces incentives to work and to invest in human capital, although ‘in-work benefits’ can

improve work incentives for low wage workers while increasing progressivity"⁷⁴. In the case of Ireland, FIS is used to supplement low paid workers to incentivise work.

- Job creation: The recently introduced *Employer Job (PRSI) Incentive Scheme* provides for a twelve month employer PRSI exemption, when an employer hires an employee who has been unemployed for at least 6 months and the job is full-time, new, additional and lasts for 6 months or more. The scheme will cease at the end of 2010 and as of early October 2010, the scheme has supported 629 jobs⁷⁵.
- Necessity entrepreneurs support: Individuals are incentivised to become self-employed through a number of schemes including:
 - The back to work enterprise allowance (self-employed) permits individuals to retain a percentage of their social welfare payment for up to two years.
 - Short term enterprise allowance provides an allowance for a maximum of one year and there is no qualifying period.

4.6.3 Extending the Hours of Those on Three Day Weeks

A number of commentators have recently focused on the need to ensure that people currently engaged in part time work take up offers of full time employment as such opportunities become available. The primary motivations behind such concerns are to (i) reduce the numbers on the Live Register; and (ii) reduce the State's expenditure on social welfare.

It is important to note that while encouraging part time workers to transition to full time work is a valid policy objective, it is not one of the Government's stated priorities for labour market activation policy. Part time workers are already close to the labour market and so are in a relatively strong position to take advantage of any economic upturn. Such workers may be more amenable to a directive/control approach.

Instead, the Government have already identified four cohorts of workers at whom activation policies should be targeted as a priority in order to prevent a drift into very long term unemployment - those with lower skills or education levels (i.e. those unemployed who do not have a Leaving Cert qualification or equivalent); those on the Live Register for longer periods of time, especially those on it for over 1 year; those up to age 34 years, especially those aged under 25 years; and those who were previously employed in sectors that have been most affected by restructuring and where recovery to previous activity levels is not in prospect (mainly construction, manufacturing, and the wholesale and retail trade).

While actions to encourage part time workers to take up full time employment as opportunities become available would reduce the State's expenditure on social welfare, they are unlikely to have a significant positive impact on direct labour costs for employers (although some efficiency gains may accrue as a result of employees working in full time positions rather than part time positions through economies of scale).

In order to address this issue, it is important to first identify the various categories of part-time workers and to understand the entitlements which accrue to each cohort. Information on part-

⁷⁴ OECD, Tax and Economic Growth, Economics Department Working Paper No. 620, July, 2008

⁷⁵ Department of Social Protection

time workers can be obtained through two primary sources - the Live Register and the Quarterly National Household Survey (QNHS)⁷⁶.

Table 8: Data on Part-time Working from CSO

LIVE REGISTER	
Part-time and casual	76,879
QUARTERLY NATIONAL HOUSEHOLD SURVEY	
Total Unemployed	293,600
Part time workers	413,100
Under-employed	14,000
Not under-employed	399,100
Unemployed (seeking full-time)	271,000
Unemployed (seeking part-time)	22,700

Source: CSO, Live Register & Quarterly National Household Survey

According to CSO data, there were 76,879 casual and part-time workers on the Live Register in September 2010, which represents 17.4 percent of the total Live Register. The definition of casual and part-time work includes those who work up to three days a week, as well as seasonal and casual workers who are entitled to jobseekers benefit. The definition includes those who want to work more hours and those content to work part time on a permanent basis. Crucially, the Live Register figures exclude systematic short-time workers, a sub-category of part-time workers, who are workers that have suffered a temporary reduction in their working hours⁷⁷.

Looking at the QNHS data, the scale of part time working becomes apparent. In Q2 2010 there were more than 413,000 workers in Ireland engaged in part time work, the vast majority of who (399,000) do not consider themselves to be underemployed.

Based on these figures and upon the anecdotal evidence available, there would appear to be a number of distinct challenges in relation to part time workers:

- i. For workers engaged in systematic short time work (SSTW), once the defined period of systematic short time work has elapsed and an opportunity to resume full time work is available, appropriate mechanisms are required to ensure workers resume full time employment. While this will not affect the Live Register figures, it will reduce the State’s expenditure on social welfare. The numbers actually engaged in SSTW, however, remain quite low (approximately 12,700 in September 2010);

⁷⁶ The Live Register is not designed to measure unemployment. It includes part-time workers (those who work up to three days a week), seasonal and casual workers entitled to Jobseekers Benefit or Allowance. Unemployment is measured by the Quarterly National Household Survey.

⁷⁷ Systematic short-time employment occurs when an employee normally works full-time in a firm but because of a temporary reduction of work in the business, his or her hours per week are reduced for a temporary period. SSTW generally covers relatively short time periods (e.g. 12 weeks).

- ii. There may be scope to encourage more part time workers to move into full time employment. Identifying and addressing any disincentives to take up full time employment would reduce the numbers on the Live Register and would reduce the State's expenditure on social welfare.

In both cases, there is a need to identify and address any disincentives which may be preventing part time workers from returning to full time work. Table 9 summarises the broad categories of workers and the entitlements to which each category is entitled.

Table 9: Categories of Short Time Workers and Relevant Entitlements

Category of Worker	Qualifying Criteria/Details	JB Entitlements (i.e. no. of days)	Other Entitlements / Notes
Unemployed	Must be unemployed & under 66 years of age; Have sufficient PRSI contributions Be capable of, available for and genuinely seeking work	Jobseekers Benefit (JB) based on a 6 day week	JB is taxable
Part time workers	Must be unemployed for at least 3 days out of 6 & continue to look for permanent employment	JB - 1/6 normal JB for each day of unemployment for at least 3 days (based on 6 day wk)	JB is taxable
Systematic short time	Cannot work more than 3 days	1 or 2 days JB (based on 5 day wk)	Temporary reduction in hours) JB is not taxable on SSTW Not included on Live Register

Addressing Systematic Short Time Working

As illustrated in Table 9, workers engaged in systematic short time working are entitled to either one or two days Jobseekers Benefit (based on a five day working week). By definition, SSTW is a temporary arrangement - workers on a three day week are compensated for the out of work days because the employer does not have work for them. Once an employer offers to return to a five day working week and the employee is unwilling, according to the conditions of the welfare scheme, the employee is not entitled to supports and they should be withdrawn efficiently and expeditiously.

Under present arrangements, there is scope to recoup any unwarranted spend on social welfare from employers. This facility is important as it places an onus on employers to report workers whose period of SSTW has expired but who seek to continue receiving social welfare.

Incentivising Part Time Workers to Take-Up Full Time Employment

Social welfare entitlements may create a disincentive for many part time workers to accept full time employment⁷⁸. As illustrated in Table 9, part time workers are entitled to claim up to three

⁷⁸ The Commission on Social Welfare 1986 recognised that for many, part-time work was not a deliberate choice (paragraph 10.6.3, page 243).

days Jobseekers Benefit based on a six day week - although entitlement to Jobseekers Benefit runs out after twelve months.

All individuals on the Live Register and claiming Jobseekers Benefit, however, must satisfy the 'Genuinely Seeking Work (GSW)' condition. In relation to part-time workers, this clause affects those who do not wish to work more hours - the GSW clause should preclude them from claiming jobseekers benefit/allowance for those days that they do not work⁷⁹.

In addition to ensuring that the GSW condition is enforced, a number of other options might be considered in order to incentivise part time workers:

- Change the basis of calculation for social welfare entitlements from a 6 day week to a 5 day week.
- Ease the transition back into full time employment by extending certain entitlements for an initial period of employment thus cushioning the impact from the loss of social welfare.
- Ensure that the taxation system properly incentivises workers to take up full time employment.

All of these options are considered in greater detail in the recommendations section.

4.7 Role of the taxation system in setting labour costs

4.7.1 Tax Wedge

The difference between the employers' cost of hiring an individual and the individual's actual take home pay, due to income taxes and payroll taxes, is known as the tax wedge. The tax wedge increases labour costs which can have a negative influence on the employer's decision to retain or hire individuals. The tax wedge also reduces the take-home pay of workers, who therefore increase the pre-tax wage they bargain for in wage negotiations. In terms of the labour tax increases introduced in Budget 2009 and the April Supplementary Budget, anecdotal evidence suggests that this weakened the ability of employers to cut wages as employees had already suffered an effective wage cut through the increased taxes. Table 10 below illustrates the development of average tax rates across various income levels since 2000.

