National Competitiveness Council Bulletin

NCC Competitiveness Bulletin 18-2: Costs of Doing Business in Ireland 2018

COST COMPETITIVENESS PRESSURES RISE AS THE ECONOMY CONTINUES TO GROW

- **The costs of doing business in Ireland have a significant influence on how competitive we are internationally.**
- **Ireland remains a relatively high-cost location and growth has resulted in a series of upward cost pressures. Increases in property, business services, labour costs and consumer prices have the potential to undermine recent competitiveness gains.**
- **Brexit underlines the importance of keeping costs down to mitigate the effects of continuing uncertainty and unfavourable exchange rate movements. This is a key element in facilitating firms to stay competitive in international trade.**
- **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.**
- **It is imperative that Government continues to place competitiveness at the heart of our Brexit response and prioritises policies and actions that are within Ireland's control to enhance cost competitiveness.**
- **As the economy continues to grow, the pressure on costs increases and it is critical that domestic policies do not contribute to overheating of the economy.**

Introduction

As a small open economy, the relative cost of doing business in Ireland is a significant determinant of competitiveness and, ultimately, economic growth, employment and our standard of living. The **NCC's Cost of Doing Business in Ireland 2018** report focuses on costs which affect business and assesses Ireland's relative competitiveness with regard to a range of OECD countries.

Context

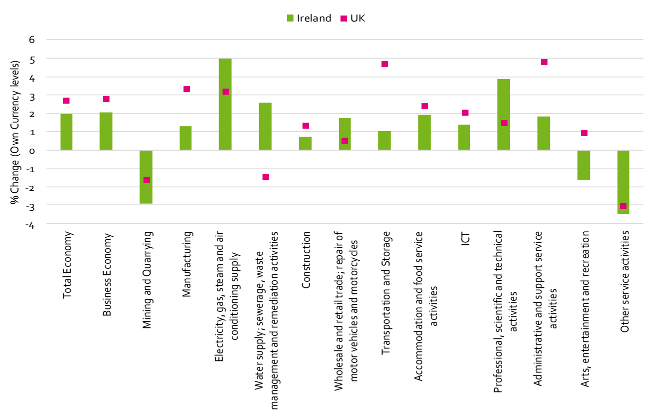
Ireland's continued strong economic performance is reflected in strong employment growth and substantial improvements in the public finances. The outlook for the economy appears positive. Pressures have emerged in key areas. Capacity constraints are, again, immediate drivers of upward cost pressure. Uncertainty in relation to Brexit also remains a concern. In addition, the performance of a relatively small cohort of firms has a disproportionate influence on value added, exports, and corporation tax leaving the economy vulnerable to firm-specific shocks. The globally connected nature of Ireland's trade, technological and financial links means Ireland remains vulnerable to external shocks. This reinforces the importance of prioritising policies and actions that are within Ireland's control to enhance cost competitiveness.

How Ireland performs

Labour Costs

Labour costs represent the largest cost factor for business. Upward labour cost pressures are evident across the economy and across the sectors. In Ireland, the hourly labour cost was €31.0 in 2017, compared to €25.7 in the UK and €30.3 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 2017, representing a competitiveness gain for Ireland. A sectoral level, there is considerable divergence within the Irish economy, and between Ireland and the UK, in terms of labour-cost growth in 2017. In Ireland, the sectors with the highest rates of growth were financial and insurance (5%), and electricity, gas&steam (5%). As the economy nears full employment, skills shortages are likely to emerge and it is anticipated that wages will rise at a faster pace in 2018 and into 2019. With inflation expected to remain relatively modest over the next two years, rising wages should translate into higher real incomes. Ireland must avoid a situation where wage growth outpaces productivity growth and wage growth in competitor countries.

Figure 1: Eurostat Growth in Labour Costs 2017

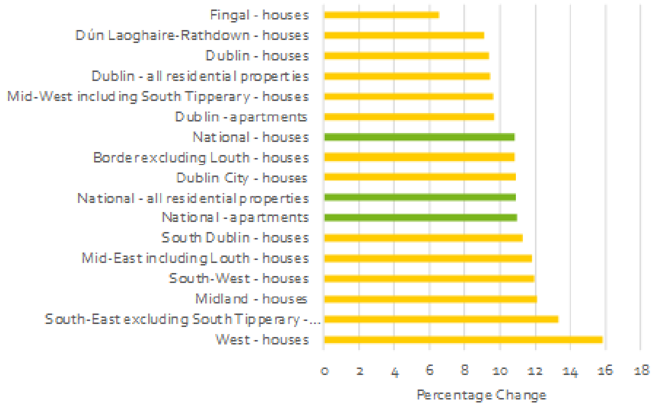


Source: Eurostat

Property Costs

Increasingly, the shortfall and affordability of residential housing affects Ireland's ability to attract and retain talent, and can indirectly impact on enterprise costs and influence the competitiveness of Irish goods and services. High rents affect decisions around labour mobility, entering employment and expansion of operations by enterprises, therefore they are a significant infrastructure impediment, particularly in urban areas. Prices in Ireland remain relatively high and rents push the cost of living out of line with other developed European economies. On average in 2017 the rate of increase in house prices was highest in the West (16%) and lowest in Fingal (6.6%). National prices increased by 10.8%. On a national basis apartments increased by 11% with prices increasing by 9% in Dublin.Despite an increase in construction activity, strong demand means property price inflation is likely to continue.

