

Re-conceptualising Ireland's Competitiveness

A Summary of the 2008 National
Competitiveness Council
Conference

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1. Background and Introduction

This paper provides a brief summary of the key themes that emerged from the NCC's Competitiveness Conference, which was held in Farmleigh on January 9th, 2008. As the event was held under the Chatham house rule, views and comments are not attributed to individual participants. It should be noted that the views expressed in this paper do not necessarily represent those of the National Competitiveness Council and neither do they reflect a consensus view among conference participants, but rather a summation of the various opinions expressed during the event.

Over the last fifteen years, Ireland has experienced unprecedented success and economic growth. It has been widely accepted, however, that the policy actions which are required to sustain and build upon these achievements differ from those factors which combined to bring us thus far. Our recent success addressed many of our earlier challenges, such as high unemployment and outward migration. However, our achievements have been accompanied by the arrival of new challenges, such as high costs and infrastructure deficits. In addition, globalisation has changed the world environment. The opportunities and challenges it brings have become key agenda items for businesses and countries.

The purpose of this day long event was to create a forum in which leaders in the fields of Irish business, policy making and academia could assist in identifying and exploring the key challenges to Ireland's competitiveness in the medium and long term. It is hoped that the views expressed by both speakers and delegates during the event will provide new ideas and perspectives on Irish competitiveness and will contribute to developing solutions to the challenges and to realising the opportunities identified.

2. Dimensions of Competitiveness in the 21st Century

The opening session of the conference focused on assessing the opportunities available to Ireland by harnessing a new wave of competitiveness - which participants argued, will be based around innovation and quality rather than simply cost competitiveness.

Growing complexity was highlighted as a key challenge for all countries. This presents, it was argued, two key issues. First, how can we simplify procedures and avoid red tape and make it easier to do business from Ireland. While the ease of doing business from Ireland is regarded as one of our traditional strengths, it was noted that there is a tendency over time to make procedures and regulations more complex. It is important that this is avoided. Second, while complexity should be eliminated where possible, in a developed economy it is unavoidable and indeed, where managed well, can form a source of competitive advantage. Therefore, we need to develop the ability to better manage the intricacies of a prosperous economy and society. We need to train people to manage complexity through joined up thinking and integration of systems (e.g., transport and ICTs, health systems, etc.). Singapore and Amsterdam were cited as two leading cities in this regard.

It was noted that Ireland has made substantial economic progress in recent years. Income per capita in Ireland is now approaching that of other leading countries. However, income is not the same as accumulated wealth. It was argued that Ireland needs to move from a **'nation of employees to a nation of business owners'**. It was highlighted that the **'Irishness'** of our economy needs to be enhanced by growing a cadre of indigenous technology and innovation intensive firms competing aggressively on international markets (indigenous firms currently account for 11% of exports from Ireland). In order to develop the indigenous sector, it was felt that greater recognition of the importance of both small and medium sized companies is essential. In Germany, key drivers of growth are the medium sized private companies, the *Mittlstand*, often family-owned, that have developed niches - based on their own technologies and know-how - to serve world markets. Highlighted policy areas included the availability of finance - **'angel funding'** at the earliest stages of starting a business, venture capital to expand internationally and national investments in R&D for

SMEs. The nurturing of indigenous firms should not undermine the importance of FDI to Ireland's competitiveness, as it was felt it may take decades before our SMEs have the capacity to be a leading driver of Ireland's competitiveness. The importance of business and financial services in particular as drivers of growth and jobs in the global economy was also discussed.

It was highlighted that the Irish economy is currently in a **transitional phase**. The challenge facing Ireland (and many other countries) is to complete the transition from an economy which primarily competed on low costs to one based on the development, production and marketing of innovative, high value goods and services which are supported by a world class business environment. Differing views were expressed on the importance of cost competitiveness for an economy that is endeavouring to transition towards high value sectors and activities. The impact of the rising costs of doing business in Ireland was assessed, with particular reference to location decisions by multinational corporations.

