

# Ireland's Competitiveness Challenge 2014

December 2014

National  
Competitiveness  
Council





# **Ireland's Competitiveness Challenge 2014**



## Introduction to the National Competitiveness Council

The National Competitiveness Council reports to the Taoiseach and the Government, through the Minister for Jobs, Enterprise and Innovation on key competitiveness issues facing the Irish economy and offers recommendations on policy actions required to enhance Ireland's competitive position.

Each year the NCC publishes two annual reports.

- **Ireland's Competitiveness Scorecard** provides a comprehensive statistical assessment of Ireland's competitiveness performance.
- **Ireland's Competitiveness Challenge** uses this information along with the latest research to outline the main challenges to Ireland's competitiveness and the policy responses required to meet them.

As part of its work, the NCC also publishes other papers on specific competitiveness issues.

The work of the National Competitiveness Council is underpinned by research and analysis undertaken by the Strategic Policy Division of the Department of Jobs, Enterprise and Innovation.

## National Competitiveness Council Members

Dr Don Thornhill	Chair, National Competitiveness Council
Liam Casey	Chief Executive Officer, PCH International Ltd.
Prof. Peter Clinch	Jean Monnet Professor of European Economics and Professor of Public Policy, University College Dublin
Shay Cody	General Secretary, IMPACT Trade Union
Clare Dunne	Assistant Secretary, Department of Jobs, Enterprise and Innovation
Isolde Goggin	Chairperson, Competition Authority
John Herlihy	Vice President, International SMB Sales and Head of Google Ireland
Danny McCoy	Chief Executive Officer, Ibec
Jane Magnier	Joint Managing Director, Abbey Tours
Seán O'Driscoll	Chairman and Chief Executive Officer, Glen Dimplex Group
Louise Phelan	Vice President of Global Operations, Europe Middle East and Africa, PayPal
Heather Reynolds	Director, Eishtec
Dave Shanahan	Head of Strategic Health Initiatives Worldwide, AbbVie
Paul Sweeney	Former Chief Economist, ICTU
Ian Talbot	Chief Executive, Chambers Ireland
Siobhán Talbot	Group Managing Director, Glanbia

## Council Advisers

John Callinan	Department of the Taoiseach
Michael Layde	Department of Environment, Community and Local Government
Katherine Licken	Department of Communications, Energy and Natural Resources
John McCarthy	Department of Finance
Deirdre McDonnell	Department of Education and Skills
Conan McKenna	Department of Justice and Equality
David Moloney	Department of Public Expenditure and Reform
Aidan O'Driscoll	Department of Agriculture, Food and the Marine
Ray O'Leary	Department of Transport, Tourism, and Sport

## Research and Administration

Adrian Devitt	Department of Jobs, Enterprise and Innovation
Conor Hand	23 Kildare Street, Dublin 2
	Tel: 01 6312121
	Email: <a href="mailto:info@competitiveness.ie">info@competitiveness.ie</a>
	Web: <a href="http://www.competitiveness.ie">www.competitiveness.ie</a>

## Taoiseach's Foreword



Ireland is slowly but surely building its recovery. Economic growth has resumed, employment is growing and unemployment is going down. Public debt has stabilised, and we are on track to beat our deficit targets. We are seeing positive investor sentiment towards Ireland as we re-establish our reputation as a good place to do business. Our firms are competing successfully in markets around the world, and, at home, business and consumer confidence is increasing.

Internationally, our efforts to restore economic competitiveness are being recognised and we have been climbing up the rankings since 2011.

This recovery has not happened by chance. It has been built on sound policy choices, the right decisions, and the hard work and diligence of the Irish people.

Companies and entrepreneurs throughout Ireland deserve huge credit for the way in which they have helped to rebuild our brand and our competitiveness: their commitment to innovation and productivity shines through; their reward can be seen in our global trade performance where Ireland continues to enjoy a share of world markets that belies our small size.

The Action Plan for Jobs is at the heart of the Government's drive for recovery. Over the course of three years, we have made a concerted effort to identify and address weaknesses in Ireland's competitiveness offering, to support employment and encourage enterprise. To date, over 500 actions have been implemented under the 2012 and 2013 Action Plans. A further 385 actions are due to be implemented over the course of this year by all 16 Government Departments and by 46 agencies.

The Action Plan is underpinned by a strong commitment to implementation. That is what makes it different and what makes it work. We are having a real, positive impact on the environment for enterprise. Through in-depth engagement at Cabinet Committee level, a cross-departmental approach specifically targeting competitiveness has been developed. In this, the work of the National Competitiveness Council is an especially important input.

Recovery, though gaining hold, remains fragile. As the international context remains uncertain, it is important that we continue to build on what has been achieved, and that we reinforce the progress made. There is no room for complacency. As a small open economy, we need to be constantly looking to the future, to new markets, new products, and new opportunities. Maintaining and improving our competitiveness will remain vital to our success.

As we recover, it is important that the benefits reach every citizen and every corner of the country. I am, therefore, delighted to see the Council discuss the importance of social capital and active citizenship. The analysis and recommendations put forward by the National Competitiveness Council deserve, and will receive, serious consideration. They will focus minds, and will undoubtedly help to shape future policy choices. I would like to thank the Council for their work in compiling this report, and I look forward to engaging with them over the coming months and years, as we continue to build the recovery together.

Enda Kenny, T.D.,

Taoiseach

## Chairperson's Preface

### Improvements in our economic performance must not distract us from implementation



Earlier this year, the National Competitiveness Council published *Ireland's Competitiveness Scorecard*. The overall conclusion from this analysis of a comprehensive assessment of our international competitiveness performance across a wide range of indicators was that Ireland's recovery maintained its momentum through 2013 and into 2014. Since then, further improvements in the labour market, continued stability in the public finances, and a generally positive macroeconomic outlook reinforce the view that we have to capacity to address the consequences of the recession. However, the negative consequences of the last five years will continue to be felt for the foreseeable future. Incomes and quality of life have been reduced, and society continues to bear the scars of unemployment, emigration and debt. Improving our competitiveness is central to any recovery strategy.

From a competitiveness perspective, the cost reductions that occurred since the onset of recession, allied to the elimination of many capacity constraints, have resulted in improved international competitiveness. This provides our enterprises with advantages when selling into foreign export markets, makes them more competitive at home, and makes Ireland a more attractive proposition for international investors.

In looking to the future, we must also protect what we have achieved. The *Scorecard* was quite clear that the hard won competitiveness gains that we have made since 2008 are in danger of being eroded as the economy returns to growth. These gains cannot be allowed to dissipate through either overconfidence or inertia.


The Council believes that a range of challenges must be addressed if we are to create the employment and wealth necessary to improve the lives of all of our citizens, and to lay the foundations for future prosperity. This year, the Council has identified six specific challenges.

#### 1. The cost base

There is (as always) a need to maintain vigilance in relation to our cost base. Despite the upward price pressures that almost inevitably accompany economic growth, we must be rigorous in our pursuit of efficiency and take the steps necessary to minimise those costs within our domestic policy control. This year, the Council has turned the spotlight on the cost of labour, property and energy - the three most significant cost factors for most firms.

#### 2. Restoring balance to the public finances

The Council is focused on the need to put the public finances on a sustainable basis. Our day-to-day public spending on recurring goods and services still exceeds our taxation revenues despite the major corrections made over recent years which have required huge political will and courage. Public sector borrowing is continuing to increase. The Council is, however, mindful of the need to provide for public investment in essential economically and socially productive infrastructure (such as water, broadband and social housing). Such investments will enhance our productive potential as an economy. The Council has also directed its attention to actions that will broaden the tax base to



provide sustainable streams of revenue and actions that protect our international tax competitiveness.

### **3. Education and skills**

The development of Ireland's skills base is a continuing concern for the Council, and the 2014 Challenge is no exception. Whilst recognising the need to invest in all areas of the education system from pre-primary right through to fourth level education, the Council's is particularly focussed on the development of the Further Education and Training (FET) and Apprenticeship systems. The goal is to ensure that FET can deliver more high quality, flexible and responsive education and training programmes that explicitly meet the needs of the learner and the employer.

### **4. A broader enterprise base**

The resilience of our exporting sector has been one of the economy's greatest strengths in recent years. We do need to pay attention though to minimising the risk of sector specific shocks. A more sustainable, diversified and broad-based export oriented enterprise sector would enhance our resilience but this is a difficult challenge. Notwithstanding continued attention and support by successive Governments, this has been one of the continuing deficits in Irish economic policy outcomes for more than half a century. We must strive to capitalise on our newfound cost competitiveness, maximising our exports, competing for mobile international investment, and encouraging the development of a new cohort of outward looking indigenous firms. A range of actions aimed at the both foreign and indigenous companies are put forward, and actions are targeted across the full life cycle of the firm.


### **5. Finance for enterprise**

Finance plays a critical role for firms - both in terms of facilitating existing operations and in creating opportunity for growth and investment. A range of actions are proposed to increase the supply of credit, particularly to SMEs. To fully support our enterprises, we will need to ensure that we make full use of all possible sources of credit, traditional bank finance and more innovative, non-traditional approaches.

