

PRESS RELEASE

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RISING COSTS OF DOING BUSINESS THREATEN SUSTAINABLE AND PROLONGED GROWTH

National Competitiveness Council publishes Costs of Doing Business in Ireland 2017 report

The National Competitiveness Council (NCC) today launched its Costs of Doing Business in Ireland 2017 report. This report benchmarks the main business costs across over 70 indicators and focuses on areas where Irish enterprise costs are out of line in those in key competitor countries. The report concentrates on costs that are largely domestically determined such as labour, property, energy, water, waste, communications and business services, and considers both price levels, and changes in those levels (i.e. price inflation).

In terms of business costs, as a small open economy, dependent on exports and foreign investment as major drivers of growth, our relative cost competitiveness is a significant determinant of our overall competitiveness, and ultimately of our economic prosperity, employment and our standard of living.

The improved competitiveness of Ireland's exporting sector has been one of Ireland's greatest strengths in recent years and has been key to economic growth and job creation. It has been critical to the success of Irish based exporters, allowing them to maximise the opportunities arising from increases in global demand. Despite improvements in Irish cost competitiveness since the global economic and financial crisis, threats to continued economic success abound. While the Irish economy is experiencing rapid growth, the global economy is not proving as robust, with growth prospects curtailed by lower consumption, investment, trade and productivity levels. To protect the gains achieved to date, to further embed and sustain the recovery, and to ultimately spread the benefits of economic growth to all, we must continue to enhance all aspects of our competitiveness.

In this regard, costs are paramount: a competitive cost base helps to create a virtuous circle between inflation, wage expectations and cost competitiveness. On the other hand, high business costs make Ireland less attractive for foreign direct investment and reduce the competitiveness of Irish enterprises' goods and services trading in both the domestic and international markets.

Ireland is particularly vulnerable to negative economic shocks which are outside the influence of domestic policymakers. Over the past 12 months, for instance, we have seen the challenges created for Irish firms exporting to the UK as a result of Brexit, resulting from the weakness of sterling on international currency markets. The international price of oil has almost doubled over the past 12 months and the favourable tailwind of low international energy prices, which to date have countered increases in other domestic costs, is now dissipating. Such external developments reinforce the need to pursue policies to enhance Irish cost competitiveness.

Domestically, a number of short and medium term downside risks for Ireland have already emerged and these could potentially undermine national competitiveness, growth, and ultimately living standards. These pressures include emerging infrastructure bottlenecks, skills shortages and increasing levels of industrial unrest. Maintaining fiscal sustainability and a broad tax base, supporting structural reform, innovation, and productivity, and growing our enterprise and export base will remain significant immediate challenges.

Specifically in terms of costs, the cost base for enterprise has improved across a range of metrics since 2010, (e.g. the cost of starting a business, communications costs and average income taxes). Ireland, however, remains a relatively high cost location and already the return to sustained levels of growth has resulted in a series of upward cost pressures.

The Council is especially concerned about the rise in both commercial and residential property costs - the availability and cost of property is again a significant threat to sustained cost competitiveness. In particular the dramatic increase in residential rents (back to, and in some locations exceeding pre-recession levels) is a major cause for concern with potentially significant adverse consequences for the entire economy. Rising rents and increasing house prices will inevitably impact upon wage demands, increase the cost of living and will damage competitiveness. Likewise, the low vacancy rates in some urban areas coupled with concerns about the availability of prime commercial space is causing a rapid increase in commercial rents – especially office rents. Our previous property boom was at the epicentre of so many of our recent economic problems. We must try to avoid this sector undermining the current economic recovery and threatening its sustainability in the future.

The report also highlights the high costs associated with a range of business services including postal and courier, legal services and market research. Services associated with the construction sector, namely architecture and engineering have also been significant drivers of the service price increases over the past 12 months. The upward trend across these business services also serves as a warning signal that cost pressures are emerging in a myriad of sectors.