⁷⁹ Government Publication, Review of the Application of the Unemployment Benefit & Assistance Schemes Conditions to Workers who are not Employed on a Full-time Basis, 2006, page 68

Table 10: Comparative Average Tax Rates 2000-2010

Income Levels	Single Person 2000	Single Person 2008	Single Person 2010
€15,000	13.9%	0%	0%
€20,000	19.1%	4.4%	6.4%
€25,000	24%	8.3%	10.3%
€30,000	28.4%	12.9%	16.9%
€40,000	33.3%	18.6%	22.1%
€60,000	37.7%	27.5%	31.7%
€100,000	41.1%	33.8%	39.2%
€120,000	41.9%	35.4%	41.1%

Source: Department of Finance, Budget 2008; Budget 2010

Notes: Tax = Income tax + PRSI + levies

The OECD highlight that a reduction in income taxes for low-income earners will result in an increase in aggregate demand in the short time and raise employment rates for this group with positive GDP per capita in the longer term⁸⁰. According to the OECD Jobs Strategy 2006, a permanent one-percentage point reduction of the average tax burden on labour would increase the employment rate by about 0.4 percentage points in the typical country over the long run. In addition, lower marginal tax rates can induce second earners to increase their hourly participation in the workforce. OECD analysis suggests that a one-percentage point decrease in the marginal tax rate would typically raise the hours worked by women by 0.7 percent⁸¹.

The tax wedge on labour is the gap between what the employer pays and what the employee receives. A competitive tax wedge is vital to encourage employment growth across all income categories and is an important competitive advantage in attracting and retaining highly skilled and internationally mobile workers. In Ireland, the labour tax wedge has risen for all income categories assessed by the OECD since 2008 while the tax wedge in most OECD countries is unchanged or falling. Overall, Ireland's tax wedge compares favourably to the OECD average for many categories of income but recent competitiveness losses are an issue of concern.

- At the low income threshold (67 percent of average earnings), the tax wedge⁸² for a single person (with no children) increased from 16 percent in 2008⁸³ to 22.5 percent in 2009. Yet it remains significantly below the OECD-28 average of 32.5 percent for this cohort in 2009.

⁸⁰ OECD, Going for Growth 2009, March 2009

⁸¹ OECD, Economic Surveys: Brazil, 2009

⁸² Income tax plus employee and employer contributions less cash benefits (as a percentage of labour costs), 2009, 2008

⁸³ Two-earner family

- At the medium income threshold (100 percent of the average earnings), a single person (with no children) experienced an increase in the tax wedge from 22.9 percent in 2008⁸⁴ to 28.6 percent in 2009. Notwithstanding this increase, the tax wedge for this cohort remains below the OECD-28 average of 36.4 percent in 2009.
- Ireland has become significantly less competitive for higher income earners. The highest income category included in the OECD report is for a single person on 167 percent of the average wage (with no children). For such a person, the tax wedge increased from 34 percent in 2008⁸⁵ to 39 percent in 2009 compared to the OECD-28 average which declined from 41.9 percent in 2008 to 41.1 percent in 2009.

4.7.2 Administrative Burden

The administrative burden associated with payroll systems in particular social security systems has been raised on a number of occasions. The Expert Group on the Integration of Tax and Social Welfare Systems noted the complexity of the existing systems as well as the cost of administering the system. This complexity can also affect employment by “making it difficult to for an unemployed person to establish the effect of his/her net income of taking up a particular job offer”⁸⁶. At present, there are 11 different classes of PRSI, which are further divided into over 30 different sub-classes. This can reduce the efficiency of the labour market.

4.7.3 Tax incentives impact on Labour Costs

In addition to the impact of the tax wedge, the taxation system can affect labour costs in a number of additional ways, as summarised below.

Retention of employees: The Irish taxation system provides an employment support incentive by exempting employees on systematic short term work from paying income tax. Systematic short-time work arises where short-time working is introduced on a temporary basis for workers who are working full-time. This is to incentivise workers to agree to reduce working time which may prevent lay-offs or plant closure. The OECD has noted that a majority of OECD countries have responded to the recent crisis by introducing or expanding short-time work schemes, which aim to reduce the labour costs of companies in temporary distress, cushion the income of workers and preserve jobs that could be viable in the long run⁸⁷.

Hiring individuals who have been long term unemployed: The tax system provides incentives to encourage long term unemployed to take-up employment and to encourage employers to employ the long term unemployed. Firstly, an individual who has been long term unemployed is given an additional income tax deduction, tapered over three years, with a tapering child allowance for dependent children also if applicable. Secondly, employers are given a double deduction in respect of payroll costs, in the first 36 months of employment, for the payroll costs and the related employer PRSI contribution in respect of the qualifying employee. This scheme seeks to reduce labour costs as an incentive to the employer to hire those who have been long term unemployed and to increase the incentive to work for the individual.

⁸⁴ Two-earner family

⁸⁵ Two-earner family

⁸⁶ Report of the Expert Working Group on the Integration of the Tax and Social Welfare Systems, 1996, p.6

⁸⁷ OECD, Going for Growth 2010, page 35

Restructuring: The Irish taxation system had a support incentive which exempted from income tax certain lump sum payments paid to employees under agreed pay restructuring, where the restructuring was necessary to safeguard the future of the firm, up until 1 January 2004. Approximately 10 companies availed of the scheme, but it did facilitate the buy-out of old work practices at a time when the business model was moving to the shift work model. While the current economic times mean that firms' ability to make lump sum payments is adversely impacted, it might be argued that employees are more willing to engage in a change process in the current environment.

Redundancy/Termination: There are various tax provisions in relation to termination payments which have a role to play in facilitating business rationalisation and assisting employees with their financial commitments while seeking new work or making the transition to retirement. The provisions include exemption from income tax for statutory redundancy payments and income tax relief for termination payments in excess of the statutory amount can apply.

4.8 Role of open international labour markets in setting labour costs

An open labour market, where people can travel across national boundaries to take employment opportunities supports the efficient functioning of the labour market. The evidence relating to the impact of migration on the economy is mixed. According to the Expert Group on Future Skills Needs in general immigration has a small, positive impact on GDP⁸⁸. The impact on growth per capita (which is more reflective of improvements in living standards) is more ambiguous and it is likely that immigration has a neutral impact on GDP per capita. Nevertheless, an immigration policy that targets individuals possessing high or scarce skills can have a significant, positive impact on economic performance, addressing skills shortages and eliminating barriers preventing enterprise from expanding.

The ESRI have undertaken a number of studies in recent years to examine the effects of migration on the Irish economy and the labour market. They have found that in earnings terms, the impact of immigration is dependent on a number of factors such as skill level of migrants, whether immigrants were employed at a level befitting their education etc. A 2002 study⁸⁹ found that immigration has reduced earnings inequality between high skilled and low skilled employees⁹⁰. A subsequent 2006 study considered the impact that the occupational gap experienced by immigrants had on earnings distribution. While immigrants to Ireland in the 1990s and 2000s were generally found to be high skilled, Barrett et al (2006)⁹¹ showed how immigrants were also less likely to be working in high-skilled occupations. Therefore, the impact that immigration has upon earnings is dependent on whether immigrants were employed at a level fitting their education.

⁸⁸ EGFSN, Skills Needs in the Irish economy: The role of migration, Forfás, 2005

⁸⁹ Barrett, A., J. FitzGerald and B. Nolan (2002), "Earning Inequality, Returns to Education and Immigration into Ireland", Labour Economics Vol. 9 No. 5, 665-680

⁹⁰ Barrett et al (2002) concluded that the inflow of migrants between 1994 and 1997 led to a fall in skilled wages of 4.7 percent. As unemployment in Ireland at the time was high, the complementarity between skilled and unskilled labour was shown to lead to a fall in the rate of unemployment as opposed to leading to an increase in the wages of the unskilled. Hence, this period of immigration was seen to have reduced earnings inequality.

⁹¹ Barrett, A., Bergin, A., and Duffy, D. (2006), "The Labour Market Characteristics and Labour market Impacts of Immigrants in Ireland", The Economic and Social Review, Vol. 37, no. 1, Spring 2006, pp. 1-26

Where migrants were employed at a level fitting their education, it was found that they lowered the skilled wages by around 6 percent⁹².

While migration is a useful tool to address some of Ireland’s skills needs it is not, however, a long term solution to all of Ireland’s skills shortages. While there will always be a need to recruit some very high skilled, experienced people from abroad, the first priority of Irish policy makers should be to ensure that the resident population is educated and trained to meet the requirements of current and future job opportunities.

According to QNHS estimates, there were an estimated 392,000 non-Irish nationals aged 15 and over in the State in Q2 2010. Looking at these figures in more detail, 276,500 non-Irish nationals were considered to be part of the labour force, a decrease of 48,900 or 15.0 percent in the year. Of these, 229,600 were in employment representing a decrease of 45,000 (-16.4 percent) over the year. A further 46,800 were unemployed, a decrease of 4,000 in the year to Q2 2010. Nationals of the EU 15 to EU 27 States showed a decline in employment of 16,100 (-13.0 percent) and a decrease in unemployment of 2,600 (-8.9 percent) over the year.