### **6. Attaching priority to trust**

Finally, in something of a departure for the Council, we draw attention to the complex topic of trust - trust by our citizens in institutions, trust in companies, and trust in regulations. More specifically, Ireland must address the failures of the past and rebuild the trust of the public in the ability and willingness of public and private bodies in Ireland to adhere to the highest international standards.

As with any agenda for reform, implementation is critical. Given the diverse and crosscutting nature of the recommendations contained in this report, implementation can only be achieved through the cooperation and collaboration of a wide range of actors. The Action Plan for Jobs (APJ) is a welcome whole of Government initiative that drives the implementation of actions to support



competitiveness across the economy. It is vital that the focus on competitiveness in the 2014 APJ continues in the 2015 Plan.

The Council will be making a formal submission to the APJ process shortly. The Council looks forward to working with the relevant Government departments and agencies to assist with implementation in any way that we can.

Finally, I would like to thank the members and advisors of the Council for their valuable contributions in producing this report. On behalf of the Council, I would also like to acknowledge the work of the members of the Executive for their essential support for the Council and for their work in regard to the preparation of this report.

Dr Don Thornhill

Chair, National Competitiveness Council



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# Executive Summary

## Introduction

National competitiveness is a broad concept that encompasses a diverse range of factors and policy inputs including education and training, entrepreneurship and innovation, Ireland's economic and technological infrastructure and the taxation and regulatory framework. Competitiveness is not an end in itself, but is a means of achieving sustainable improvements in living standards and quality of life. Only by ensuring that Irish based firms can compete successfully here and abroad can we create the employment, income and wealth necessary to improve the lives of all of our citizens.

Ireland's international competitiveness has improved. As evidenced through trade and investment flows, Ireland remains open for business and indeed, offers an attractive location from which to do business. Costs have fallen and a number of structural reforms introduced. Many of the competitiveness gains achieved in recent years, however, have arisen because of cyclical factors. External pressure to reform also played an important role.

Paradoxically, an improving economy could quickly erode these gains and choke off recovery if costs increase; skills become scarcer, infrastructure congested, etc. We must learn the lessons of past mistakes. A return to growth should offer the space to accelerate and deepen the pace of reform - rather than delay inevitable actions. It is important that we do not become complacent about the need for continuous reform. We must tackle those factors that affect our competitiveness negatively.

While the economic crisis in Ireland and across the EU has adsorbed much of our attention in recent years, long-term global trends continue to affect us. As highlighted by Bruegel in their memo to new EU leaders 'all European Union countries need to adapt their economies and even societies to the Great Transformation resulting from the combined forces of globalisation, demographic, technological and environmental change... In 2013 emerging and developing countries together accounted - for the first time since at least 1850 - for more than 50 percent of global GDP'<sup>1</sup>.

The Action Plan for Jobs process is a welcome whole of Government initiative that drives the implementation of actions to support competitiveness across the economy<sup>2</sup>. Actions 89 and 90 in the Action Plan for Jobs 2014 promote in-depth engagement on competitiveness matters at senior official and cabinet committee level. With regard to the National Competitiveness Council, action 92 requires the Council to produce a medium term policy report on competitiveness. This report is the Council's response to this request from Government.

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<sup>1</sup> Bruegel is a European think tank specializing in economics. See Sapir, A, and Wolff, G., Memo to the New EU Leadership, To the Presidents of the European Commission, the European Council and the European Parliament, Bruegel

<sup>2</sup> The OECD has noted that "the APJ's most striking innovation in the Irish public policy context is a coordination mechanism that ensures high-level political buy-in and oversight, whole-of-government engagement and the establishment of quarterly targets underpinned by a robust monitoring system. These are important steps towards addressing long-standing gaps that undermine successful policy implementation". See OECD, Ireland's Action Plan for Jobs: A Preliminary Review, April 2014

## Ireland's Current Competitiveness Performance

Earlier this year, the Council published *Ireland's Competitiveness Scorecard 2014*, which analysed Ireland's competitiveness performance vis-à-vis 18 competitors<sup>3</sup>. This benchmarking report provides the Council with the necessary evidence to identify those policy areas most in need of action. The main findings from the report are presented below to provide context and rationale for the subsequent prioritisation of actions herein.

- After an extended period of recession, the Irish economy is once again growing: In 2013, GDP grew by 0.2 per cent while GNP grew strongly by 3.2 per cent<sup>4</sup>.
- This data, allied to the restoration of the State's borrowing capacity and improved public finance sustainability, the downward trend in unemployment, the continuing improvement in the current account of the balance of payments and the strength of the export sector provides a clear indication that the Irish economy is on a more positive trajectory.
- Further, growth is becoming more balanced - whereas in recent years, net exports was the only positive contributor to growth, 2013 saw a resumption in consumer demand, whilst government investment held constant.
- Ireland continues to be an attractive location for foreign direct investment. In terms of both FDI stock and return on investment, we rank among the top three performers in the OECD; the stock of inward investment, at 142 per cent of GDP, remains amongst the highest in the OECD. While some of the advantages that allowed Ireland to win initial investments from abroad during the 1980s and 1990s have been eroded (i.e. we are no longer a low cost location), many advantages remain. Issues of particular importance to the FDI sector include the development of the national innovation system; increasing the supply of highly educated workers; and successfully leveraging the agglomeration benefits offered by already established clusters.

Overall, as an extremely open and trade-dependent economy, the health of the Irish economy is heavily determined by the performance of the wider global economic environment and particularly by the strength of UK and US demand. Strengthening global economic activity in the second half of 2013 and the expected further improvement in 2014-15 is particularly welcome from an Irish perspective. The US is expected to perform strongly in 2014, aided by a recovery in the domestic real estate market. In the UK, growth of almost 3 per cent is forecast for 2014. Growth prospects in the Eurozone are likely to be weak and subject to risks. A number of large emerging countries are also likely to face weaker growth prospects than in recent years.

Weaknesses identified in *Ireland's Competitiveness Scorecard 2014* are outlined in the competitiveness policy priorities areas below.

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<sup>3</sup> See National Competitiveness Council, *Ireland's Competitiveness Scorecard 2014*, Forfás, July 2014

<sup>4</sup> Figures presented in constant market prices. CSO, *National Income and Expenditure Annual Results 2013*, July 2014

## Competitiveness Policy Priorities

This year, the Council has identified six challenges, which we believe must be addressed if we are to enhance Ireland's competitiveness - challenges that must be addressed if we are to create the employment and wealth necessary to improve the lives of all of our citizens.

### 1. Cost of Doing Business

The Council is once again highlighting the need for vigilance with regard to cost competitiveness. The Council recommends a series of actions to maintain and enhance cost competitiveness.

A range of indicators suggest that Ireland has already begun to slip in terms of our cost competitiveness, with overall relative cost competitiveness weakening and a series of upward cost pressures emerging. Particular focus is required to address domestically influenced cost factors in the labour market and in the energy sector. Likewise, the current rapid increases in house prices and residential rents have the potential to produce adverse knock-on consequences in terms of prices and wage expectations across the entire economy. There is a risk that a lack of corrective action will result in lost cost competitiveness with negative implications for economic and employment growth. Chapter One sets out a series of recommendations aimed at:

- Enhancing labour cost competitiveness, through reform of income taxes, changes to the PRSI structure for lower paid workers, and actions to improve replacement rates for those who face high rates;
- Lowering energy costs over time by tackling controllable costs and taking measures to enhance energy efficiency and manage peak demand; and
- Managing property costs by replacing commercial rates with a site value tax and supporting the long-term development of the property sector.

### 2. Macroeconomic Stability and Public Investment

Stable and sustainable public finances and strong public investment are prerequisites for competitiveness. High deficits limit the scope for growth and productivity enhancing investments, have adverse impacts on the State's potential to borrow, damage consumer confidence and leave the State vulnerable to external events.

Despite the corrective action taken to date, our public debt level is exceptionally high - general government debt remains amongst the highest in both the euro area and OECD at 123.7 per cent of GDP in 2013. It is also notable that while Ireland's current corporate tax regime is regarded as competitive by the business sector, the international tax environment is evolving rapidly. Chapter two sets out a range of recommendations designed to broaden our tax base and to support competitiveness, while ensuring that the tax system is progressive.

At the same time, the availability of competitively priced world-class infrastructure (e.g., energy; telecoms; transport - road, public transport, airport, seaports; waste and water) and related services is critical to support competitiveness. However, public capital expenditure has declined significantly since 2008. Learning from past experience, we need to ensure that as the economy returns to growth that existing and likely infrastructural bottlenecks, which will constrain growth in the economy, are addressed. The Council believes that it is time to reverse some of the cuts to the

capital expenditure budget in recent years and highlights a range of infrastructure projects that would support competitiveness.

### 3. Developing the Skills Base

Labour and skills challenges are impeding competitiveness and are limiting how the gains from improved competitiveness are shared.