More generally, an assessment of Ireland as a location for overseas investment found that Ireland continues to perform well in attracting FDI and that our competitive corporate tax rate, skilled workforce, access to markets and general business environment are among Ireland's key strengths. Our greatest weaknesses concern the recent growth in unit labour costs, the cost of domestic services and infrastructure deficits.

Finally, it was noted that the **current slowdown in the economy** presents both opportunities and threats. Reduced pressures on the construction sector could enable infrastructure elements of the NDP to be rolled out faster and more efficiently. However, if Government revenues come under pressure, it was noted that it would be necessary to prioritise key projects that can sustain and enhance our competitiveness.

3. The Changing Competitive Dynamics for Enterprise in Ireland and the Key Drivers of Competitiveness

A significant part of the conference reflected on how a range of businesses are successfully reacting to the competitive pressures they face and how the current business environment in Ireland supports their competitiveness. The development of key policy areas to support future economic growth through nurturing and sustaining a competitive enterprise sector was central to the discussion.

Key themes that emerged included:

- managing fundamental change;
- identifying areas where Ireland can be successful;
- maintaining a skilled and flexible workforce;
- developing the knowledge economy;
- developing Ireland's infrastructure;
- developing the all-island economy; and,
- the growing importance of quality of life issues.

3.1 There was broad agreement among conference participants that **rapid and sustained change** has become a defining element of the global economy. To sustain competitiveness into the future, firms and policy makers need to have the necessary mindset and agility to respond to ongoing change. Delegates were asked to consider whether the Irish business community, the public sector, trade unions and academia were meeting this challenge and, if not, how the national agenda could be reframed to assist 'Ireland Inc.' in achieving its full potential.

It was highlighted that a range of international challenges exist that are driving the need for continuous change. The implications of a slowdown in the US economy combined with the current weakness of the dollar and sterling for Ireland remain unclear. In addition, it was noted that China is rapidly transitioning from a low cost mass producer of products to

strategically developing clusters in key internationally trading sectors where Ireland has a presence. The Chinese Government and enterprise base is investing significantly in the development of new technologies, including environmental technologies. The opportunities for Ireland to benefit from China's growth were also highlighted as significant - in terms of exports, tourism and international education. It was suggested that potential exists to market Ireland as a gateway to Europe for Chinese companies. It was felt that the initiation of direct flights from Ireland to China could play an important role in this regard.

3.2 Where can Ireland be successful? The proposition was put forward that through specialisation, countries and firms should seek to carve out niche markets for themselves that build on their strengths. It was proposed that Irish based enterprises have the greatest growth potential in those niche markets that have high margins and that require specialised skills, intense interactions with customers, are knowledge intensive and in emerging areas which are anticipated to experience high growth. By focussing on emerging rather than established sectors, it was suggested that Ireland can avoid the difficulties of 'playing catch up' with those already leading the field. It was noted that this would require proactive and focused planning by enterprises together with the Government providing a supportive policy environment. Growing the scale of indigenous companies remains important to developing a strong base of internationally trading enterprises.

3.3 The importance of maintaining a **skilled and flexible workforce** was a recurring topic. Many aspects of the education system were addressed that focused on the delivery of a labour force that is committed to continuous training and development and has the skills to acquire knowledge quickly and effectively. In particular, the implementation of the National Skills Strategy was emphasised.

Participants highlighted the importance of ensuring that Ireland remains an attractive destination for **foreign workers**. It was noted that the recent introduction of the Green Card system, along with amendments to the work permit system, provide a flexible model for attracting skills from overseas. It was highlighted that Ireland needs to continue to be an attractive location for migrants. Ireland may face increased competition to attract skilled people in the future - it was noted that migrants have driven innovation in Silicon Valley.