Compared to similar figures for Q3 2007, employment of non-Irish nationals has decreased by 18,400 (7.4 percent) to the period Q2 2010, while unemployment has increased by almost 30,600 (176 percent). Similar figures for the Accession states showed a decrease of 18,500 (14.6 percent) in those in employment, and an increase in unemployment of 19,900 (306 percent).

As illustrated in Figure 9, in the second quarter of 2010 non-Irish nationals accounted for 12 percent of all persons aged 15 and over in employment. This compares with 13.5 percent in Q4 2009, 14.9 percent in Q4 2008 and 16.2 percent in Q4 2007. Despite this decline, the proportion of non-nationals employed remains high by EU standards.

Figure 9: Migrants as a Proportion of Total Employment (2005-2010)



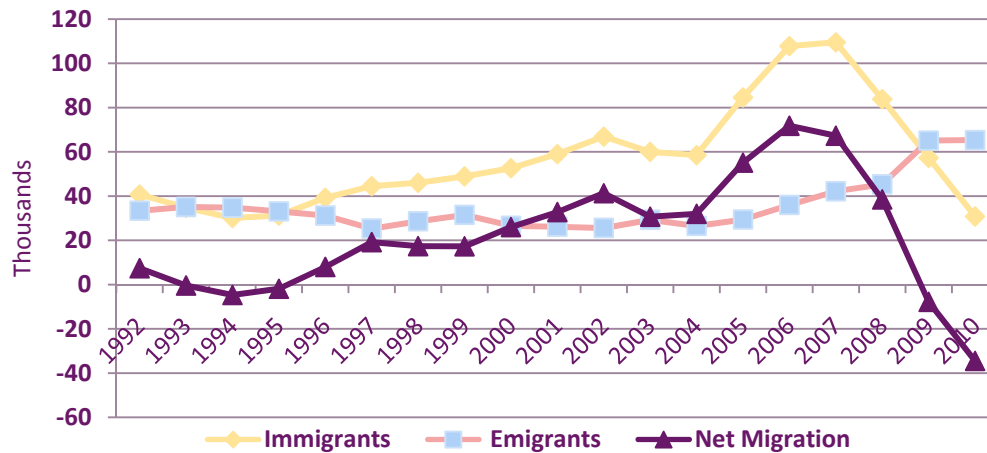
Source: CSO, QNHS. Note: **Includes figures from two new accession states, Bulgaria and Romania from Q2 2006.

The reduction over recent years in net migration has been driven by the deterioration in the labour market (reductions in employment opportunities and parallel increases in unemployment)

⁹² Based on an analysis of immigrants who arrived between 1993 and 2003

rather than policy changes. Figure 10 illustrates in quite stark terms the dramatic shift that has occurred over recent years, as Ireland, once a country of mass emigration adjusted to become a country of mass immigration. This has now reversed with net emigration negative (-34,500) in the year to April 2010.

Figure 10: Immigration, Emigration and Net Migration in Ireland (1992-2010)



Source: CSO, Population & Migration Estimates, April 2010

Despite the challenging labour market conditions, it is important that Ireland maintains open labour markets.

Firm Level Policies

4.9 Role of firm level incentives on setting labour costs

Limited information is available in Ireland on the firm level responses to labour costs during a recession. US research⁹³ suggests that employers resist pay cuts largely because the savings from lower wages are usually outweighed by the cost of denting workers' morale: pay cuts hit workers' standard of living and lower their self-esteem. Falling morale raises staff turnover and reduces productivity. Consequently, firms generally:

- Do not favour wage reductions that just take advantage of labour market conditions; they view them as being counterproductive. Only in cases where a trusted management team can communicate that the company itself is in serious danger of going out of business are wage reductions acceptable. Research from the Irish Central Bank suggests that the incidences of wage cuts and freezes in Ireland are significantly lower than the European average. (Note data was from late 2007/early 2008).
- Prefer layoffs to pay cuts because they harm morale less. Although layoffs also hurt morale, their effects are less severe and long-lasting than those of wage reductions.

⁹³ Bewley, Truman F., *Why Wages Don't Fall During a Recession*, 1999, Harvard University Press, 527 pp. ISBN 0-674-95241-3

- Remain reluctant to hire overqualified people or staff at lower rates than existing staff as perceptions of internal wage equity are important for morale. Almost 80 percent of the EU firms surveyed by the EU Wage Dynamics Network report that internal factors such as collective wage agreement and internal pay scales are more important in determining the wages of new hires than external labour market conditions⁹⁴.

Despite economic theory which suggests that pay levels should fall to enable the labour market to clear, the available evidence suggests that economy wide wages levels rarely fall. While, it is easier for new enterprises and existing troubled enterprises, to lower costs, the majority of businesses are reluctant to lower pay levels. While beneficial for those in employment, these softer barriers to labour cost adjustment may impede enterprise development and the resolution of our unemployment challenge.

⁹⁴ Lamo, A., and Smets, F., Wage dynamics in Europe: Some New Findings, European Central Bank, Research Bulletin No 10, June 2010

5. Actions to improve wage competitiveness.

Summary & Key Conclusions

- To the greatest extent possible the market should set wage levels, as opposed to state interventions determining pay rates
- As real wages determine living standards, the challenge for Ireland is to engineer a situation where both wage competitiveness and consumer prices continue to improve in order to protect real living standards
- It will take time to effect change. In many instances, the actions identified here will not have an immediate effect on lowering costs and increasing employment - some actions are about ensuring that once economic recovery is underway, barriers to growth and employment creation are minimised
- No single policy action can resolve all of the issues confronting us in Ireland - a range of coordinated and complementary responses are required. Action in one area, without complimentary action elsewhere may in fact exacerbate current problems - actions must be sequenced correctly in order to have impact
- Policymakers must be cognisant of a range of potentially conflicting principles, including the need to broaden the tax base, to reduce public expenditure, to protect those on low incomes and maintain good industrial relations
- Forfás recommend that replacement rates (i.e. social welfare rates) be addressed as a matter of urgency, ensuring that all replacement rates move below the 100 percent mark and towards the 70 percent benchmark
- In parallel, Forfás recommend that ERO's and REA's be reformed to ensure that they contribute to labour market efficiency. In particular in relation to ERO's, the premia over the national minimum wage and the secondary benefits are of particular concern to enterprise. Additionally, because the wage rates contained in these agreements are legally enforceable, the existence of ERO's in their current form would negate the impact of any changes in the NMW. The abolition or suspension of ERO's and removal of the legally binding clause relating to REA rates should also be considered
- Other measures such as changes to the NMW can also be considered, though in the first instance replacement rates and sectoral agreements represent the primary barriers to labour costs adjustments. Options for consideration include:
 - Cutting the headline NMW rate of €8.65 by a designated amount. A reduction in the NMW would result in an increase in employment in the medium term, although it is difficult to estimate how significant this increase might be
 - Extending the lower rate for younger workers. Currently a rate of €6.06 exists for workers less than 18 years of age. Consideration might be given to introducing a rate lower than €8.65 for all workers aged under 21 or 25 years of age
- Finally, all of the above must be complemented by an efficient, effective and relevant activation and enforcement system, which takes account of the needs of both employers and individuals.

5.1 Context

As noted at the outset, the purpose of this paper is to identify actions which can improve the efficiency of the labour market. To the greatest extent possible, the market should set wage levels, as opposed to state interventions determining pay rates.

Regardless of the action taken, the nature of the labour market challenge means that it will take time to effect change. In some instances, the actions identified here will not have an immediate effect on lowering costs and increasing employment – some actions are about ensuring that once economic recovery is underway, barriers to growth and employment creation are minimised. Other actions are intended to remove the causes of previous overheating that resulted in Irish wage levels growing at a rate not justified by productivity, undermining international competitiveness.

The labour market is complex and no single policy action can resolve all of the issues confronting us. Labour market expectations and wage demands are not divorced from happenings elsewhere in the economy. If employees genuinely believe that the cost of living in general is falling, this will be reflected in nominal wage demands. It is important, therefore, that appropriate and credible actions are taken to address all elements of the cost base in Ireland. A long term opportunity arises for shifting negotiations on pay away from increases in living costs and focusing instead on improvements in productivity⁹⁵.

Looking specifically at labour costs, the complex relationship between the various drivers of wage levels means that coordinated and complementary action is required – when interventions in one area of labour market policy are being considered, the impact of such action on other parts of the labour market must also be considered. Action in one area, without complimentary action elsewhere may in fact exacerbate current problems.