Sustained high levels of structural unemployment coupled with falling participation rates and outward migration erode our skills base. From a demand-side perspective, a number of skills deficits persist despite the large numbers of unemployed workers<sup>5</sup>. Many unemployed workers, particularly long term unemployed workers, are ill equipped to work in those sectors most likely to experience employment growth.

Developing the skills base is a challenge for all parts of Ireland's education and training system and there is a continuing need to invest in all areas of the education system from pre-primary right through to fourth level education<sup>6</sup>. Chapter Three focuses on two particular issues.

- Firstly, we need to implement the new Further Education and Training strategy and deliver the structures to provide better high quality, flexible and responsive education and training programmes, with a particular focus on increasing employer engagement, enhancing the reputation and value of further education and training, and on activating the unemployed.
- Secondly, we need to modernise the apprenticeship system to bring about a greater focus on on-the-job learning, engagement with employers, and the development of a wider range of relevant apprenticeships.

### 4. Developing the Enterprise Base

While the resilience of our exporting sector has been one of the economy's greatest strengths since the onset of the recession, this does not obviate the need to develop a more sustainable, broad-based enterprise base. Ireland's enterprise base must continue to evolve.

The Scorecard highlights that our exporting base is highly concentrated in terms of products produced, sectors, markets covered, firm ownership, etc. The challenge is to grow new sectors, expand into new markets and produce new products and services. This will require an enterprise environment that increases the export capacity of indigenous firms and supports continued foreign investment. Chapter Four sets out actions in a range of areas including:

- Promoting investment - Ireland's attractiveness to investors (both indigenous and foreign) is shaped by a combination of factors. However, Ireland's broader tax competitiveness (e.g. income taxes, capital taxes, etc.) has weakened in recent years as key competitors such as the

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<sup>5</sup> According to the most recent National Skills Bulletin, these shortages continue to be confined to niche skill areas and in most instances are of low magnitude. See Expert Group on Future Skills Needs, National Skills Bulletin 2014, July 2014

<sup>6</sup> In 2011, public expenditure on educational institutions represented 6.2 per cent of Ireland's GDP, an increase from 4.2 per cent in 2000 and 5.7 per cent in 2008. While this expenditure is slightly above the average share of GDP expenditure for OECD countries of 5.6 per cent in 2011, it is far below the highest values, which were in the Scandinavian countries (spending between 6.8 per cent and 8.8 per cent of GDP in 2011). See OECD, Education at a Glance 2014, September 2014

UK has sought to enhance their regime<sup>7</sup>. The targeted use of State funds (Strategic Banking Corporation) and meeting skills deficits (e.g. ICT) are also important;

- Promoting trade development and diversification through trade policy (a greater focus on agreed priority markets, and advancing the Transatlantic Trade and Investment Partnership negotiations while addressing important public interest concerns), enhanced skills (foreign languages and marketing skills, logistical skills), better infrastructure (improving international transport links) and strong cluster development (enhanced linkages between indigenous and foreign owned firms, a more joined up approach to the development of world class clusters, and sustained investment and development of enterprise agency programmes);
- Enhancing productivity, innovation and R&D (through the implementation of competition policies in the remaining sheltered sectors such as the legal and public transport sectors; through sustained investment in research, development and innovation; and through continued actions to improve the efficiency and efficacy of the public RDI funding system);
- Supporting entrepreneurship (firstly, through the implementation of the Government's entrepreneurship statement and through actions to remove unnecessary administrative costs); and
- Using public procurement to support competitiveness (through the alignment of procurement policy with the Government's overarching policy goals, and encouraging SME access and participation).

## 5. Access to Finance

Finance is the life-blood of every business. In their latest review of the Irish economy, the IMF notes that “a sustained job-rich economic recovery hinges on reviving healthy lending”.

While demand for credit has remained sluggish in Ireland, limited access to credit and the associated high costs, is acting as a drag on the enterprise sector, inhibiting investment and growth, particularly amongst start-ups and SMEs. Limited credit flows in the economy damage the environment for entrepreneurship and limit the scope of firms to expand their operations. The collapse in business investment has been a particularly visible trend in recent years.

Notwithstanding recent improvements, credit for enterprise requires further attention. Interest is also growing in non-bank funding sources. Chapter Five sets out a range of actions to:

- Enhance bank funding (through monitoring and encouraging bank lending - particularly to the SME and manufacturing sectors, developing the range of products and services provided by the banks, developing/ attracting new entrants to the banking market, and pro-actively dealing with legacy debt);
- Support other non-banking funding sources (through taking steps to encourage equity investment and State support for other funding mechanisms such as peer-to-peer lending).

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<sup>7</sup> For example, in Budget 2013, the UK announced that it was going to reduce its main corporate tax rate from 24 per cent to 21 per cent from 1 April 2014 and to 20 per cent from 1st April 2015.

## 6. Social Capital, Data Protection and Corporate Governance

Finally, given the ongoing development of the knowledge economy, trust in institutions and corporations is becoming ever more central to Ireland's ability to compete.

Many of the difficulties of the last few years have arisen to one degree or another through the failure of individuals and organisations to live up to the expectations of citizens. We must address the failures of the past and rebuild the trust of citizens in the ability and willingness of public and private bodies in Ireland to adhere to the highest international standards. Trust is also important as we pursue economic opportunities in areas such as international financial services, data analytics and other big data sectors.

Chapter Six sets out a range of recommendation aimed at:

- Supporting corporate social responsibility (through the implementation of the new National Plan on Corporate Social Responsibility).
- Improving corporate governance through the completion of the white paper on crime (with a clear timeline for the development and implementation of additional actions designed to tackle white-collar crime), and through strengthening the corporate governance code.
- Developing Ireland's data protection infrastructure (through continued engagement on the proposed European "data reform package", enhancements of the resources of the Office of the Data Protection Commission, and delivering on the Government's open data commitments).

Each of these issues and associated policy areas are considered in detail in the subsequent chapters. In total, 57 recommendations have been made and potential implementers identified.

# 1. Cost of Doing Business

Despite significant improvement, the need for further gains in cost competitiveness is still evident through high levels of unemployment and low levels of business investment. However, against a backdrop of modest recovery, cost pressures are already re-emerging.

Particular focus is required to address domestically influenced cost factors in the labour market and in the energy sector. Likewise, the current rapid increases in house prices and residential rents (particularly in Dublin) have the potential to produce adverse knock-on consequences in terms of prices and wage expectations across the entire economy. Such adverse cost developments put all of the recent hard-won competitiveness gains at risk. The policy focus needs to be on achieving enhanced competitiveness through a combination of cost reductions in key business inputs and enhanced productivity growth.

## 1.1 Labour

High costs, including high labour costs that are not supported by high productivity, damage enterprise development and employment creation<sup>8</sup>. Wages increases, supported by productivity improvements, allow the benefits of enhanced competitiveness to be shared, and support recovery in the broader domestic economy.

As shown in Ireland's Competitiveness Scorecard 2014 Irish labour costs increased in 2012 and 2013. Ireland has the eighth highest gross and net wage level in the euro area-17. While gross earnings are 8 per cent below the euro area average, net earnings are 11.6 per cent above the euro area average. The fact that gross earnings are below average but net earnings are above average is partly a result of the relatively small gap between before and after-tax earnings in Ireland.

Wages in Ireland are largely led through a wage bargaining process between employers, Trade Unions, and employees. Instead, the State's main influence relates to issues such as the level of taxation imposed on labour, how taxes are applied, and social welfare entitlements (which influence replacement rates)<sup>9</sup>. The State also sets the national minimum wage. The Council has a number of concerns about the structure of the income tax and social insurance system.

### Income Tax

A competitive income tax regime is essential in attracting and retaining individuals in Ireland and more generally in terms of encouraging people to remain in or return to the labour market (by

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<sup>8</sup> A recent Department of Finance simulation considers the effect of a loss in competitiveness caused by higher labour costs across the economy that is not accompanied by a commensurate improvement in productivity. Exporters in the manufacturing sector, who are price-takers, are unable to "pass-on" the increase in costs to international customers and respond by reducing output and their demand for labour. Employment falls in manufacturing in response to price (wages) rises and a reduction in demand for output. The general government balance is held constant such that initial gains from higher personal income taxes and VAT are offset by higher payroll and unemployment benefit costs. Higher income taxation ultimately increases the cost of employment and results in a loss in competitiveness. Department of Finance, Quantification of the Economic Impacts of Selected Structural Reforms in Ireland, Irish Government Economic and Evaluation Service, Working Paper, July 2014

<sup>9</sup> Of course, the State is also a major employer; according to the most recent CSO data, over 374,000 people were employed in the Public Sector in Q2 2014. See CSO, Quarterly National Household Survey Q2 2014, August 2014



protecting after-tax income). High rates may act as a disincentive for entrepreneurship and risk-taking<sup>10</sup>.

Increases in personal taxation since the start of the recession have eroded competitiveness and incentives to work. Higher labour taxes raise the costs of labour, raise replacement rates (i.e. make work less attractive vis-à-vis social welfare), reduce take home pay and domestic demand and risk stimulating the informal economy.