3.4 Concerns over the optimum level of **labour market regulation** were raised. Differing views were expressed as to whether Ireland is striking the right balance between (over)regulating the labour market and ensuring labour market flexibility and voluntary best practice. Much of the debate centred on the implementation of the EU directive on Agency Workers. It was suggested that the policy focus should be on creating employee security rather than job security. It was also noted that employers could adopt greater workplace flexibility to enhance competitiveness. Specifically, employers were encouraged to develop flexible work options in order to create an environment that is conducive to increasing female participation in the workforce.

3.5 The need to develop and implement a **knowledge economy** strategy was highlighted as a concern. It was argued that the Government could play a stronger role in promoting innovation - through driving the rollout of advanced broadband infrastructure and services, through innovative eGovernment services, and developing pro-innovation and pro-SME procurement procedures.

A number of education related issues were also highlighted including the need to develop and implement an information and communications technology (ICT) education strategy for primary level students. It was felt that the potential for the higher education sector to assist in developing a competitive economy remained largely untapped by businesses and that the higher education institutions could play a stronger role as regional drivers of competitiveness.

It was felt that Ireland needed more ambitious targets for new business start-ups. It was suggested that there is potential for the various enterprise development agencies to work more closely and the proposed 'Team Ireland' approach of Enterprise Ireland, IDA and Science Foundation Ireland working together was welcomed. The need for greater clarity as to the funding available for frontier enterprise-led research projects was also identified.

It was suggested that many Irish businesses operate using outdated technologies. Addressing this issue will require a commitment from Irish businesses to invest in the best technology available and to continuously upgrade and innovate. As most innovation is driven by customer demands, it was argued that the further development of sales skills was essential. In terms of business funding for entrepreneurs and new knowledge intensive firms, attracting angel funding was identified as the most difficult stage. It was also noted that the availability of venture capital in Ireland is low which may be forcing Irish owned firms to sell out early. It was suggested that potential exists to encourage Irish pension funds to invest VC in the Irish market.

- 3.6 There was a broad consensus among participants that continued investment in **infrastructure** (e.g. roads, public transport, R&D, etc.) will be core to Ireland's future success and that these investments must be aligned closely with the needs of a competitive economy. Specifically, we need to continue to focus on our capacity for infrastructure planning and how we organise our cities. In a 'world of congestion', it is vital that the necessary infrastructure is provided to enable Ireland and particularly our cities to work effectively. It was argued that while we train people on how to manage companies and countries, it was felt that the processes for managing cities and their competitiveness are less well understood and communicated.
- 3.7 With regard to **all-island competitiveness**, it was recommended that businesses in both parts of the island should begin to operate within an all-island context and mindset in terms of growing market share and accessing resources. It was highlighted that the corporate tax differential on the island was a significant competitive advantage for the south.
- 3.8 The impact of **increasing costs on businesses** was highlighted as a particular challenge for competitiveness. It was noted that while a range of costs are outside our control (e.g. commodities such as oil, steel, etc.) we do have control over a range of other costs. The divergence in compensation per employee between sheltered sectors and those open to global competition was illustrated, along with the marked increase in non-labour domestic business input costs. It was felt that many of these cost increases are driven by Government (e.g. water, waste and Local Authority development charges) and domestic services sectors. While sheltered domestic sectors are driving up the cost base in Ireland, it was noted that firms competing internationally are required to continuously deliver better products and services, often at lower prices. It was agreed that a renewed emphasis on enhancing Irish productivity growth was essential, through both a sustained focus on skills enhancement and human capital development and through the promotion of competition and open markets in sheltered sectors of the economy.
- 3.9 Finally, it was noted that rapid economic change has resulted in an array of **quality of life issues** which must be addressed such as commuting times, life-work balance and the integration of immigrants into Irish society. It was also noted that softer infrastructures (e.g. cultural and sporting facilities) also play a critical role in enhancing competitiveness - especially in terms of attracting and retaining indigenous and overseas talent. The role of a vibrant indigenous media sector in promoting high levels of political and societal debate was also highlighted.