The bulk of the State's interventions in the labour market affect those who are either unemployed or on low or average incomes. The policy recommendations herein, therefore, largely focus on these areas. Wage moderation, however, is desirable at all levels in order to restore competitiveness. Ultimately when deciding upon what action to take to lower costs, policymakers must be cognisant of a range of potentially conflicting principles:

- The need to broaden the tax base (to bring lower paid workers into the tax net)
- The necessity to reduce public expenditure;
- The protection of those on low incomes and,
- The need to maintain good industrial relations⁹⁶.

The actions and recommendations outlined below are designed to ensure that the labour market is working efficiently. In this context, efficiency means that wage levels adjust to support employment and economic growth and those individuals are incentivised to work at market rates.

⁹⁵ Flexibility in wage contracts in response to possible currency fluctuations with major trading partners would also be a desirable feature. Geary and Honohan proposed a mechanism for the sharing of currency risk between employers and employees through such a flexible wage contract – see Geary, P.T. and Honohan, P., *Can Better Contracts Help Solve Ireland's Sterling Dilemma*, 1995

⁹⁶ Good industrial relations minimise days lost through strikes. Days lost can impose a considerable additional cost on business.

5.2 Facilitating Labour Cost Adjustment

From a basic theoretical standpoint, economics tell us that a perfectly functioning market should adjust to reach equilibrium. In the case of an efficiently functioning labour market, the wage level should adjust to bring labour supply and demand into balance. While the labour market is more nuanced than simple demand and supply curves, the following sections examine a set of actions that could potentially reduce the barriers restricting wage adjustment.

5.2.1 The National Minimum Wage

As illustrated in section 4.3, less than five percent of employees in Ireland (83,700) were earning €8.65 per hour or less in 2007. Given its role in setting a base on wages in other low wage jobs, an additional 26 percent of the workforce who earn less than 150 percent of the NMW could be potentially influenced by developments in the minimum wage. The NMW is most prevalent in the wholesale and retail, and hotels and restaurants sectors rather than internationally trading sectors.

The first and perhaps most obvious thing to state is that at present, there is no justification to increase the NMW rate - Irish wage rates remain out of line with our key competitors and wages rates across the economy are adjusting downwards, albeit at a slow rate.

A second option is to maintain the NMW at its current rate. Were social welfare rates to be reduced and the NMW to remain unchanged, this would have a positive effect on replacement rates, increasing the incentive to work. It would, however, have no immediate impact on labour costs⁹⁷.

The final option is to reduce the NMW. This could be achieved through a number of different mechanisms:

- **Cut the headline NMW rate:** The simplest option would be to reduce the current NMW of €8.65 by a designated amount. It is unclear if many firms would seek to lower existing wages to take advantage of a lower national minimum wage (presence of contracts, implications for staff morale and productivity). However, it is more likely that new recruits that would have availed of the €8.65 rate would start at a new lower rate. Assuming that the elasticity of labour demand mirrors that found in the majority of international cases reviewed by Neumark and Wascher, a reduction in the NMW would result in an increase in employment in the medium term, although it is difficult to estimate how significant this increase might be. It should also be noted that an increase in labour demand is also predicated on an increase in demand for the final good or service being produced.
- **Targeted Approach:** Rather than cutting the headline rate for the NMW, a more targeted approach could be considered. Reducing the NMW for specific cohorts of the workforce where the NMW has greatest impact on the cost base may yield greater returns. However, differentiated minimum wages increase complexity from an enforcement, taxation and social welfare perspective and can be somewhat arbitrarily set. Nevertheless, a number of options exist, and these are outlined below.
- **Extend the lower NMW rate for younger workers:** Currently a rate of €6.06 exists for workers less than 18 years of age. Further rates exist for workers aged over 18 years of age but in

⁹⁷ Recent increases in the NMW in the UK (from £5.80 to £5.93) also mean that in the event that the Irish NMW remains unchanged, the differential between Irish and UK rates has narrowed - representing a competitiveness gain for Ireland.

either their first or second year of employment (see Appendix 3). Consideration might be given to introducing a rate lower than €8.65 for all workers aged under 21 or 25 years of age. This would reflect the fact that the unemployment rate for adults aged 20-24 years is 25.8 percent, significantly more than the national average of 13.6 percent⁹⁸ and it would mirror social welfare changes in Budget 2010. As noted above, a lower NMW already exists for workers aged less than 18 years. While this cohort has the highest rate of unemployment (40.6%), we do not have data to determine if the presence of a lower minimum wage impacts positively on employment levels. For this cohort, a lack of qualifications and work experience is likely to be the greatest barrier to employment.

- **Introduce differentiated minimum wages rates for different sectors:** The effects of the recession have not been uniform across the economy. Many labour intensive, locally trading sectors have borne the brunt of the job losses. While complex, potential exists to introduce a lower sectoral minimum wage to promote activity in areas such as retail and hospitality, or to introduce a seasonal NMW. The application and enforcement of such differentiation would be significantly more complex than the current system.

From an administrative perspective, the present system for determining changes in the NMW is not particularly reactive to changes in the labour market. Consideration should be given to introducing mechanisms that facilitate downward revision in NMW rates in the face of significant economic deterioration.

While the NMW is an important element in the labour market, Forfás believe that changes in the NMW alone will have limited impact on employment costs⁹⁹. Since many workers' hourly earnings are determined by the rates agreed in ERO's, the impact of a reduction in the NMW would be limited. Furthermore, changes to the NMW without parallel reform of social welfare rates, for example, could have an adverse impact on replacement rates damaging labour supply.

Finally, there is also a fundamental policy question as to whether the NMW should reflect what is happening with earnings in the labour market or whether it can act as a driver of behaviour (i.e. whether reducing the NMW would lead to a reduction in wages across the labour market).

5.2.2 Employment Regulations Orders

Section 4.4 found that in general ERO's have delivered a premium on top of the NMW to those workers covered by the agreements, adding to the cost of employment. The additional terms and conditions which are often set out in ERO's (e.g. travel costs, Sunday working rates etc.) place further costs on employers. Adjustments which reduce these costs would have a potentially significant impact on overall wage costs for some employers. Perhaps of most concern, however, is the fact that ERO's (and indeed REA's) impose an additional set of rigidities on the labour market and prevent the labour market from adjusting quickly during times of economic change. The rate of adjustment of the sectoral agreements to the current economic crises has been slow. Reform of ERO's is necessary to ensure a flexible labour market.

- In the first instance, much of the power in relation to ERO's rests with the members of the Joint Labour Committees. Either side can request a meeting of the JLC to make proposals for variations in the terms and conditions - this approach has recently happened in the Hotels,

⁹⁸ CSO, Quarterly National Household Survey, Q2 2010

⁹⁹ Interestingly, Neumark and Wascher (2007) found that the impacts of changes in the national minimum wage rate are often dependant on the effectiveness of other related policies.

Catering, Retail and Grocery, and Agriculture JLCs. Given the need to enhance labour market flexibility, employers could seek to renegotiate the various ERO's, reducing the premia paid above the minimum wage and/or reforming the additional terms and conditions (such as Sunday working rates). While such negotiations may be agreed by both parties, in the absence of an agreement the casting vote of the JLC Chairperson is required.

- It would also be useful to include a mechanism in future ERO's that would automatically reflect any variations to the national minimum wage - many agreements do not contain any such provision that would allow for a reduction in hourly rates¹⁰⁰.
- An alternative, more radical approach could be considered. It can be argued that the existence of a NMW and the introduction of extensive employment legislation render the JLC's irrelevant. Their abolition (as occurred in the UK) or suspension would not preclude employees and employers from engaging in local bargaining, and workers would still be protected by the NMW. This could be achieved through amendments to the Industrial Relations Acts¹⁰¹.

5.2.3 Regulated Employment Agreements

REA differ from ERO's both in terms of their structure and in that they tend to be determined primarily from the top down and through national wage agreements, rather than through changes in the NMW. The State has less direct influence on REA's than ERO's as they are collective agreements entered upon voluntarily and sector and enterprise level.

As with ERO's, either employer or employee representatives can seek to renegotiate hourly rates and to include provisions in future agreements that would mirror any reductions in the NMW and allow for reductions in hourly rates.

An alternative approach would be to remove the clause making REA rates legally binding. Again, this would not preclude employees and employers from engaging in local bargaining, and workers would still be protected by the NMW.

The abolition of the construction-related REA's could result in some non-national companies entering in the Irish market as they would now be able to compete on the basis of lower costs. While this would increase pressure on companies already trading here, it would also boost levels of competition.

¹⁰⁰ The Minister for Labour Affairs has declared his intention to introduce an "inability to pay" provision into the forthcoming Industrial Relations (Amendment) Bill, 2009 which covers ERO's. Such a clause, however, could give rise to concerns about the impact on competition - for example, granting an exemption to an individual firm from ERO rates and allowing that same firm to compete for projects on the basis of lower labour costs confers an unfair advantage on them vis-à-vis competitor firms.