Figure 2: Residential Property Index, Average annual Percentage Change, 2017

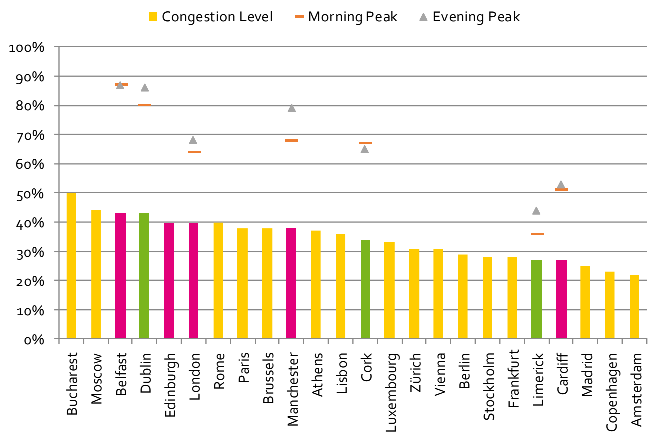


Source: CSO

Transport Costs

Economic and employment growth has increased pressure on transport infrastructure capacity, which manifests itself in increased journey times and traffic congestion. Census data shows 200,000 commuters, representing almost 11 per cent of all commuters, spent an hour or more on the journey to work in 2016. Nearly 53,000 workers commuted 90 minutes or more. Congestion statistics based on TomTom's database (Figure 3) shows, on average, journey times in busy periods taking 43%, 34% and 27% more time in Dublin, Cork and Limerick. Dublin is one of the most traffic-congested cities in Europe, with morning and evening congestion times 80% and 86% higher compared to a free flow.

Figure 3: Traffic congestion levels, 2016



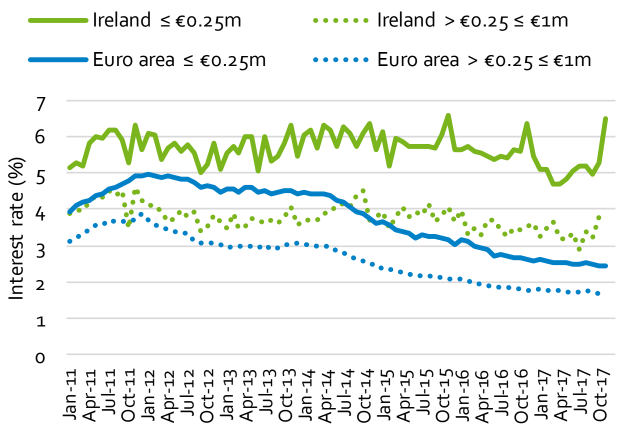
Source: Tom Tom International

While fuel prices are relatively stable, the implications of extra administrative costs and tariffs, standards and regulations and customs on the transport of goods between Ireland and the UK may negatively impact on indigenous exporters' supply chains, and their capacity to competitively price products, not only in the UK but domestically and in other international markets.

Credit and Financial Costs

The supply and demand for credit has improved significantly since the crisis. However, the cost of credit remains relatively high, particularly for SMEs. The determinants of such costs are complex, but the concentrated lending market, coupled with higher credit risk premiums in Ireland, has led to higher interest rates. The impact of an interest rate shock on borrowing costs could be significant. Interest rates on new business loans in Ireland have been consistently higher than equivalent Euro area rates. This puts Irish businesses at a competitive disadvantage. The divergence is particularly noticeable for loans of up to €0.25 million, where the interest rate on new business loans in Ireland was more than double the Euro area average rate throughout 2017.