In Ireland, the difference between the employers' cost of hiring an individual and the individual's actual take home pay has widened for all income categories while in most OECD countries it is unchanged or falling<sup>11</sup>. The difference is wider for higher paid workers in Ireland, which is of concern as Ireland competes internationally for mobile talent.

It is also notable that the level at which individuals start paying the higher rate of tax in Ireland (€32,800 for single individuals) is low relative to other countries<sup>12</sup>. The higher rate of tax impacts on single individuals earning less than the average wage, meaning that marginal tax rates (i.e. the tax paid on an individual's last euro of income) are now in excess of 50 per cent for single individuals earning €32,800 per annum. This can influence individual decisions to work more to indeed not to work at all. On the other hand, average income tax rates combined with employee social insurance contributions are relatively low in an OECD context, particularly for two-income married couples earning the average wage<sup>13</sup>. This reflects the relatively high earnings threshold below which no income tax is paid, and the low rates of social insurance levied in Ireland, compared with most other developed economies<sup>14</sup>.

The OECD highlights that employment tax reforms targeting groups that are highly responsive to tax disincentives (e.g. low-income workers, older workers, second earners and mobile high-skilled workers), are likely to generate the greatest employment gain for a given fiscal cost<sup>15</sup>.

**Recommendation:** As economic conditions improve, income taxes (e.g., credits, thresholds, rates, etc.) should be reviewed to support improvements in after-tax income while protecting labour cost competitiveness.

**Responsibility:** Department of Finance

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10 The effective marginal rate is 55 per cent for individuals with non-PAYE income over €100,000.

11 OECD, Taxing Wages, 2014

12 Department of Finance, Tax Strategy Group - Income Tax and USC, Document 13/08, 2013

13 According to OECD data, combined average income tax and social insurance contributions in Ireland (for a married couple earning 100 per cent of the average wage) were the second lowest out of 32 countries in 2013.

14 Some of the idiosyncrasies of the Irish income tax system are examined in a recent TASC paper. The paper notes (i) the high level of tax credits, tax reliefs and tax breaks available in Ireland; (ii) the low level of PRSI (especially employers' social security contributions) paid; and (iii) the relatively uncommon feature of having two income tax rates (20 per cent and 41 per cent) rather than more rates and bands. See O'Connor, N., Staunton, C., and Sweeney, P., A Defence of Taxation: Progressive Alternatives to Reducing Public Services Through Tax Cuts, TASC, June 2014

15 OECD, Taxation and Employment, OECD Tax Policy Studies, No. 21, 2014

## PRSI Step Effect

Regardless of tax rates applied, the design of the tax and social insurance system should create the best conditions for job creation. It is important that there are not barriers in place (from both an employer and employee perspective) for employees to work additional hours and to increase pay where appropriate.

Employee PRSI is applied at zero per cent on earnings of below €352 per week and at 4 per cent on entire earnings where earnings equal or exceed €352 per week. Employer PRSI is applied at 8.5 per cent on earnings below €356 per week and 10.75 per cent on entire earnings where earnings equal or exceed €356 per week. As the higher rates apply to all earnings, this produces step-effects<sup>16</sup>.

These step-effects act as a general disincentive to work, and specifically create disincentives for part-time workers to work additional hours or for full-time workers to work paid overtime (where it brings workers above these thresholds). In the case of the introduction of the USC, such step-effects were largely avoided via the graduated structure used<sup>17</sup>.

**Recommendation:** Consideration should be given to replacing the step-effects of employee and employer PRSI with a tapering effect that would both remove the existing disincentive effects of applying higher tax rates to all earnings and provide an incentive to work at all earnings levels.

**Responsibility:** Department of Finance, Department of Social Protection

## Social Welfare and Replacement Rates

The replacement rate measures the proportion of out-of-work benefits received when unemployed against take home pay if in work. In general, a replacement rate in excess of 70 per cent is considered to act as a disincentive to work (i.e. if an individual can receive more than 70 per cent of in-work income in benefits, they will demand a higher wage in the market to retain a monetary incentive to work). It is also important to note that costs, such as travel and childcare arising from the decision of an individual to return to work can have a significant impact on whether there is sufficient additional net income for the household to incentivise work, particularly for second earners.

Most individuals face replacement rates of less than 70 per cent. Replacement rates (excluding housing benefits) tend to be lower for single people than for married couples - for example, a couple with 2 children and 1 earner on the average wage has a replacement rate of 66 per cent compared with a replacement rate of 37 per cent for single individuals earning the same amount.

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<sup>16</sup> Under the current system, anyone earning below €10,000 pays no tax at all (from income tax, USC or PRSI), while someone earning above €10,000 begins to pay a small effective rate of tax. For example, someone with gross pay of €11,000, will pay an effective rate of 2 per cent of tax (from USC), which increases to an effective rate of 4.9 per cent by the time he or she earns €18,000. However, while someone earning €18,304 pays an effective tax rate of 5.25 per cent, someone who is paid one euro more will pay an effective tax of 9.25 per cent due to the onset of PRSI. This has the perverse consequence that a person earning €18,000 has higher net pay than someone earning €19,000. These figures are taken from O'Connor, N., Staunton, C., and Sweeney, P., A Defence of Taxation: Progressive Alternatives to Reducing Public Services Through Tax Cuts, TASC, June 2014

<sup>17</sup> A smaller €200 step-effect was created at the €10,000 earnings level, following the exemption of the first €10,000 in earnings from the USC in Budget 2012.

The inclusion of housing benefits has an adverse impact on results pushing several recipient types above the 70 per cent threshold, particularly those earning less than the average wage<sup>18</sup>.

Reforms (i.e. Housing Assistance Payment provisions) are being piloted in six local authority areas that will allow people to take up employment and retain housing support. These will be subject to a means test. The scheme is due to be rolled out nationally from January 2015. It is crucial that, depending on the success of the pilot, rollout is carried out as speedily as possible.

**Recommendation:** The rollout of the Housing Assistance Payment (i.e. decoupling housing support from social welfare payments) is an essential element in removing barriers to employment and reducing replacement rates. Once fully implemented, the impact of HAP on replacement rates should be monitored to ensure that the payment successfully reduces barriers to employment, whilst protecting living standards.

**Responsibility:** Department of Environment, Community and Local Government

Irish replacement rates for the long-term unemployed are significantly higher than the OECD average for both single earners and one-earner married couples with two children (earning 67 per cent of the average wage). These replacement rates apply to a small subset of those in receipt of jobseekers supports in Ireland, and where high replacement rates are recorded, they are generally a result of either family size and/or entitlements to secondary benefits such as housing support.

The European Commission has recently noted that Ireland's welfare structure can result in the creation of poverty traps. It noted that:

*“The flat structure of unemployment benefits under the Jobseeker's Benefit and Jobseeker's Allowance system, the unlimited duration of the Jobseeker's Allowance and the loss of supplementary payments (in particular rent supplement and medical cards) upon return to employment mean that replacement rates are relatively high for the long-term unemployed with low income potential and other categories of workers depending on family circumstances”<sup>19</sup>.*

It should be noted, in the context of social welfare reform, that minimising replacement rates may not necessarily entail a reduction in direct social protection expenditures - it is about ensuring that incentives to take up work exist.

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18 Callan, T., Keane, C., Savage, M., Walsh, J.R. and Timoney, K., Work Incentives: New Evidence for Ireland, published in ESRI, Budget Perspectives 2013, Research Series No. 28, September 2012

19 European Commission, Recommendation for a Council Recommendation on Ireland's 2014 National Reform Programme and Delivering a Council Opinion on Ireland's 2014 Stability P COM(2014)408, Brussels, June 2014

**Recommendation:** Reform the social welfare system so that replacement rates decline in line with the length of time a person is out of work. Early and timely labour market interventions (i.e. enterprise relevant training) are required to support such an approach.

**Responsibility:** Department of Social Protection

**Recommendation:** Review social welfare supports (relating to those in receipt of Jobseekers Benefit or Jobseekers Assistance) to ensure that (a) part time workers have a significant financial incentive to avail of full time employment opportunities; and (b) the receipt of secondary benefits does not impede employment take-up.

**Responsibility:** Department of Social Protection

## 1.2 Energy

A reliable and competitively priced supply of energy is vital for business and its ability to compete successfully in international markets. From a competitiveness perspective, the challenge facing Ireland is to reduce energy costs while delivering on our security of supply and environmental sustainability objectives. Ireland also needs to recognise the greater role that demand management solutions can play in meeting Ireland's energy objectives, particularly in terms of improving cost competitiveness and protecting the environment.


While many aspects of the Irish energy market have improved in recent years (e.g., security of supply, the establishment of the all island electricity market and the opening of the energy retail business markets), there has been a sharp deterioration in energy cost competitiveness.