¹⁰¹ Reform of ERO rates, however, may not yield the rewards anticipated. The National Employment Rights Authority (NERA) is tasked with ensuring that all aspects of employment law, including the terms and conditions set out in ERO's are fully complied with. According to their recent quarterly report, the main issues encountered by NERA when carrying out inspections of these agreements are in relation to the payment of the appropriate sectoral pay rate, overtime rates and Sunday premium; and trainee rates. This suggests that in some cases employees are receiving less than the agreed sectoral wage. This would, to some degree, negate the impact of reducing hourly ERO rates or abolishing JLCs. Statistics on discovered breaches of employment law can be found in NERA, Quarterly Update, June 2010

5.2.4 Employers PRSI

An Employer PRSI Incentive Scheme is currently underway but is due to cease taking applications on 31st December 2010. To date, take up has been relatively low, with just 629 applications processed. Potential exists to review this scheme to assess the impact of immediate withdrawal of relief on companies that have already availed of the scheme and look at the potential to either roll-over the scheme for an additional year or taper the exit of the scheme over a number of years. If this scheme is deemed unsuccessful, there may be merit in looking at a reduction in the tax wedge to stimulate demand and accelerate a recovery once the opportunity arises. In this context, an examination of a reduction in Employers PRSI should be considered.

5.2.5 Administrative Burden

Anything which adds to the administrative burden borne by employers ultimately adds to their cost base. For this reason, Forfás supports the simplification of the tax system for labour. Specifically, Forfás recommend the introduction of a tiered Universal Social Contribution - this would reduce the cost of administration by reducing the number of levies and contributions to be administered by employers.

5.2.6 Public Sector Pay and Procurement

Public sector wage setting including that in state owned enterprises can have an important effect on a country's cost competitiveness through its effects on private wage setting and through the price level. As discussed in section 4.1, current Irish pay levels in the public sector are high relative to those in other developed countries from a range of occupations. From a public policy perspective, the ECB suggests that 'public wage restraint is a crucial factor in maintaining a country's competitiveness'¹⁰². Public sector pay policy must, therefore, continue to support the adjustment in the labour market.

Additionally, the State is the largest procurer of goods and services in the Irish economy. Building on progress to date, further potential exists for the State to use its purchasing power to exert downward pressure on professional fees, lowering costs to the benefit of all enterprise sectors.

5.3 Incentivise individuals to enter the labour market

Actions that reduce labour costs for employers could potentially result in reduced nominal wage levels. This might in turn discourage potential workers from selling their labour because of the reduced income on offer. It is important, therefore, to consider real incomes, and to ensure that the wage on offer in the market is an attractive enough proposition vis-à-vis alternative sources of income (e.g. social welfare and income earned in the informal economy) to encourage workers to enter the labour market.

¹⁰² Holm-Hadulla, F., Kamath, K., Lamo, A., Pérez, J., & Schuknecht, L., Public Wages in the Euro Area - Towards Securing Stability and Competitiveness, European Central Bank, Occasional Paper Series No 112, June 2010

5.3.1 Replacement Rates

In the context of the upcoming budgetary cuts, when determining an appropriate level for social welfare, it is important to bear in mind that Jobseekers' Benefit is designed to offer income maintenance during periods of frictional or cyclical unemployment, not to serve as an alternative long term source of income¹⁰³.

It is inevitable that there will be some cuts to social welfare rates introduced in the forthcoming budget, given the need to reduce government expenditure. Given this context, any cuts that are introduced should be designed to positively impact on the labour market and encourage people back into employment. Based on analysis carried out, it is believed that between 15 and 20 percent of those on the Live Register may experience a disincentive to work (i.e. their replacement rate is above 70 percent). It is important to note that replacement rates do not just act as a disincentive to work just for low income earners, for example a one-earner-couple with two children on Average Industrial Earnings (€33,633) in receipt of the maximum rent allowance for the Dublin region could receive 98.63 percent of their income if unemployed. This is based on in-work income consisting of gross wage less any taxes or levies due plus the greater of family income supplement or spouses jobseekers allowance (in this case spouses jobseekers allowance) plus child benefit compared with out-of work income consisting of maximum jobseekers allowance including adult and child dependent allowances, plus fuel allowance, smokeless fuel allowance, maximum rent allowance for the Dublin region and child benefit.

A summary of the key cohorts for which replacement rates¹⁰⁴ are an issue (i.e. replacement rates of over 70 percent) are as follows:

- One earner couples in receipt of fuel allowance with children on the National Minimum Wage (NMW)
- One earner couples in receipt of fuel allowance with two or more children on 67 percent of Average Industrial Earnings (AIE)
- Those on the NMW and 67 percent of AIE in receipt of fuel allowance and maximum rent allowance in the Dublin region
- One earner couples with and without children on AIE in receipt of fuel allowance and maximum rent allowance in the Dublin region
- One earner couples with children on 150 percent of AIE in receipt of fuel allowance and maximum rent allowance in the Dublin region
- One earner couples with 4 or more children on 200 percent of AIE in receipt of fuel allowance and maximum rent allowance in the Dublin region

¹⁰³ Jobseekers' Allowance (and other assistance payments) may serve as income support on a long-term basis - subject to satisfying scheme conditions.

¹⁰⁴ Basic replacement rates are calculated according to the following methodology: In-work income for a single individual consists of gross wage less any taxes or levies due compared with out-of work income consisting of maximum jobseekers allowance, fuel allowance and smokeless fuel allowance; In-work income for a couple with no children consists of gross wage less any taxes or levies due plus spouses JA compared with out-of-work income of maximum jobseekers allowance plus relevant adult dependant allowances plus fuel allowance and smokeless fuel allowance; In-work income for a couple with children consists of gross wage less any taxes or levies due plus the greater of FIS or spouses JA, plus child benefit compared with out-of-work income of maximum jobseekers allowance plus relevant adult and child dependant allowances plus fuel allowance, smokeless fuel allowance and child benefit. Where replacement rates state that they include rent allowance, this is set as the maximum rent allowance available for the Dublin region.

- One parent families in receipt of fuel allowance with one or more children on the community employment scheme up to AIE
- One parent families in receipt of fuel allowance with 3 or more children on the community employment scheme up to 150 percent of AIE.
- Two earner couples, where the second earner is on the NMW and becomes unemployed in receipt of fuel allowance with or without children at wage levels up to 200 percent of AIE.

As illustrated previously, high replacement rates discourage recipients from entering the labour market. They also potentially force employers to compete against social welfare rate for employees which bids up labour costs. In order to address these high rates a number of options should be considered:

- Amend social welfare rates to ensure no replacement rates exceed 100 percent immediately and in the longer term ensure that replacement rates move towards 70 percent. If taxes on employment or social contributions are increased in Budget 2011 without similar changes to social welfare, replacement rates will increase with negative implications for the labour market. At a minimum, replacement rates should not increase.
- The issue of secondary benefits is quite complex and varies according to individual and household circumstances. However, potential still exists to reform this area, for example:
 - Department of Social Protection have identified that replacement rates in excess of 70 percent which occur as a result of individuals receiving rent allowance may be addressed through a movement to the rental accommodation scheme;
 - Potential may also exist to allow some secondary benefits to be retained for a period of time after take up of full time employment, depending on income levels - this would reduce the impact from the loss of social welfare entitlements upon taking up employment.
- Reform the social welfare system so that benefits decline in line with the length of time a person is out of work - this would be in line with European approaches to social welfare. It is important to note, however, that the European model is predicated on relatively high contributions bestowing a relatively high post-employment income that generally declines over time (but is normally longer than Irish entitlement - the Irish system has low contribution levels and a flat rate payment system that lasts for 9/12 months).
- Reduce or taper social welfare rates and/or secondary benefits based on duration on Live Register.
- High quality social welfare systems (i.e. generous protection) must be accompanied by high levels of conditionality in order to ensure their sustainability. Conditionality of social welfare needs to be strengthened in Ireland. Activation measures also need to be strengthened.

5.3.2 Systematic Short-Time Working (SSTW)

Having reviewed the evidence in section 4.6.3, it appears that systematic short time working is not a particularly problematic issue. The numbers engaged in SSTW are relatively low and current procedures should be able to prevent workers rejecting offers to return to full time employment and retaining access to benefits. Furthermore, greater awareness amongst employers about the

potential sanctions they could face if they do not report workers who refuse to return to full time employment would also have a positive effect.

