

COST COMPETITIVENESS CRUCIAL FOR SUSTAINED ECONOMIC GROWTH

- The costs of doing business in Ireland have a significant influence on how competitive we are internationally
- A competitive cost base helps create a virtuous circle between inflation, wage expectations and competitiveness
- A favourable exchange rate, low fuel prices and muted inflation have driven recent improvements in Irish cost competitiveness. These favourable tailwinds are fading. Brexit has structural cost implications for many exporters
- Increases in property, business services and labour costs and consumer prices have the potential to undermine recent competitiveness gains
- This reinforces the importance of prioritising policies and actions that are within Ireland's control to enhance cost competitiveness and avoid unsustainable economic growth

Introduction

Ireland's economic prosperity is inextricably linked to how competitive we are internationally. As a small open economy, relative cost competitiveness is a significant determinant of Irish competitiveness, and ultimately economic growth, employment and our standard of living. More broadly, a more competitive cost base can help to create a virtuous circle between inflation, wage expectations and competitiveness. The **NCC's Cost of Doing Business in Ireland 2017** report focuses on those costs which affect business most and assesses Ireland's cost competitiveness vis-a-vis a range of OECD countries.

Context

High and rising business costs reduce the competitiveness of goods and services produced in Ireland trading in both domestic and international markets and make Ireland less attractive for mobile investment. Over the course of the recession, Ireland underwent a sharp correction in terms of our cost competitiveness. While the economy is in its strongest place since the onset of the recession, we are at a critical juncture. Pressures have emerged in key areas. Infrastructure bottlenecks and capacity constraints in particular are again immediate drivers of upward cost pressure. In recent years, the weak Euro exchange rate, low interest rates, and low international fuel prices have driven improvements in Irish competitiveness. Through currency effects, Brexit has seen immediate cost implications for exporters. Such external developments reinforce the importance of prioritising policies and actions that are within Ireland's control to enhance cost competitiveness.

How Ireland performs

Labour Costs

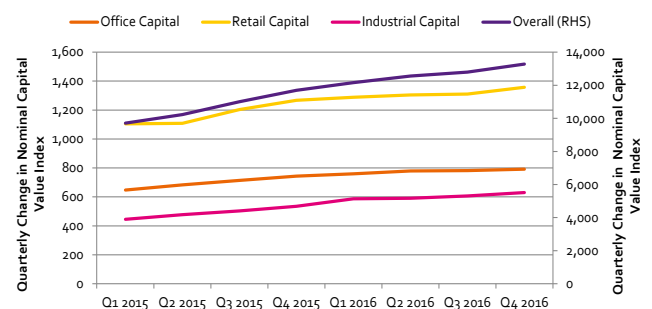
Labour costs (which include wages and salaries, employer-paid statutory plans, and other employee benefits) represent the largest cost factor for business. Upward labour

cost pressures are evident across the economy and across sectors. In Ireland, the hourly labour cost was €30.4 in 2016, compared to €26.7 in the UK and €29.8 for the Euro area 19. While labour cost growth has been positive in Ireland, the growth has been below EU and Euro area averages in the 5 year period to 2016, representing a competitiveness gain for Ireland. However, the trend masks considerable divergence at sectoral level particularly in both the ICT and Wholesale & Retail sectors where growth has outpaced average Euro area increases. We must ensure that wage growth is sustainable and thereby avoid finding ourselves in a position where wage growth outpaces productivity growth and doesn't outpace similar growth in competitor countries.

Property Costs

The last number of years has witnessed a sustained recovery and upward price pressure in the Irish commercial property market. However, concerns persist about the availability of competitive commercial property solutions which are a key requirement for start-ups, the expansion of enterprises and winning mobile investment.

Figure 1: Quarterly change in capital values in Ireland



Source: Jones Lang LaSalle, Irish Property Index

Despite an increase in construction activity and planning permissions residential property supply also remains constrained. Continued strong demand means property price inflation is likely to continue in the short term without additional supply becoming available.

Transport Costs

Ireland is characterised by high taxes on motor fuel and 58 per cent of total diesel costs are made up of various taxes, the 5th highest proportion in the Euro area. The impact of these taxes is becoming more evident as the international price of oil increases. The recent sharp rise in international oil prices has been a contributing factor. Irish petrol and diesel prices increased by 14.8 and 22 per cent respectively in the 12 month period to February 2017.