A comprehensive review of the EU's energy competitiveness from the European Commission found that EU energy prices have risen significantly and that the EU is among the most expensive locations for electricity and gas globally - and within the EU, Ireland is among the most expensive countries for electricity<sup>20</sup>. In detail:

- EU industrial electricity prices are more than twice those in the US (a key competitor and source of FDI) and 20 per cent higher than in China while EU industry pays three to four times more for gas than competitors in the US, Russia and India;
- Electricity prices for large users in Ireland increased by 34 per cent between the second half of 2010 and the same period in 2013<sup>21</sup>;
- In the second half of 2010, Irish prices for large electricity users were the 17<sup>th</sup> most expensive in the EU-28 but deteriorated to become the fifth most expensive in second half of 2013; and
- Prices for SMEs are among the most expensive in the EU - Ireland was seventh most expensive in first half of 2010 and fifth most expensive of the EU-28 in second half of 2013.

<sup>20</sup> European Commission, Commission Staff Working Document: Energy Prices and Costs Report, January 2014

<sup>21</sup> This is partly because the temporary rebate introduced in 2009 for large users was phased out in 2011 and 2012.



Changes in relative energy prices can have far-reaching effects on investment, production and trade patterns in internationally trading sectors and directly affect the ability of enterprise to retain and grow output and employment. The deterioration in Ireland's energy cost competitiveness in recent years is making Ireland less attractive for new mobile investment in energy intensive sectors like food and drink, life sciences, ICT (data centres and sectors dependent on these facilities such as digital media, cloud computing, big data, etc.), construction materials and other manufacturing sectors. It is also putting existing businesses in these sectors under pressure to remain competitive in international markets. Some of these firms are large regional employers, operating in low margin markets where their prices are determined globally.

The Department of Communications, Energy and Natural Resources (DCENR) is currently developing a new Energy Policy White Paper. This provides a timely opportunity to reassess our energy priorities and ensure we are making the right policy choices today to support long-term economic growth and international competitiveness. Of particular importance are decisions that will affect Ireland's future fuel mix and thereby the cost of electricity in Ireland relative to competitor countries:

- Ireland already has considerable spare electricity capacity, the cost of which is being borne by electricity customers. The implications of further investment in additional capacity for energy cost competitiveness against medium term security of supply considerations must be carefully assessed before decisions are made to promote more electricity generation capacity.
- Under the EU 2030 climate change and energy proposals, member states will have the flexibility to determine their own targets for renewable energy generation. While improving Ireland's environmental sustainability is important, it must be done at least cost. Before Ireland decides on its 2030 renewable energy targets, a full cost benefit analysis of the implications of various target options for national economic, social, environmental and competitiveness policy objectives should be undertaken. Consideration also needs to be given to other potential fuel options such as shale gas.
- Given that energy is an important input to the entire enterprise base, it is critical that we support the development of the enterprise opportunities in the energy sector without adversely affecting the competitiveness of the wider enterprise base and Ireland's attractiveness as a location to do business.

In relation to climate change, the likelihood is that Ireland will miss its 2020 target for greenhouse gas emissions reduction (due, in part, to the shortfall in achieving our renewable energy targets). In this eventuality, the exchequer will incur significant costs in order to comply with our obligations under EU law. There are likely to be tighter targets for 2030 that would pose an even greater challenge<sup>22</sup>.

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<sup>22</sup> The EC is proposing a 40 per cent reduction in greenhouse gas emissions by 2030 but no binding national renewable energy targets for member states. It does propose a renewable energy target of at least 27 per cent for the EU by 2030 but with flexibility for member states to set national objectives.

As the EU transitions to a low carbon economy (with aspirations for an 80 per cent reduction in greenhouse gas emissions by 2050), there will be challenges for all sectors of the economy. Particularly acute challenges for Ireland emerge in the transport and agriculture sectors with the restoration of economic growth likely to put upward pressure on emissions from the former and opportunities in food production under Harvest 2020 leading to expectations of an expansion in agricultural output.

Delivering on our emissions reductions obligations while maintaining the competitiveness of key economic sectors represents a major challenge for the Government and this should be done at least cost to the economy backed up by evidence-based research of costs and benefits of actions across the sectors.

**Recommendation:** Before Ireland decides on its 2030 targets, a full cost benefit analysis of the implications of various target options for national economic, social, environmental and competitiveness policy objectives should be undertaken.

**Responsibility:** Department of Communications, Energy and Natural Resources

In addressing energy costs, it is important to note that a balance needs to be struck between the immediate needs of enterprise from a cost competitiveness perspective and the requirement to ensure security of supply. It is also necessary to differentiate between controllable costs that can be influenced by domestic policymakers and non-controllable costs (e.g., fuel costs) which are determined globally<sup>23</sup>. While international fuel prices exert a very significant influence of energy prices here, it is important that we acknowledge the impact of policy decisions made in Ireland on energy prices. Tackling the controllable cost components must be prioritised in the new energy policy.

The NCC believes that the new energy policy should explicitly address cost competitiveness issues and set out the actions to address the cost drivers that are within the State's control. Much of the potential to reduce energy costs in Ireland involves policy decisions rather than regulatory decisions. Among the issues that need to be addressed are:

- Delivering energy infrastructure investment at least cost: Energy is an essential business input and Ireland needs to ensure adequate regional/local spare network capacity to meet additional enterprise demand, especially in the main urban centres. This is particularly important to facilitate large, energy intensive manufacturing activity. However, we also need to ensure that energy network investment is targeted to meet future demand in a timely manner and that investment costs are minimised as the cost of energy infrastructure is passed through to energy users in the form of higher energy prices;

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<sup>23</sup> For example, according to the CER, approximately 60 per cent of the electricity cost base is outside of Ireland's control (it is higher for larger users), a large part of which is accounted for by fuel. See CER, Pass-Through Costs for Business Electricity Customers from 1st October 2013 (CER 13/229), October 2013. A recent report from Forfás on sectoral regulation includes an assessment of the drivers of costs in the energy sector. See Forfás, Sectoral Regulation: A study to identify changes to sectoral regulation to enhance cost competitiveness, April 2013

- Ensuring the optimal functioning of the Integrated Single Electricity Market (I-SEM): The Council welcome the recent I-SEM consultation and the focus on retaining the positive elements of the SEM (e.g. transparency, cost reflective wholesale prices, etc.) while addressing its shortcomings. In particular, it is important that new market design sends the right investment signals to ensure that future energy needs are met at least cost - that is that it delivers the right amount of capacity with the right characteristics in the right locations<sup>24</sup>. Decisions made as part of the new energy policy will also have a significant bearing on how successful the I-SEM is in achieving its objectives. It is therefore critically important that the new energy policy considers the impact of related decisions/actions on the effective functioning of the I-SEM and ensures that Ireland's energy policy priorities are aligned with the I-SEM objectives;
- Reviewing supports for electricity generation: An increasing share of Ireland's generation capacity is subsidised<sup>25</sup>. This is not sustainable. It is critically important for the effective functioning of the all island electricity market that renewable generation capacity is subject to market forces to the greatest extent possible. As a mature technology, price supports for new onshore wind projects should be discontinued when REFIT 2 ends in 2017. Enterprise opportunities in emerging energy technologies should be funded by the exchequer through competitive funding mechanisms for R&D rather than by energy customers;
- Discontinuing peat subsidies: The peat PSO levy increased from €40.6 million in 2011/12 to €51.9 million in 2012/13 to €54.8 million in 2013/14. Given the significant additional costs for electricity users arising from the peat PSO, subsidies for peat-generated electricity should be discontinued.
- Reviewing the regulatory framework: There have been significant changes in the energy space since the White Paper was published in March 2007. It is vital, therefore, that the energy regulatory framework is reviewed now to ensure that it is best placed to support the delivery of the revised priorities in the new energy policy. In particular, DCENR needs to put in place a hierarchy of policy/regulatory objectives, which prioritises the promotion of consumer interests (business and residential) and effective mechanisms to rigorously assess whether policy objectives are being achieved. The revised regulatory framework also needs to ensure regulatory certainty, which is critically important for efficient investment and well-functioning markets. The timing of announcements of changes to the regulated components of energy prices (e.g. PSO levy, network charges) makes budgeting very difficult and needs to be revised to provide greater certainty to businesses; and
- Reviewing the structure of the electricity market: Competition has increased in both the electricity generation and supply markets over recent years. However, the International Energy Agency (IEA) review in 2012 raised concerns about the continued high level of State involvement in the energy market. In particular, ESB retains a significant share of the price setting generation plant in the SEM. As highlighted by the OECD, the IEA and others, some of ESB's

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24 As highlighted by the SEM Committee, there are concerns that the location and type of the substantial investment in generation capacity over the past seven years was not optimal.

25 There are subsidies for electricity generated from peat and renewable energy. In 2012, 16 per cent of gross electricity consumption in Ireland was generated from renewable sources (wind and biomass) and 9.4 per cent from peat. Under the EU 2020 targets, Ireland has committed to generating 40 per cent of its electricity generation from renewable sources, much of which will be wind.

price setting generation plant should be divested to reduce ESB's dominance and increase competition<sup>26</sup>.