4. Global and National Drivers of Competitiveness

This session sought to examine a number of key policy areas in greater detail. A wide range of issues were addressed including,

- Globalisation and trade liberalisation;
- Energy and climate change;
- The impact of the international macro-economy and cost competitiveness;
- Modernisation of the public sector;
- The role of the taxation system; and,
- The role of the education system.

4.1 It was highlighted that Ireland and Europe have much to gain from ongoing **globalisation and trade liberalisation**. Over the last decade the European economy has created 18 millions new jobs. Europe is still the world's biggest exporter of goods and services, the world's biggest investor abroad and the biggest magnet for inward investment in the global economy. It was argued that a relative decrease in Europe's weight in the global economy, given the rise of Asia, need not translate into falling European living standards or a weakening in export performance. Globalisation has injected a billion new workers into the global economy in the last two decades, which has created an intense downward pressure on labour costs. However, it has also delivered over two billion new consumers. India and China's estimated consumer spending will top a trillion euros annually by the end of the decade, and it was argued that European companies are well positioned to exploit this. In this context, the ongoing development of the EU, the European single market (e.g. services) and the conclusion of the current round of the world trade talks are critical. Given the growing role of outward direct investment from Ireland by Irish firms and citizens, it was suggested that this should also form a key part of Ireland's trade agenda.

4.2 **Energy and climate change** are becoming critical issues. The need to address climate change challenges while maintaining competitiveness was discussed in some depth. It was argued that the challenge for all countries, including Ireland, is to achieve a transition to a more secure, lower carbon economy. In this context, it was stressed that current polices are unsustainable from an economic and environmental perspective. It was noted that Ireland is using an increasing amount of oil and gas, both as a share of its energy needs and in total volume, which has clear implications for Irish energy costs, security of supply and environmental sustainability. International climate change obligations will also increase the cost of energy - in effect 'we will have to pay for the fuel and also the cost of burning the fuel'. Finally, it was highlighted that China and India are transforming the global energy system by their sheer size and growth, which will continue to drive up demand, prices and carbon emissions.

It was argued that the challenge for Ireland is to diversify our sources of supply and the types of fuel we consume. Greater use of LNG could potentially achieve the first goal. It was argued that greater use of renewable sources, combined with a possible role for nuclear energy, would diversify the types of fuel we consume. With regard to Irish renewable energy, the critical challenges are ensuring cost efficiency and security of supply. The option of nuclear energy would require careful analysis, in particular of the methods of waste disposal.

It was also noted that additional investment in Ireland's energy infrastructure is required and this will have to be paid for by energy users, directly or indirectly. It was also argued that as a result of climate change, we should attempt where feasible to shift away from industries with relatively high carbon emissions towards lower emission industries and services. It was highlighted that industry has already made significant progress in reducing its carbon intensity, and that a strong focus on energy efficiency measures had huge potential to reduce both business costs and carbon emissions.

4.3 The wider international and national macro-economic challenges to Ireland's future competitiveness were examined. The slowdown in the Irish and US economies was a key concern. It was highlighted that a slowdown could have a number of potential implications for Ireland:

- Greater pressure may be placed on the education and training system as unemployed (construction) workers must upgrade their skills to avail of other opportunities;
- An economic slowdown combined with uncertainty in the financial markets may reduce investment in productive enterprise and entrepreneurship, particularly in funding risky research and innovation. During downturns, firms also tend to cut spending on R&D and other long-term growth enhancing investments.