The cost of credit for enterprise in Ireland is the third area the Council focuses on in the 2017 report. While the cost of finance and the supply of credit has undoubtedly improved in recent years, Irish firms face higher interest rates on loans of up to and including €1 million than their competitors abroad. While most firms are understandably primarily concerned about accessing credit rather than the cost of that credit, the interest rate differential between Ireland and the euro area places Irish based enterprises at a distinct disadvantage.

Finally, in relation to labour costs, the Council notes that although demands for wage increases are understandable after a period of economic stagnation and wage cuts, our relative competitive position will be negatively affected if wage growth outpaces that in competitor countries. Therefore, to ensure that wages are sustainable, wage growth should not outpace productivity growth but, at the same time, there must be a relentless focus on protecting real living standards by avoiding, as best as possible, significant increases in the costs of living. This is why the Council is advocating that attention be paid to a broad range of costs in an effort to promote a virtuous circle encompassing the costs of living, wage expectations, productivity and cost competitiveness.

Speaking at the launch of the report, Prof Peter Clinch, Chairman of the NCC commented: “Over the course of the recession, the Irish economy underwent a sharp correction in terms of our cost competitiveness. The recent appreciation of the euro vis-à-vis sterling and the higher international price of oil provides a timely warning about just how vulnerable Irish firms are to external international shocks. The appreciation of the euro has placed Irish exporters under increased cost competitiveness pressure. Higher international oil prices exert a significant influence on energy and transport prices. This reinforces the importance of prioritising policies and actions that are within Ireland’s control to enhance cost competitiveness”.

He continued: “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 unnecessarily high costs. Such actions will ensure that improvements in relative cost competitiveness are more sustainable, leaving Ireland better positioned to cope with external shocks. At the same time, productivity performance will assume an even more prominent role in driving Irish international competitiveness. Indeed, in the longer term, productivity growth is the preferred mechanism to improve competitiveness as it can support cost competitiveness in tandem with high and increasing income levels. There remains a need to increase the productivity levels across all sectors and occupations, particularly in Irish owned business”.

Key Findings

Labour

- There is considerable heterogeneity across Europe with regard to, average hourly labour costs in the whole economy. 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 Irish labour cost growth has been positive, the growth has been below EU and Euro area averages in the 5 year period to 2016, representing a competitiveness gain for Ireland.
- Sectoral wage growth rates have been lower in Ireland than the Euro area over the corresponding period with the notable exception of Wholesale & Retail and ICT. Domestically, at sectoral level, hourly labour costs in Construction and Wholesale & Retail in Ireland grew by 4.6 per cent and 4.1 per cent respectively between 2012 and 2015. Across all sectors the average growth was 1 per cent.
- Ireland has a very progressive income tax regime. According to the OECD, the levels of taxation in Ireland are below the Euro area on average income levels and on marginal income levels for married couples. The corresponding marginal levels are, however, high for single earners.

Property

- The last number of years has witnessed a sustained recovery in the Irish commercial property market. The cost of constructing a prime office unit and a High Tech Factory / Laboratory facility in Ireland rose by 6 per cent and 2 per cent in 2016 over the previous year.
- Commercial rents growth has been driven by an increase in demand, reflecting the improving economy. This in turn, has boosted capital values, the price that would have been paid for property if it had been purchased at the point of valuation, in all commercial sectors (e.g., office, industrial and retail).
- The availability of competitive property solutions is a key requirement for the expansion of enterprises and winning mobile investment. In 2016 prime retails rents increased by 32 per cent year-on-year on Dublin's Grafton St. In the 5 years to Q2 2016 Compound Annual Growth Rates associated with Office Rents were 14.1 per cent in Dublin (D2 and D4 districts) and 7 per cent in Cork. The growth rates in Dublin were over three times the equivalent rates in both London City and London's West End.

Transport

- 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.
- Irish petrol and diesel prices increased by 14.8 and 22 per cent respectively in the 12 months to February 2017. In addition, the cost of 1,000 litres of diesel in Ireland (€1,269) was 4.8 per cent above the Euro area average (€1,211) in the corresponding month. Ireland was the 4th most expensive country with taxes on diesel, at 58 per cent, accounting for the majority of this differential in Ireland. This is the 5th highest proportion in the Euro area.