**Recommendation:** Address the controllable cost components of energy costs in Ireland. This will require:

- Ensuring that the Integrated Single Electricity Market (I-SEM) supports energy competitiveness (i.e. it delivers a reliable and competitively priced supply of electricity);
- Delivering energy infrastructure investment (network investment and new generation/storage capacity) at least cost;
- Reviewing supports for new electricity generation and discontinuing supports for new projects using mature technologies;
- Discontinuing the supports provided for electricity generated from peat;
- Providing funding for enterprise opportunities in emerging energy technologies through exchequer funded support mechanisms for R&D, if deemed competitive, rather than by energy customers through expensive guaranteed price supports;
- A review of the regulatory framework to ensure that it reflects the Government policy statement on sectoral economic regulation and agreed best practice; and
- A review of the electricity market structure to address market power issues.

**Responsibility:** Department of Communications, Energy and Natural Resources

At the same time as promoting cost competitive energy supply, the Council recognise the need to ensure security of supply and the importance of enhancing environmental sustainability. In this regard, a range of issues must be addressed, for example:

- The diversification of gas sources/supplies through the development of a twin gas pipeline in Moffat, Scotland and the exploitation of the Corrib gas reserves etc.;
- Adapting Ireland's fuel mix through the use of policy tools to incentivise investment in particular fuels or type of generation plant;
- Increasing electricity interconnection to Britain and continental Europe; and
- Improving energy efficiency to support both competitiveness and environmental sustainability.

Not only is energy efficiency regarded as one of the most effective tools to improve environmental sustainability; it is also effective in reducing costs and improving security of supply. Significant progress in improving energy efficiency has been made by business, particularly large users under the Large Industry Energy Users Network (LIEN)<sup>27</sup>, Enterprise Ireland's lean business programme<sup>28</sup>,

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<sup>26</sup> In their response to the Green Paper, the CER favour a structural solution to address market power issues in electricity, noting, "The continuing concentrated nature of the SEM necessitates the need for regulatory market power mitigation measures, in the absence of a structural solution to significantly reduce ESB's market share". See Commission for Energy Regulation, CER Response to Government Consultation on Green Paper on Energy Policy in Ireland, September 2014

<sup>27</sup> 140 of Ireland's largest energy users are members of the LIEN and work together to develop and maintain robust energy management. For more details see: [http://www.seai.ie/Your\\_Business/Large\\_Energy\\_Users/LIEN/](http://www.seai.ie/Your_Business/Large_Energy_Users/LIEN/)



the enterprise agencies' environmental aid programme<sup>29</sup>, the accelerated capital allowance initiative<sup>30</sup> and the SEAI programmes for SMEs<sup>31</sup> and exemplar energy-efficiency projects<sup>32</sup>.

Continued and enhanced efforts to promote energy efficiency improvements are required, in particular for small business and domestic users. It is essential that individuals and firms are fully aware of how best to reduce their energy use. Actions to improve domestic energy efficiency (e.g. smart metering, retrofitting of homes) also need to be progressed as reducing peak domestic electricity use will lead to benefits for all users, reducing required investment levels and, therefore, lowering costs. Actions to reduce peak demand include the provision of more efficient building stock, the electrification of public transport, and working with large, public sector energy users such as Irish Water to reduce and smooth out usage.

The 2014 Action Plan for Jobs sets out a number of actions, including the establishment of an energy efficiency fund, to improve energy efficiency<sup>33</sup>. Earlier this year, Government committed up to €35 million to generate an energy efficiency fund of over €70 million when matched with investment from the private sector<sup>34</sup>. While the fund is designed to provide finance to energy efficiency projects across all sectors of the economy, 2014 will see a broadening and deepening of supports to industry.

**Recommendations:** Reducing energy use and lowering peak demand offers a range of benefits. Actions required include:

- Continued and enhanced efforts are required by Government departments, enterprise agencies and business representative associations to ensure that businesses are fully aware of how best to reduce their energy use.
- Measures to improve domestic energy efficiency (e.g. smart metering, retrofitting of homes) need to be progressed as reducing peak domestic electricity use will lead to benefits for all users.
- Measures to manage public energy use can also reduce peak demand. For example, provision of more efficient public buildings (educational and health facilities, public offices, etc.), the electrification of public transport, and working with large, public sector energy users such as Irish Water to reduce and smooth usage.

**Responsibility:** Government departments, enterprise agencies, business representative associations, Sustainable Energy Authority of Ireland

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28 Enterprise Ireland's Lean Business Offer is designed to encourage clients to adopt Lean business principles in their organisation to increase performance and competitiveness - see: <http://www.enterprise-ireland.com/en/productivity/lean-business-offer/>

29 The objective of the programme is to assist client companies to implement major initiatives that incorporate renewable energy, significantly increase energy efficiency or address other environmental issues such as waste.

30 This is a tax incentive to encourage investment in energy efficient equipment. It allows companies to write off 100 per cent of the purchase value of qualifying energy efficient equipment against their profit in the year of purchase. This is net of any grant aid provided for the equipment in question.

31 The SME Support Centre provides advice and training for businesses to help reduce their energy spend - see: [http://www.seai.ie/Your\\_Business/SEIs\\_services\\_for\\_SMEs/](http://www.seai.ie/Your_Business/SEIs_services_for_SMEs/)

32 In June 2013, the first tranche of exemplar energy efficiency projects was announced - see [http://www.seai.ie/News\\_Events/Press\\_Releases/2013/Minister-Pat-Rabbitte-announces-exemplar-energy-projects-.html](http://www.seai.ie/News_Events/Press_Releases/2013/Minister-Pat-Rabbitte-announces-exemplar-energy-projects-.html)

33 For more details, see Section 3.5 at <http://www.djei.ie/publications/2014APJ.pdf>

34 See the first progress report for the 2014 Action Plan for Jobs at: [http://www.djei.ie/publications/2014APJ\\_First\\_Progress\\_Report.pdf](http://www.djei.ie/publications/2014APJ_First_Progress_Report.pdf)

Given the importance of energy policy - energy is an essential input into everything we do - it is critical that we have a whole of Government approach to addressing energy challenges and opportunities.

### 1.3 Property

Housing costs have a direct impact on wage demands and standards of living. Since their peak in 2007, Irish house prices have experienced a major downward adjustment. The current rapid increases in house prices and residential rents, however, have the potential to produce adverse knock-on consequences in terms of prices and wage expectations across the economy. In this context, there is a need to ensure an adequate supply of both housing and commercial property.

#### Site Value Tax

An annually recurring site value tax - levied without regard to how land is used or what is built on it - is considered the most effective type of property tax in terms of ensuring the most productive use is made of land<sup>35</sup>. Since the amount of land is fixed, a non-discriminatory tax on it cannot distort supply in the way that taxing employment affects the supply of labour. Instead, a land tax encourages efficient land use and taxes the value added by investment from the community, rather than the value created by the site owner<sup>36</sup>.

Under a site value tax, those sitting on derelict or under-used sites in Ireland's cities and towns will be encouraged to use it, sell it on, or pay for the privilege of wasting land. The costs of such vacancies are currently borne by others in general, by other ratepayers in particular. Essentially, a site-value tax rewards those who use land well and punishes speculators and land-hoarders. This has obvious benefits such as the rejuvenation of town centre: property developers, for instance, would be less inclined to hoard undeveloped land if they had to pay an annual levy on it. It could also be used to increase the availability of land for housing as market needs grow.

Following recommendations from the Council and others, an annual value based property tax for residential households has been introduced. However, the taxation of commercial properties in the form of commercial rates has not changed significantly in many decades - despite long held concerns on its transparency, fairness and efficiency (as well as the relatively disappointing collection rate). At present, the revenues generated through the commercial rates system (which is a form of property tax levied by local authorities on tenants of commercial properties) enable Local Authorities to provide important services to both businesses and households<sup>37</sup>. However, as it stands, the commercial rates system does nothing to encourage the efficient use and development

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<sup>35</sup> Site value is measured based on the rental value of the land. A SVT is ordinarily charged as a percentage of the value of a site with regular valuations undertaken by an independent statutory body.

<sup>36</sup> The value of a site derives from its location and access to publically funded or subsidised infrastructure, utilities and services. See Collins, M., and Larragy, A., *Designing a Site Value Tax for Ireland*, ERU Working Paper Series, ERU WP 2011/1, November 2011

<sup>37</sup> The annual commercial rate for commercial property in Ireland is calculated by multiplying the annual rate of valuation (ARV) by the rateable valuation for the property which is determined by the Valuation Office.

of vacant commercial land. The current system of commercial rates serves to weaken the incentive for existing business to expand and discourages entrepreneurship<sup>38</sup>.

Consideration should be given to replacing the current system of commercial rates with a site value tax. This could help to resolve the current housing and commercial property shortages in key urban centres, as land would be used in a more efficient manner<sup>39</sup>.