5.3.3 Part-Time Working

In addition to ensuring that the Genuinely Seeking Work (GSW) condition is enforced, a number of other options might be considered in order to incentivise part time workers:

- One option might be to reform the existing system of paying jobseekers benefit to part-time workers. By spreading the payments over a five day week instead of a six day week as is currently the case this would reduce the incentive for individuals to work 3 days and claim social welfare for the remainder of the week. This would increase the incentive to the individual to seek full time employment *and* would reduce the cost to the state of paying job benefit. A further benefit is that such a move would bring the basis for calculating social welfare into line with the method used under SSTW. This issue should not be divorced from the issue of Sunday working - the Department of Social Protection have already recommended that Sunday be included as a day of work when calculating social welfare entitlements.
- A second option would involve extending certain entitlements for workers who move from part time into full time work for an initial period of employment thus cushioning the fall in their income (e.g. allow workers to retain medical card/rent supplement entitlements for the first 3 or 6 months of full time employment). This option might also be applied to unemployed workers re-entering employment and could have a significant positive impact on replacement rates.
- A third option would be to examine the manner in which such workers are taxed. Rather than extending entitlements to social welfare, it may be preferable to ensure they are properly incentivised to work through the taxation system.

5.3.4 Activation and Upskilling

To meet the current challenges of high unemployment there will need to be a focus on the efficiency, quality and effectiveness of activation programmes for the unemployed to ensure the best use of the education and training budgets. This will require collaboration and co-ordination between employment services, training and education providers and enterprise. Working from a shared view of the future skills needs of the economy, an innovative and integrated approach can be followed to determine agreed education and training priorities. The *Review of Labour Market Programmes*¹⁰⁵ recommended that the focus of labour market programmes should be on three main areas:

- **Activation** - Activation measures aimed at improving the employability of unemployed persons by providing 'progression pathways' of relevant job search, training, education and employment opportunities for different target groups. This includes the need to ensure that the responsibilities and mutual obligations of individuals able to take up opportunities are made clear and that any disincentives to participation are minimised.
- **Upskilling** - Boosting our human capital by enhancing education and skills levels in line with the National Skills Strategy is essential to meet the needs of the 'Smart Economy' and the need to improve productivity. Notwithstanding our current economic difficulties, other

¹⁰⁵ Forfás/DETE, Review of Labour Market Programmes, 2010

countries are also upskilling and we must do so to compete and to take advantage of the economic upswing when it comes.

- **Participation** - Ensuring that the training and education needs of target groups such as young unemployed, those previously employed in sectors most affected by restructuring, long term unemployed, older workers and women returners are provided for through enterprise relevant programmes.

5.4 Sequencing of Reform

The actions below are sequenced in an order designed to maximise impact.

Forfás recommend that **replacement rates** (i.e. social welfare rates) be addressed as a matter of urgency, ensuring that all replacement rates move below the 100 percent mark and towards the 70 percent benchmark¹⁰⁶. Failure to tackle replacement rates as the first step would place a major barrier upon employment growth, and would undermine economic recovery.

In parallel with the replacement rate issue, Forfás recommend that **Employment Regulation Orders** be reformed. Analysis suggests that the costs imposed by these collective agreements are more of a concern to enterprise than, for example, the NMW. Additionally, because the wage rates contained in these agreements are legally enforceable, the existence of ERO's in their current form would negate the impact of any changes in the NMW. At the same time, reform of **Regulated Employment Agreements** is also required.

The likely simplification of PRSI in the next budget is to be welcomed. Again, these changes must be implemented in a manner that reflects need to minimise employment costs and maximises the incentive to work. Other measures such as changes to the **National Minimum Wage** can also be considered, though we believe that replacement rates and sectoral agreements represent the primary barriers to labour cost adjustments.

Finally, all of the above must be complemented by an efficient, effective and relevant activation system that takes account of the needs of both employers and individuals.

¹⁰⁶ Moves to address replacement rates must also be cognisant of the impact that secondary entitlements can have - the Department of Social Protection is currently working on a paper relating to Child Income Support which addresses many of the relevant issues.

Appendix 1: Hourly Earnings excluding Irregular Benefits (All Employees)

	Quarterly Change to Q2 2010	Annual Change to Q2 2010
Industry (B to E)	1.1	1.5
Mining and quarrying (B)	1.7	7.9
Manufacturing (C)	1.3	1.4
Electricity, water & waste (D,E)	0.3	-0.8
Construction (F)	-0.7	-2.7
Wholesale and retail trade	0.3	0.1
Transportation and storage (H)	0.6	-4.1
Accommodation and food service activities (I)	-1.8	-0.2
Information and communication (J)	-1.5	-1.4
Financial, insurance and real estate activities (K,L)	-1.5	2.5
Professional, scientific and technical activities (M)	-3.9	-0.4
Administrative and support service activities (N)	-2.2	-3.5
Public administration & defence (O)	0.2	-5.6
Education (P)	-1.6	-5.1
Human health and social work activities (Q)	-3.5	-5.7
Arts, entertainment, recreation & other services (R, S)	0.0	-1.1
Total Economy	-0.6	-1.3

Appendix 2: Weekly Earnings including Irregular Benefits (All Employees)

	Quarterly Change to Q2 2010	Annual Change to Q2 2010
Industry (B to E)	1.9	2.3
Mining and quarrying (B)	9.5	12.3
Manufacturing (C)	0.9	1.9
Electricity, water & waste (D,E)	6.8	0.5
Construction (F)	-3.7	-5.5
Wholesale and retail trade	3.6	0.9
Transportation and storage (H)	3.5	-7.3
Accommodation and food service activities (I)	2.9	-4.3
Information and communication (J)	-1.4	-0.5
Financial, insurance and real estate activities (K,L)	-4.1	3.8
Professional, scientific and technical activities (M)	-6.2	-0.3
Administrative and support service activities (N)	-2.9	-3.0
Public administration & defence (O)	3.7	-3.8
Education (P)	-2.2	-8.3
Human health and social work activities (Q)	3.7	-2.9
Arts, entertainment, recreation & other services (R, S)	3.0	-1.5
Total Economy	1.0	-1.6

Appendix 3: National Minimum Wage Rates

Employee	Minimum wage (Hr)	% of minimum wage
Experienced adult worker	€8.65	100%
Aged under 18	€6.06	70%
1 st year from date of 1st employment aged over 18	€6.92	80%
2 nd year from date of 1 st employment aged over 18	€7.79	90%
Employee aged over 18, in structured training during working hours		
1st one third period	€6.49	75%
2nd one third period	€6.92	80%

Appendix 4: Minimum Wage Scorecard¹⁰⁷

Variable	Impact	Strength of Evidence
Employment	Reduces employment of vulnerable, lowest skilled workers.	Majority of studies point to a small negative impact. Some studies find a positive effect.
Wage Distribution	Increases the wages for workers covered, particularly for young, low-skilled, migrant & female workers.	Unambiguous evidence for low paid workers, less clear for workers on higher earnings.
Income Distribution	No compelling evidence the minimum wage assists low income families. Some evidence it may harm them.	No positive evidence. Clear evidence of either negative or no effects.
Training	Evidence of negative effects, some evidence of no effect. No convincing evidence of positive effect.	Unclear whether evidence is stronger for negative effects or no effect.
Education	Most evidence points to negative effects.	Unambiguous for the US; less clear for Canada.
Long Run Earnings	Young workers exposed to minimum wages see negative effects on earnings when they are in their late twenties.	Strong evidence but from only one study.
Prices	The minimum wage increases prices of goods & services produced with low-wage labour & which are labour intensive.	Clear evidence.

¹⁰⁷ This table is based on the work of David Neumark and William L. Wascher in their book *Minimum Wages*, The MIT Press (2008)

Appendix 5: List of EROs

List of Employment Regulation Orders	
Aerated waters and wholesale bottling	Hotels (Dublin and Dun Laoghaire)
Agricultural workers	Hotels (Other excluding Cork)
Catering (Dublin and Dun Laoghaire)	Law clerks
Catering (Other)	Provender milling
Clothing	Retail, grocery, and allied trades
Contract cleaning	Security industry
Hairdressing	

Appendix 6: Summary of Main Recommendations from University of Limerick's Review of the JLC System