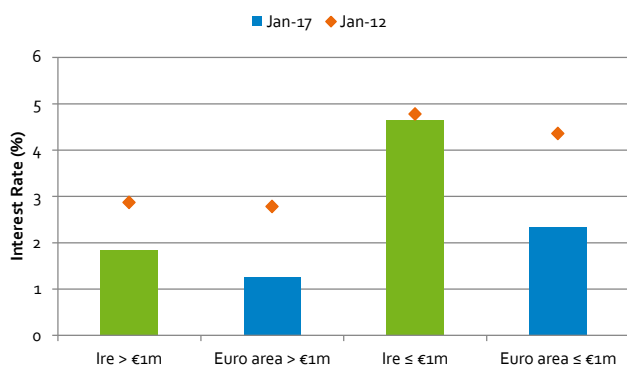
Utility and Telecommunications Costs

The differential average price for electricity between Ireland and the UK has gone from a point where we are almost 12 per cent more expensive in 2012 to a situation where in the first half of 2016 electricity prices are 6 per cent cheaper in Ireland. On average, water and waste water costs for enterprise in Ireland compare favourably to those in competitor markets. Ireland is relatively cost competitive for telecoms, especially for business mobile broadband. However, concerns persist around the issues of quality (speed) and the regional availability of high speed services.

Credit and Financial Costs

The cost of credit in Ireland, while falling, remains high in an international context. Ireland had the 4th highest SME interest rates on bank overdrafts and credit lines in the Euro area in 2016. In January 2017, the interest rate in Ireland on loans of up to and including €1 million was almost double the Euro area average rate for new business (See Figure 2).

Figure 2: Interest rates for non-financial corporations (new business) by loan size



Source: European Central Bank

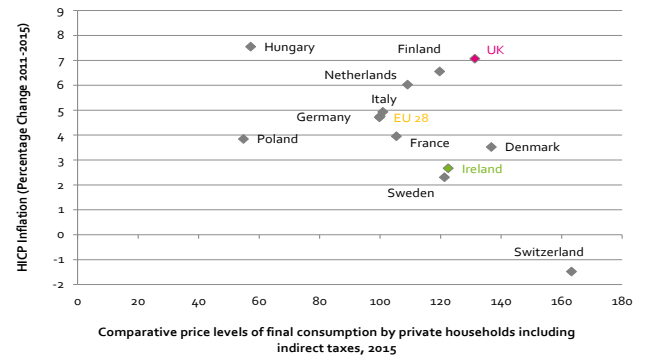
Business Services Costs

Services prices in Ireland have risen continuously since the beginning of 2012 and the magnitude of the increase has been higher than the Euro area 19 average during this period also. Large increases in prices were recorded in Postal and Courier services and Advertising, Media & Market Research since 2012. While the price of legal services dipped for a brief period in 2013, in Q3 2016 legal service prices were 8.3 per cent higher than the corresponding quarter in 2012.

Broader Costs Environment

Ireland's current price profile could be described as 'high cost, rising slowly'. Price levels in Ireland were 22.5 per cent more than the EU average in 2015; the UK was 31.3 per cent above the EU average. Prices on average, as measured by the CPI, were 0.9 per cent higher in April 2017 compared with April 2016. The services sector is likely to remain the main source of upward price pressure in Ireland, with the price pass-through of exchange rates and expected increases in energy prices.

Figure 3: HICP Price levels and inflation, 2011-2015



Source: CSO/Eurostat

Conclusion

While the economy is experiencing continued strong growth, increasing business costs reduce the competitiveness of enterprises based in Ireland and our attractiveness as a location for mobile investment.

Ireland remains a relatively high cost location and growth has resulted in a series of upward cost pressures. The appreciation of the euro vis-à-vis sterling provides a timely warning about just how vulnerable Irish firms are to external shocks. Brexit reinforces the importance of prioritising policies and actions that are within Ireland's control to enhance cost competitiveness. A willingness to take action on costs and the controllable drivers of cost increases is essential. There is a role for both the public and private sectors alike to manage proactively the controllable portion of their respective cost bases, drive efficiency and continue to take action to address costs.

The policy implications of the Costs analysis will be included in the Council's annual **Competitiveness Challenge** report which will be published later this year.

Further Reading: The data and policy positions summarised herein are drawn largely from **Costs of Doing Business 2017**. See www.competitiveness.ie. The NCC reports to the Taoiseach on key competitiveness issues facing the Irish economy. This Bulletin has been issued by the Chair and Secretariat.