The Commission on Taxation<sup>40</sup> and an Inter-Departmental Committee<sup>41</sup> recognised the strong economic rationale for introducing a site value tax on residential properties, while also acknowledging the practical difficulties that would have to be overcome (e.g. the difficulty in decoupling the site value from the overall property value; issues relating to the perceived fairness of a site-value approach to taxation). However, a site value tax on land other than residential and agricultural property, administered on a self-assessment basis with oversight by the collection agencies would be much more efficient and economically aligned than the existing commercial rates system.

It is likely that the introduction of a site value tax would need to be progressed in parallel with reforms to the planning/zoning system to ensure that appropriate development occurs.

Likewise, greater transparency and certainty is required in relation to the calculation and use of development contributions. There would be merit in ensuring that development contributions in respect of particular infrastructural projects are only used to fund such infrastructure and not any other service provided by the local authority.

**Recommendation:** The feasibility of introducing a site-value tax for commercial property to replace the current system of commercial rates should be explored in 2015.

**Responsibility:** Department of Finance, Department of the Environment, Community and Local Government

## Long Term Development of the Sector

The rapid growth in house prices and residential rents, particularly in Dublin, represents a potentially destabilising development - annual growth in the Dublin private residential rental market in the year to the end of June 2014 was 10.5 per cent<sup>42</sup>. Such rapid growth in property costs,

38 Both the NCC and Forfás have previously commented on the need to reform the commercial rates system works. In 2012, Forfás recommended that the commercial rates system should be simple, transparent and easy to administer, and that a broad based system with a lower nominal rate is preferable to one with a higher rate and a range of exemptions. Specific actions to achieve a more effective and efficient rates system included the implementation of the Valuations Bill, the use of self-assessment, continued implementation of the Local Government Efficiency agenda. See Forfás, Costs of Doing Business in Ireland 2012, April 2013

39 Recurrent taxes on immovable property are ranked as the least distortive tax instrument in terms of reducing long-run GDP per capita. Research by the OECD suggests that there could be gains in terms of long-run GDP per capita from increasing the use of consumption and property taxes relative to income tax without changing the overall level of tax revenues. A Department of Finance simulation finds that a €1 billion increase in revenue from property taxes fully offset by a cut in income taxes would result in an increase in output (real GDP would be 0.3 per cent higher) after six years with employment 0.4 per cent higher and unemployment 0.5 per cent lower. See Department of Finance, Quantification of the Economic Impacts of Selected Structural Reforms in Ireland, Irish Government Economic and Evaluation Service, Working Paper, July 2014

40 Commission on Taxation, Commission on Taxation Report, 2009

41 Department of the Environment, Community and Local Government, Design of the Local Property Tax: Report of the Inter-Departmental Committee, 2012

42 According to recent data, Dublin house rents increased by 8.5 per cent and Dublin apartment rents by 12.1 per cent in the year to June 2014. See Private Residential Tenancies Board, Quarterly Rent Index, September 2014

allied to issues around security of tenure, can be expected to have significant adverse knock on effects on wages and inflation.

While the current shortage of residential supply is a cause for concern, the Council would caution against “quick-fix” interventions in the market. Experience shows that supply generally takes 18 months or more to respond to increased demand - strong demand for housing already exists in Dublin and some other urban areas and demand is likely to grow over time<sup>43</sup>.

While economic recovery remains fragile and Ireland is a long way from a return to the undesirable construction boom of the mid-2000s, we must take action now to ensure that the conditions, which facilitated the property bubble, are not allowed to re-emerge. In the context of supporting a sustainable property sector, it is necessary to learn lessons from the recent past. Experience highlights the difficulty of designing large scale, successful interventions in the housing market. In light of this, the primary goal for policy should be to provide a coherent policy response and regulatory certainty around issues like planning and zoning, and facilitating the supply of additional housing units. The need to invest in social housing is discussed in Chapter 2.

The Government’s strategy for the sector, *Construction 2020*, has been developed to achieve just that - to ensure that “we are building the right things, in the right places, and that we are not placing unnecessary obstacles in the way of urgently needed and appropriate development”<sup>44</sup>. The Strategy also recognises the need for a whole of Government approach to achieve implementation.

**Recommendation:** Implementation of the recommendations contained in *Construction 2020, A Strategy for a Renewed Construction Sector* should be prioritised and monitored in the *Action Plan for Jobs 2015*. In particular, the development of a national planning framework, the publication of the general scheme of a Planning Bill, and the proposed Policy Statement on Planning are key milestones in addressing a range of concerns relating to the current planning system.

**Responsibility:** DPER, DECLG, DCENR, DES, DJEI, Local Authorities, Enterprise Ireland and Other Relevant State Bodies

Given the serious adverse consequences of the recent property boom and subsequent collapse, it is essential that policymakers consider any actions necessary ensure that we never again have a sustained and destructive property bubble. In this regard, the Departments of Finance, and Environment, Community and Local Government, as well as the Cabinet Committee on Construction 2020, Housing, Planning and Mortgage Arrears have a key role to play.

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43 According to Housing Agency forecasts, a minimum supply of 79,660 residential units in urban areas is required to support the population between 2014 and 2018. This equates to an average equivalent of 15,932. The per annum requirement ranges from 9,526 units in 2014 to 20,853 units in 2018. It is estimated that 47 per cent of total supply over the 5-year period is required across the Dublin Region. According to the CIF, the number of housing units that will be built in Dublin this year will be less than 2,000 units.

44 Government of Ireland , *Construction 2020, A Strategy for a Renewed Construction Sector*, May 2014

**Recommendation:** A whole of Government approach is required to ensure that appropriate policies are developed as required to avoid the creation of future sustained property bubbles.

**Responsibility:** Departments of Finance, Department of the Environment, Community and Local Government, the Cabinet Committee on Construction 2020, Housing, Planning and Mortgage Arrears

## Rent and Rent Reviews

Commercial leases in Ireland have typically been long-term in nature (i.e. often up to 25 years duration). The Land Conveyancing and Law Reform Act 2009 was introduced to ensure that all new leases signed from March 2010 contain a provision that rents can be reviewed both upwards and downwards on review<sup>45</sup>. Previously, rents could usually only be reviewed on an ‘upwards only’ basis at review under the terms of lease. While this legislation is welcome, it cannot assist existing enterprises, tied into long-term leases at rates significantly above current market rates. The Government has noted that despite extensive consideration<sup>46</sup>, it has not proved possible to develop a targeted scheme to tackle upward only rent reviews in existing business leases that would not be vulnerable to a legal challenge or require compensation to be paid to property owners.

In addition, while there is significant anecdotal evidence of tenants and property owners’ negotiating rent abatements, the Council remains concerned that such agreements are temporary in nature - in many cases, once property owners believe the worst of the crisis is over, the tenant may become liable for the full, backdated rent. This could have a negative impact on a company’s cash flow and ability to raise credit for investment.

**Recommendation:** In the interests of transparency, the Government should consider publishing the most recent advice from the Attorney General on the issue of upward only rent reviews, as well as any other relevant inputs received on the potential impact of their abolition.

**Responsibility:** Government, Attorney General

## Commentary on the Cost of Health Insurance and Health Goods and Services

The Council is concerned about the implications of increases in both health and health insurance costs. Within the basket of goods purchased by the average Irish consumer (and used to calculate inflation), health insurance is the most significant element within the “Miscellaneous goods and services” category. Previous analysis by Forfás has shown that high rates of inflation for “Insurance connected with health” has been the primary driver of price increases in relation to “miscellaneous goods and services” between 1999 and 2012<sup>47</sup>.

<sup>45</sup> Land and Conveyancing Law Reform Act, 2009

<sup>46</sup> See PQ [34262/12]

<sup>47</sup> Forfás, Consumer Costs and Inflation, February 2014



Looking at HICP data, over the period 2001 to 2012, Ireland had the highest annual average rate of health insurance inflation (11.3%) within the euro area-17, greatly exceeding the euro area -17 average (3.2%). Since 2008 average annual health insurance inflation has accelerated to 16.4 per cent, while elsewhere in the EU, health insurance inflation has been slowing down (2.6 per cent in the euro area-17, and three per cent in the EU-27).

The “Health” category (as distinct from “Health Insurance”) is not a large driver of headline consumer prices due to the small weighting assigned to it in the CPI and the HICP baskets. Nevertheless, inflation in Health has been very high and Irish cost competitiveness in this category has deteriorated significantly compared with the euro area-17 and EU-27 in recent years.

Over the period 1997 to 2012, average annual HICP “Health” inflation was 4.8 per cent in Ireland, compared to 2.1 per cent for the euro area-17. Between 2008 and 2012, the HICP inflation rate in Ireland (2.6%) was well above the overall HICP rate (0.6%). The Forfás analysis has found that Health services inflation has generally been higher than health goods inflation in Ireland.

In terms of price levels, according to Eurostat’s PPP data, Irish prices for “Health” goods and services, in PPP terms, have consistently been higher than the EU-27 and euro area-17 average since 1999 and in 2012 were 44.2 per cent and 34.5 per cent above EU-27 and euro area-17 averages respectively.

In addition to the health and health insurance costs borne by consumers, the state is also a significant funder of the health sector. In this regard, it is notable that there have been significant cost overruns in recent years, which affects our fiscal performance.