- Retention of JLC System: The Irish system of Industrial Relations is based on consensus, however as no such consensus exists on whether the JLC system should be retained or not, the only basis of judgement is the majority view. This majority view favours retention, thus we recommend the retention of the JLC system.
- Abolition of Individual JLCs: That enabling legislation be introduced allowing the Labour Court to dissolve a JLC following appropriate and defined procedures for prior consultation with employers and workers in the industry and employer and trade union representative bodies.
- Amalgamation of JLCs: That enabling legislation be introduced allowing the Labour Court to amalgamate JLCs following appropriate and defined procedures for prior consultation with employers and workers in the industry and employer and trade union representative bodies. The process of amalgamation should not require a need for prior dissolution of the JLCs involved, which would leave a gap in the protection provided. The Labour Court should continue to have the power to appoint the representative members where JLCs are amalgamated.
- Amalgamation of JLCs: The establishment of a mechanism for determining minimum wages and terms of employment to apply following amalgamation should be the subject of consultation between the Department of Enterprise, Trade and Employment working party and the Social Partners. The Department should then make a recommendation on this issue to be incorporated in amending legislation.
- Extension of JLCs: Amending legislation should be introduced to allow the Labour Court to extend JLCs on either a geographical or category basis, should there be such an application.
- Amending of the establishment order setting up JLCs: There is a lack of clarity at present in the legislation on the extent to which EROs can be amended for the purposes of updating. Amending legislation should be introduced to allow for a simplified method allowing the Labour Court to amend establishment orders on the request of individual JLCs.
- Chairpersons: The Minister for Enterprise, Trade and Employment currently makes such appointments. There are no defined criteria governing the selection of appointees. It is recommended, therefore, that criteria be established for the appointment of chairpersons of JLCs, and that these specify that nominees should have appropriate industrial relations/human resources experience. Appropriate experience would include serving IROs, former members of LRC, Labour Court, and Rights Commissioners.
- It is further recommended that a requirement be established that nominations for the appointment of chairpersons be made by the LRC (following consultation with representative bodies) to the Minister, who would make the appointment. Chairpersons should be appointed to office for a fixed term of seven years and that the Minister can only extend this term for one seven-year period and that this only happen on a recommendation of the LRC.
- Dissemination of Information on EROs: That substantially increased resources be made available to the Labour Court to improve the advertising of EROs and that simple guides to the orders be developed (similar to guides to employment legislation) and made available to employers and employees.

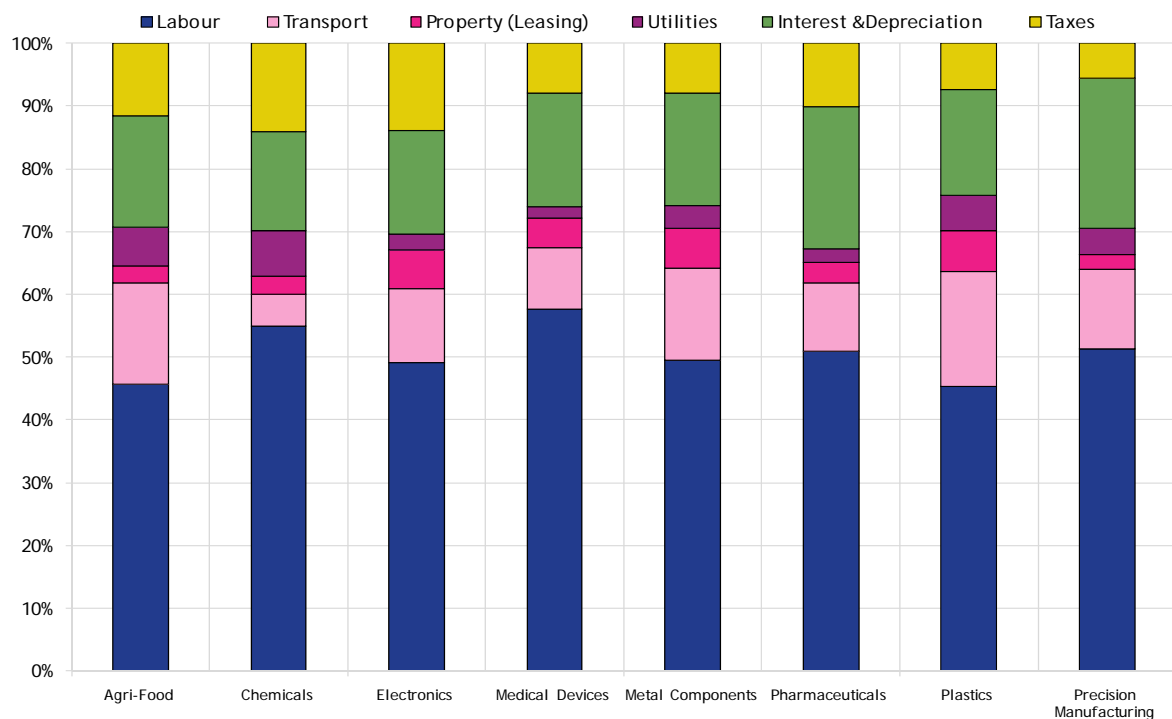
Appendix 7: Summary Cost Profiles for internationally trading manufacturing, services and R&D operations

The following sectoral cost profiles provide an indication of the contribution of various location sensitive cost components to total costs in a number of key sectors. As the profiles are based on a single case study firm in each sector, the profiles should be regarded as indicative rather than representative of the structure of costs across sectors.

Manufacturing Sectors Cost Profiles

Location insensitive costs have been eliminated from Figure 1 to facilitate a more detailed assessment of the impact of various location sensitive cost components for a range of manufacturing operations. Location insensitive costs are most significant in manufacturing sectors, averaging 56 per cent of total costs in manufacturing firms. The significance of location sensitive costs varies considerably across sectors within the manufacturing sector. 62 per cent of total costs in the medical devices sector are location sensitive compared to 32 per cent in the chemicals sector.

Figure A1: Manufacturing Sectors' Cost Profiles (Location sensitive costs)



Source: KPMG, 'Competitive Alternatives, 2010', Forfás calculations

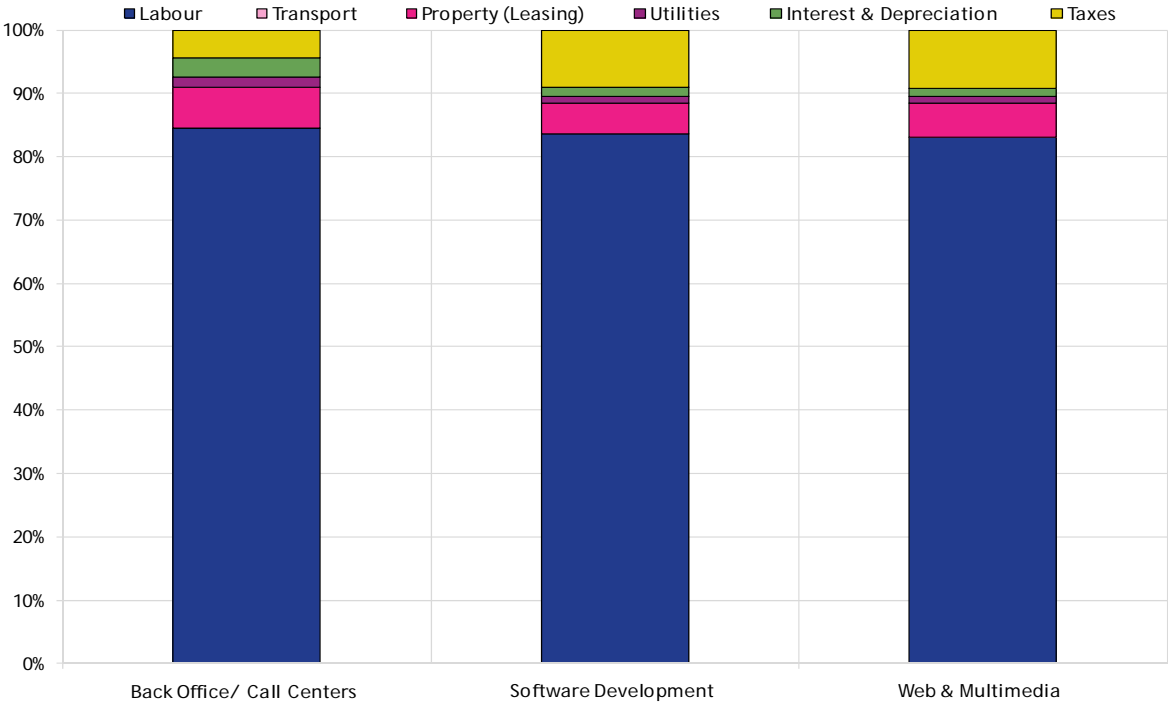
The contribution of labour costs to total location sensitive costs varies from 45 per cent in the case study plastics firm to 56 per cent in the case study medical devices firm. Transport costs are a major component of locally determined costs for the case study plastics (18 per cent) and agri-food operations (16 per cent). This is significant for Irish agri-food firms given the regional dispersion of the sector. Utilities are also an important cost input for the agri-food (six per cent) and chemicals (seven per cent). Across the sectors benchmarked, taxes are most significant in the

chemical and electronics sector (14 per cent) and to a lesser degree agri-food (12 per cent) and pharmaceuticals (10 per cent).

Service Sectors Cost Profiles

On average, location insensitive costs account for just 11 per cent of total cost for the case study services firms, making services operations highly sensitive to locally determined cost. In 2009, services exports accounted for 47 per cent of total Irish exports compared to 25 per cent in 2001¹⁰⁸.