Figure 4: Interest rates for non-financial corporations (new business) by loan size

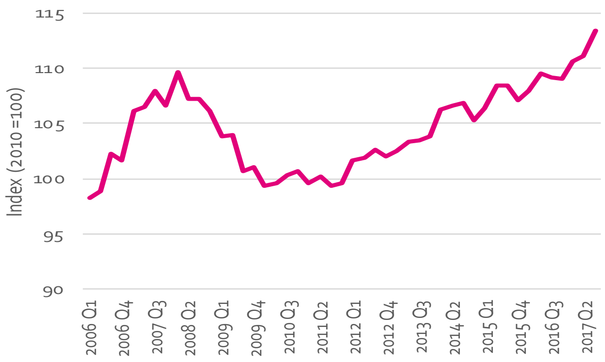


Source: European Central Bank

Business Services Costs

Services prices in Ireland have risen continuously since the beginning of 2012. In Q3 2017, the SPPI stood at 113.4 (Figure 5). Following a period of decline during the recession, an upward trend has been evident since 2011. Services Prices have increased by 3.9% in the year to Q3 2017. The most notable changes in the year were: Postal and Courier (+8.9%), Air Transport (+5.9%), Computer Programming and Consultancy (+5.8%) and Sea and Coastal Transport (-10.6%).

Figure 5: Services producer price index , 2006-2017

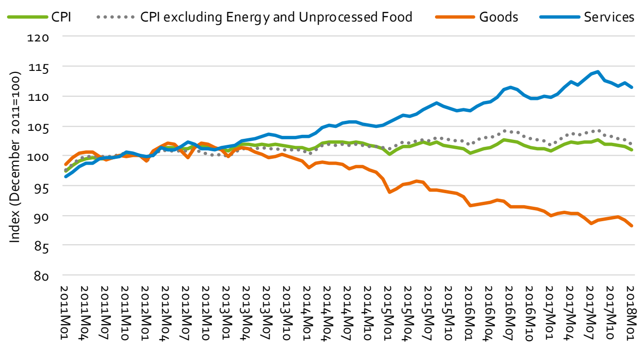


Source: CSO

Broader Cost Environment

While inflation remains moderate, this is largely due to currency effects and is likely to increase in 2018 and beyond. The annual average rate of inflation in 2017 was 0.4%. The price of Goods decreased on average by 2.1%. The price of Services (which includes mortgage interest) rose by 2.1%. Ireland remains an expensive location in which to do business with a price profile which could be described as "high cost and rising". Price levels in Ireland were 23.7% above the EU 28 average in 2016 and increasing by 0.2% in November 2017; the UK was 21.6% above the EU average and increasing by 2.6%.

Figure 6: Consumer Price Index, January 2011-2018



Source: CSO/Eurostat

Quality of Life

With the labour market approaching full employment, improving the quality of life and the creation of an attractive environment in which to live and work is particularly important. In this regard, well planned infrastructure, particularly affordable housing, transport and childcare are key pinch points for business and workers. Increasingly, the shortfall and affordability of housing affects Ireland's ability to attract and retain talent. High rents affect decisions around labour mobility, entering employment and expansion of operations by enterprises. Therefore, they are a significant infrastructure impediment, particularly in urban areas. Prices in Ireland remain relatively high and rents push the cost of living out of line with other developed European economies. The PRTB report that, on a year-on-year basis, rents for houses increased by 8.2% in 2017 Q3. Apartment rents increased by 11.5% on a year-on-year basis. The quarter-on-quarter growth rate for houses increased to 4.3% in 2017 Q3, up from 2.9% in 2017 Q2.Despite an increase in construction activity, strong demand means property price inflation is likely to continue. It is well understood that a significant increase in supply is urgently required. Gross childcare fees in Ireland are relatively high compared to EU and OECD averages and are the 8th highest in the OECD overall. As a percentage of average wages, childcare fees account amount to 50% in Ireland compared to the Euro area average of 22%.

Conclusions

- While Ireland experiences strong economic growth, the openness of the economy means the enterprise sector is particularly vulnerable to negative price and cost shocks which are outside the influence of domestic policymakers. These include unfavourable exchange rate movements, higher international energy prices or imported inflation from our major trading partners or an interest rate shock. Despite improvements in Irish cost competitiveness, several short- and medium-term downside risks have already emerged that could undermine national competitiveness, growth and living standards.
- Brexit, and the continued uncertainty it brings, calls into sharp focus the importance of cost competitiveness relative to the UK. The structure of the economy means it is imperative that Ireland remains competitive and reinforces the importance of prioritising policies and actions that are within Ireland's control to keep costs inflation low. As the economy continues to grow, the pressure on costs increases and it is important that domestic policies do not contribute to any overheating. 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 still remains a relatively high-cost location and growth has resulted in a series of upward cost pressures.
- There is a role for both the public and private sectors alike to manage proactively the controllable portion of their respective cost bases, drive productivity growth and continue to take action to address controllable costs and to increase awareness of them.

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 from **Costs of Doing Business 2018.** See **www.competitiveness.ie**. The NCC reports to the Taoiseach on key competitiveness and productivity issues facing the Irish economy. This Bulletin has been issued by the Chair and Secretariat.