The issue of high inflation and the erosion of Ireland's cost competitiveness were also addressed. It was argued that Ireland's cost competitiveness has weakened to the point where it is now damaging our international competitiveness. It was highlighted that as a result of our fixed exchange rate regime, the key cost factor we can control is **wage costs**. It was argued that the up-coming pay talks should be sensitive to the weakening cost competitiveness of the economy, and that a risk exists that pay levels could 'overshoot' sustainable levels. It was suggested that the greater uptake of employee financial participation could introduce greater flexibility into wage bargaining. It was also argued that many high wage economies are amongst the most competitive in the world - hence the need for greater productivity growth and for enterprises to continuously move up the value chain into higher margin, more knowledge intensive activities.

4.4 The importance of good public services was highlighted, given the role they can and do play in facilitating enterprise development, in enhancing competitiveness and wider quality of life issues. It was argued that trade unions have and can continue to play a key role in facilitating and **promoting public sector change and modernisation**. To advance this agenda it was argued that an 'academy for public service management' could contribute to promoting excellence and developing the leaders of the future. In terms of areas for reform, it was noted that a multiplicity of new bodies have been established in recent years and that there may be opportunities for streamlining structures. In particular it was suggested that the development of a shared services model for standard activities such as IT, HR, legal and corporate services could enhance efficiency. It was also noted that all of these bodies have individual pension schemes with potentially negative implications for job mobility.

4.5 A wide range of people addressed the role that **taxation** (especially in the areas of personal and corporate tax) has played in developing Ireland's competitiveness. An economic slowdown may put pressure on public finances. It was suggested that the correct fiscal strategy to maintain competitiveness would be to avoid increasing taxes on factor incomes (e.g. pay, capital,) or reducing capital spending. Nevertheless, it was suggested that governments under pressure often resort to quick fixes for rising deficits, overlooking the medium-term consequences for competitiveness and growth.

Key issues highlighted included the importance of retaining control of our taxation system and the need to ensure that our tax system remains competitive. Harmonisation of the corporate tax base (CCCTB) was considered by many as a possible threat. It was suggested that our tax system has lost some of its competitiveness in terms of attracting overseas investment. In this context, it was argued that it will be critical that a slowdown in tax revenues from property does not impact on our tax competitiveness. A number of areas were proposed to strengthen and promote enterprise, innovation and investment, including improving R&D tax credits and reducing further the labour tax wedge. The importance of maintaining a fair and transparent tax regime was also emphasised.



4.6 Education formed a key theme of the conference. Participants discussed how Ireland's higher education system is transforming itself. However, remaining weaknesses need to be addressed so that our higher education system can continue to drive and contribute to future competitiveness. The competitiveness objectives for higher education related to ensuring a deepening of both teaching and research capacities, sufficient links between on-campus education and the skill needs of enterprise, prioritising inter-disciplinarity, a focus on specialist skills, commercialisation of ideas, the promotion of entrepreneurship and promoting access and inclusion within the system. The current drivers of change in the education system are seen as the demand for labour and new skills, globalisation and competition, changes in technology and the need for greater alignment between education/training and labour market needs. Ireland has been very successful in attracting excellent researchers from abroad and building centres of research excellence, but there is, it was argued, a need for real alignment with enterprise needs.

Important questions regarding the future of the higher education system were posed. These concerned the optimum level of participation in higher education, to what degree educational programmes should become 'vocational', the extent to which universities should become enterprises and finally, examining how best to ensure the required funding to develop a best-in-class higher education system.

Ultimately firms, rather than countries, compete in international markets. It is the responsibility of company management to address the challenges faced by a particular company. Nevertheless, such activities need to be situated within a policy framework which is supportive of opportunities for growth and development and a strong system of national innovation. Therefore, the State plays a key role in developing a business environment that encourages competitiveness. In this regard, it is notable that many small countries rank among the wealthiest and most competitive in the world. Being small has enabled Ireland to develop a model of economic development that is based on consensus and problem solving. The National Competitiveness Council endeavours to support this process. The primary goals of the Council are to develop a shared view on Ireland's competitiveness and the competitiveness challenges facing us, and to recommend high level directions to support future competitiveness. The themes raised at this event will form important parts of the Council work in 2008.