Figure A2: Service Sectors’ Cost Profiles (Location sensitive costs)



Source: KPMG, ‘Competitive Alternatives, 2010’, Forfás calculations

Labour costs are the main component of costs in services sectors. They account for 76 per cent of location sensitive costs for back office and call centre operations and 74 per cent for software development and web and multimedia operations. Taxes (less grants) account for nine per cent of costs for software development and web & multimedia, while leasing costs are significant for back office / call centre operations (six per cent).

The KPMG report does not provide a cost profile of the tourism sector, or any of its sub-sectors. However, as part of previous research undertaken on behalf of the NCC a cost profile was developed for a case study business hotel; 59 per cent of location sensitive costs in the sample business hotel firm were accounted for by labour costs, 13 per cent was attributed to property

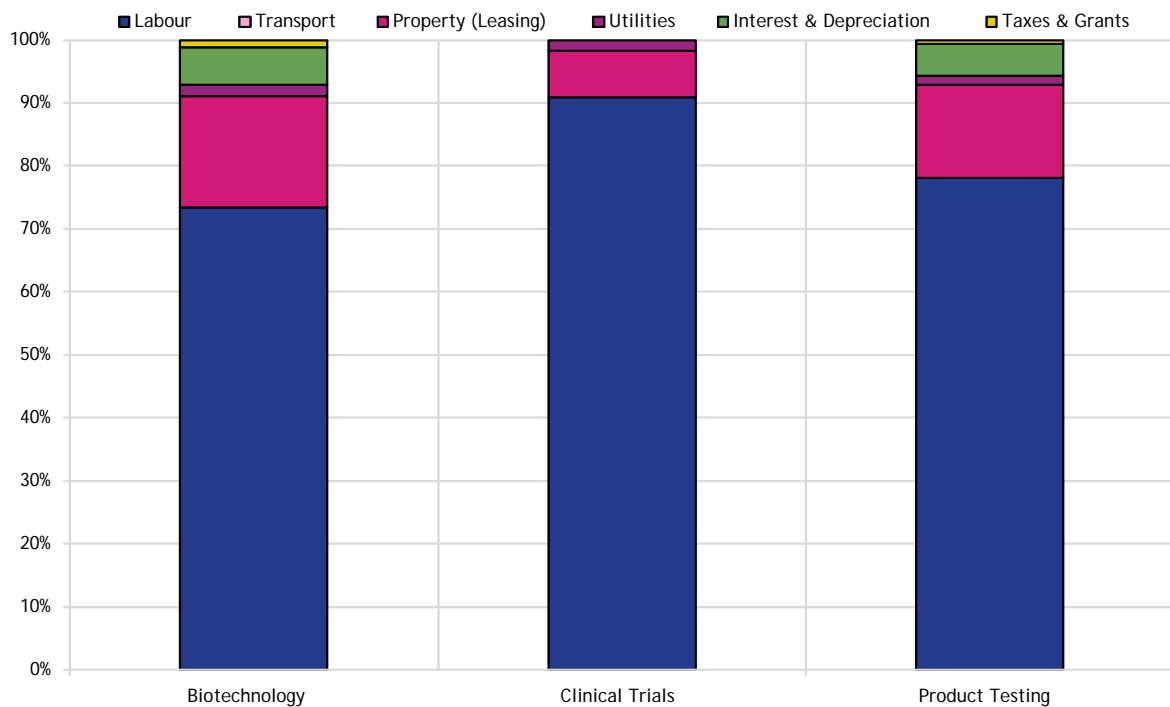
¹⁰⁸ CSO Balance of Payments, March 2010

costs and eight per cent to utilities¹⁰⁹.

R&D Sectors Cost Profiles

On average 13 per cent of costs for R&D operations are determined on global markets. Of the three R&D sectors benchmarked in this report, clinical trials operations are the most sensitive to locally determined costs (93 per cent).

Figure A3: R&D Sectors' Cost Profiles



Source: KPMG, 'Competitive Alternatives, 2010', Forfás calculations

Similarly, to the services case studies, it is unsurprising that labour costs comprise such a large component of location sensitive costs for the case study R&D operations. They account for 91 per cent of costs within the clinical trials firm, 78 per cent within the product testing operation and 73 per cent within the biotechnology firm. The leasing of property of a major cost element for these firms also (18 per cent for biotechnology, 15 per cent for product testing). Due to substantial grants for R&D operations across many countries, taxes amount to less than 0.9 per cent of locally determined costs for the case study biotechnology firm and 0.6 per cent for product testing. For the clinical trials case study operation, on average grants exceed taxes across the ten countries benchmarked and provide a 3.2 per cent cost write off.

¹⁰⁹ OCO Consulting research for NCC, Cost of Doing Business, 2006

Forfás Board Members

Eoin O'Driscoll, Chairman

Managing Director, Aderra

Martin Shanahan

Chief Executive, Forfás

Simon Barry

ROI Chief Economist, Ulster Bank Capital Markets

Bob Brannock

President, International Europe and Lifestyle Protection, Genworth Financial

Timothy Dullea

Formerly Chief Executive Officer, Tipperary Co-op

Prof. Frank Gannon

Director General, Science Foundation Ireland

Sean Gorman

Secretary General, Department of Enterprise, Trade and Innovation

Miriam Magner Flynn

Managing Director, Career Decisions

William O'Brien

Managing Director, William O'Brien Plant Hire Ltd

Barry O'Leary

Chief Executive, IDA Ireland

Paul O'Toole

Director General, FÁS

Frank Ryan

Chief Executive Officer, Enterprise Ireland

Dr Don Thornhill

Chairman, National Competitiveness Council

Michael O'Leary

Secretary to the Board, Forfás

Recent Forfás Publications

Enterprise Statistics At A Glance 2010 Forfás	November 2010
Categorisation of State Expenditure on R&D Forfás	November 2010
Future Skills Needs of the Biopharma-PharmaChem Sector EGFSN	November 2010
Waste Management in Ireland: Benchmarking Analysis and Policy Priorities - Updated 2010 Forfás	October 2010
Making It Happen: Growing Enterprise for Ireland Forfás	October 2010
Input to the Services Directive Regulatory Impact Assessment (Update September 2010) Forfás	September 2010
Ireland's Nanotechnology Commercialisation Framework 2010 -2014 Forfás	August 2010
Adaptation to Climate Change: Issues for Business Forfás	August 2010
The Irish Energy Tetralemma - A Framework for Fuel Choices in Ireland Forfás	August 2010
The Role of State Owned Enterprises: Providing Infrastructure and Supporting Economic Recovery Forfás	July 2010
Annual Competitiveness Report 2010 Volume 1: Benchmarking Ireland's Performance National Competitiveness Council	July 2010
Costs of Doing Business in Ireland 2010 National Competitiveness Council	July 2010
Monitoring Ireland's Skills Supply: Trends in Education and Training Outputs 2010 EGFSN, FÁS	July 2010
National Skills Bulletin 2010 EGFSN, FÁS	July 2010
Forfás Annual Report 2009 Forfás	June 2010

Future Skills Needs of the Wholesale and Retail Sector EGFSN, Forfás	May 2010
Review of supports for exploitation of Intellectual Property from Higher Education Research Forfás, Department of Enterprise Trade and Innovation	May 2010
The Expert Group on Future Skills Needs - Statement of Activity 2009 EGFSN	April 2010
Single Window: Assessment of the Costs of Trade-Related Regulatory Requirements in Ireland Forfás	March 2010
Annual Employment Survey 2009 Forfás	March 2010
Evaluation of Framework Programme 6 in Ireland Forfás	March 2010
Maximising the Environment for Company Research and Development Advisory Science Council	March 2010
Review of Labour Market Programmes Department of Enterprise Trade and Employment	March 2010
Profile of Employment and Unemployment Forfás	March 2010
Management Development in Ireland Management Development Council	March 2010
Forfás Evaluation of Irish Membership of the European Molecular Biology Laboratory Forfás	March 2010
Ireland's Broadband Performance and Policy Actions Forfás	January 2010
Regional Competitiveness Agendas Forfás	January 2010
Annual Business Survey Of Economic Impact 2008 Forfás	January 2010
Annual Competitiveness Report 2009, Volume Two: Ireland's Competitiveness Challenge National Competitiveness Council	January 2010
The Role of PhDs in the Smart Economy Advisory Science Council	December 2009

The publications of Forfás are available at
www.forfas.ie

To sign up for our email alerts contact us at
info@forfas.ie or through the website.

October 2010

Forfás

Wilton Park House
Wilton Place
Dublin 2

Tel: +353 1 607 3000

Fax: +353 1 607 3030

www.forfas.ie