Utilities

- 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. Whilst industrial gas prices are now equal to the average prices across the Euro area, comparable prices are over 15 per cent lower in the UK.

- On average, water and waste water costs for enterprise in Ireland compare favourably to those in competitor markets. Within Ireland, water costs vary significantly by local authority. In terms of waste costs, the cost of landfill has increased from €93 per tonne in 2010 to €113 in 2014 because of increases in the landfill levy¹. Irish landfill costs are amongst the most expensive of the benchmarked countries/regions.
- 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 supply and demand for credit has improved significantly since the height of the crisis. However, the cost of credit, 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. Furthermore, Irish interest rates for loans both under- and over the €1m threshold have been noticeably more volatile than Euro area rates. Irish and Euro area interest rates diverged further in 2014 and 2015. It is vital that cost competitiveness in this area does not weaken further.
- The cost of registering a business in Ireland as a percentage of Gross National Income was 0.2 per cent in Ireland in 2016, half the rate recorded some five years previously. The corresponding average across the OECD was 3.88 per cent.

Business Services and Other Input 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. Overall since 2010, service prices have risen by more than manufacturing prices perhaps reflecting the greater exposure of the manufacturing sector to international competition. Large increases in prices were recorded in Postal and Courier (10.6 %) and Advertising, Media & Market Research (7.9%) 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. According to the World Bank, in international terms Ireland remains an expensive location in which to enforce a business contract and is the 6th most expensive in the OECD. It also takes significant time (650 days) to enforce a contract in Ireland (compared with an OECD average of 551 days). The World Bank also estimate that the total cost of contract enforcement in Ireland amounts to 26.9 per cent of a claim, compared with 22.1 per cent across the OECD.

Broader Cost Environment

- Ireland remains an expensive location in which to do business with a price profile which can be described as “high cost, rising slowly”. Irish consumer prices remain over 22 per cent above the European Union average.
- Education costs have increased at a faster rate than overall consumer costs since 2012 and over the corresponding period prices have risen by 18.5 per cent. These increases have been driven primarily by increases in the tertiary sector.

¹The increase in the landfill levy is fully in line with the Government’s policy to move waste management away from landfill. The landfill levy is an important economic instrument to support the development of alternative treatments to landfill in the higher tiers of the waste hierarchy and lessen our impact on the environment. The landfill tax in the UK is 84.40 Sterling.

- Irish insurance price inflation as measured by the HICP has been volatile and significantly above the UK rate and Euro area average from early 2014. Health insurance, which accounts for approximately 60 per cent of the insurance category, has increased in Ireland in recent months. In March 2017 the rate of Irish health insurance inflation (8.3%) was well above the Euro area (2.3%) and UK (3.8%).
- Mainly administered prices cover the prices of goods and services on which the government including any national regulator has a significant influence. There has been a downward trend in HICP and administered price inflation over the period 2011-2016. Inflation in administered prices was particularly high in 2011 (6.3%) 2012 (7.3%) and 2015 (10.5%).
- The affordability of housing is a key component of competitiveness. It impacts upon the attractiveness of Ireland as a location for investment and directly impacts on enterprise costs through wage effects, and indirectly determines the price of Irish goods and services. Taking account of the higher cost of mortgage finance in Ireland, only two cities, Amsterdam and London had a higher 'mortgage affordability index' in 2015. In terms of rent as a percentage of income, three international cities were found to be less affordable than Dublin. Residential Tenancies Board data for 2016 indicates that private sector rents continued to trend upwards.
- At a national level, annual growth was 7.8 per cent in Quarter 4, 2016; this compares to 6.6 per cent annual growth in Q3 2016. The standard national average rent in Q4 2016 stood at €986 per month. This is nearly the same as peak rents in 2007. The CSO's Residential Property Price Index has risen by 52.1 per cent in the five years to February 2016 while year-on-year national growth in the corresponding month was 10.7 per cent.
- Childcare costs in Ireland are the second highest in the OECD for couples and the highest in the OECD for lone parents.

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The full report is available at www.competitiveness.ie

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