Costs in the health sector are driven by a wide range of factors include demographic change and citizen expectations, labour costs in what is generally a highly skilled and labour intensive sector, the costs of medical equipment and medicine, the management and efficiency of the health sector, the degree of competition the health insurance market, tax policies, etc. While at this point, the Council have not explicitly considered recommendations designed to alleviate cost pressures in Health and Health Insurance, it is important to note that high healthcare costs directly impact upon individuals, enterprise and the Government. Access to high quality, affordable health services represent a key determinant of quality of life and contribute to the attractiveness of Ireland as a good place to do business and invest.

## 2. Macroeconomic Stability and Public Investment

Stable and sustainable public finances are a prerequisite for competitiveness: high deficits limit the scope for growth and productivity enhancing investments, have adverse impacts on the State's potential to borrow, and leave the State vulnerable to external events. Long-term consumer confidence and demand is also influenced by perceptions of the health of the public finances.

However, despite the corrective action taken to date, the fiscal deficit and public debt remain high. Further actions are needed in coming years to ensure that debt remains firmly on a declining path while protecting the nascent recovery, to ensure we have a broad based, competitive and sustainable tax base, and to increase public investment and ensure that it is invested in a productive and efficient manner<sup>48</sup>.

### 2.1 Ensuring a Sustainable Revenue Base

It is essential that a credible programme to restore the sustainability of the public finances continues to be implemented, while ensuring that our taxation system continues to support enterprise development and job creation. The Council have identified two broad themes, which should be pursued in terms of taxation policy.

#### Broadening the Revenue Base

Regardless of the level of revenue raised, the design of the tax system can affect competitiveness. Maintaining a taxation system, which encourages enterprise, while simultaneously broadening the tax base, is critical to maintaining existing levels of employment and creating new jobs in Ireland. It is also essential to rebuilding the public finances and maintaining spending on public services - including those that support broader enterprise competitiveness (e.g. science, technology, research and innovation; infrastructure and education, etc.). Potential exists to learn from the "Celtic Tiger" era, where a narrowing of the revenue base made the State over-reliant on property related taxes when the crash occurred. In this regard, suggested changes to the universal social charge, which could narrow its base, would be a retrograde step - the introduction of the universal social charge helps to mitigate the risk of over-reliance on income tax receipts, which are paid from a narrow base of earners<sup>49</sup>.

It is necessary to continue to identify and implement substantial measures to broaden the tax base in a manner that causes the least damage to our competitiveness and economic recovery<sup>50</sup>. In broadening the tax system, care is required to ensure that the tax system is progressive and that that it works in tandem with the social welfare system. Recent research estimates that across

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48 Recent revisions to CSO National Income and Expenditure data mean that the end-2013 debt ratio has changed from 123.7 per cent of GDP to 116.1 per cent of GDP even though the value of the debt and the economy which has to service it is the same.

49 39 per cent of income earners paid no income tax in 2013, though some would have paid USC. See Department of Finance, Tax Strategy Group - Income Tax and USC, Ref. 13/08, page four, 2013

50 In this context, we note the OECD's hierarchy of taxation, which identifies a tax structure, which optimises economic growth. The hierarchy establishes a tax and economic growth ranking order according to which corporation taxes are the most harmful to growth, followed by personal income taxes and then consumption taxes (i.e. VAT) with recurrent taxes on immovable property being the 'least harmful' tax.

income deciles, taking account of direct and indirect taxes (e.g., VAT), the cumulative effect of household's taxation contributions displays a U-shape; contributions are highest at the bottom and top of the distribution and lowest for those in the middle decile<sup>51</sup>.

In this regard, achieving a significant revenue stream from property taxes should act as part of a wider strategy to identify alternative revenue sources in order to avoid any further increases in income tax, social security and other charges on labour. Cost reflective charges for water and wastewater services for domestic users should continue to be progressed. Finally, carbon taxes, where applicable (i.e. non-emission trading sectors), should be borne by the creator of CO<sub>2</sub> emissions and the carbon taxes should be applied consistently across sectors based on the level of CO<sub>2</sub> emissions intensity (i.e. the level of emissions that result from the combustion of one tonne of carbon). The European Commission has also identified the potential to reform VAT rates noting "Zero and reduced VAT rates result in VAT efficiency below the EU average<sup>52</sup>. Reduced VAT rates are widely used to achieve redistribution objectives even though they are not an efficient and well-targeted policy tool to protect vulnerable groups"<sup>53</sup>. Whether the ultimate consumer benefits from VAT rate changes depends on whether they are passed on to the consumer through reduced prices by sellers.

A recent Deloitte report undertaken on behalf of Fáilte Ireland considered the impact of the July 2011 decrease in VAT (from 13.5 per cent to 9 per cent on targeted tourism-related categories) on Irish tourism and employment within the tourism sector<sup>54</sup>. Notwithstanding the difficulty of explicitly identifying a causal link between a specific policy measure and an individual sector of the economy, the report's findings are positive. It concludes that the introduction of the reduced VAT rate appears to have met its original aims of driving employment and stimulating activity in the tourism sector and has achieved this without placing a significant burden on the exchequer<sup>55</sup>.

As highlighted in the Medium Term Economic Strategy continued potential exists to eliminate or curtail 'overly-generous, poorly targeted or otherwise unaffordable tax reliefs'; to 'time-limit all tax expenditures and subject those with higher costs to ex-ante evaluation', and to 'conduct a regular programme of tax relief reviews using public consultation as appropriate and publish the results<sup>56</sup>.

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51 Collins, M., Total Direct and Indirect Tax Contributions of Households in Ireland: Estimates and Policy Simulations, NERI WP 2014/No 18, August 2014

52 In Ireland, the zero rate accounts for 12 per cent of activity and applies to most food, children's clothes and shoes and oral medicine. The standard rate of 23% applies to 36 per cent of activity, including cars, petrol, diesel, alcohol, tobacco, electrical equipment and CD/DVDs. The remainder is liable at the reduced rates; 13.5% rate applies to 36 per cent of activity, including fuel for light and the 9% rate applies to 16 per cent of activity including many labour intensive services. Source Department of Finance, Tax Strategy Group - Selected VAT Issues, Ref 13/04, 2013

53 European Commission, Recommendation for a Council Recommendation on Ireland's 2014 National Reform Programme and Delivering a Council Opinion on Ireland's 2014 Stability P COM(2014)408, Brussels, June 2014

54 In May 2011, the Government announced a Jobs Initiative, which involved a reduction in the rate of VAT, which was targeted mainly at labour intensive goods and services relating to tourism. In this context, a new temporary second reduced rate of VAT at 9 per cent was introduced with effect from 1 July 2011 until end-December 2013.

55 Fáilte Ireland, Analysis of the Impact of the VAT Reduction on Irish Tourism & Tourism Employment, July 2014; A previous assessment by the Department of Finance also concluded that "The 9 per cent reduced VAT rate appears to have had the desired impact both in terms of price pass through and by contributing to employment gains". See O'Connor, B., Measuring the Impact of the Jobs Initiative: Was the VAT Reduction Passed On and Were Jobs Created?, Department of Finance, May 2011

56 Department of Finance, A Strategy for Growth: Medium Term Economic Strategy 2014 - 2020, December 2013



**Recommendation:** Efforts should continue to broaden the tax base (for example through increases in the local property tax) while ensuring that the tax system is progressive and that that it works in tandem with the social welfare system to encourage the take-up of employment.

**Responsibility:** Department of Finance, Department of the Environment, Community and Local Government, Department of Social Protection

**Recommendation:** Tax reliefs should continue to be subject to review and reform.

**Responsibility:** Department of Finance

## International Tax Competitiveness

Investment decisions are made based on a number of factors including the costs of doing business, skilled and responsive labour markets, well-developed infrastructure, access to markets, a predictable and non-discriminatory legal and regulatory framework, macroeconomic stability, and the competitiveness of the tax system.

Ireland's current corporate tax regime is regarded as competitive by the business sector. Corporate taxes, driven by a relatively narrow range of sectors, also make a significant contribution to the State's finances.

The international tax environment is evolving rapidly. Currently the key focus is on the OECD/G20 Base Erosion and Profit Shifting (BEPS) project, which sets out a wide-ranging action plan<sup>57</sup>. There are also potential US reforms and ongoing work at EU level.

Despite the complexity of international developments, there is a clear trend emerging towards an increased focus on the alignment of profits to the substantive activities of a company and on reducing the use of tax havens - trends which largely present opportunities for Ireland. In this context, given that many multinationals already have a significant number of people in Ireland and Ireland's competitive statutory corporate tax rate on trading profit, Ireland has a good strategic starting position, from a tax perspective, to continue to attract mobile investment from both foreign and Irish sources. However, it is probable that there will be increased competition to retain and attract substance in the form of key decision makers, assets (including Intellectual Property) and capital.

In tandem with retaining our competitive corporate tax regime, we believe that the primary long-term challenge is to ensure that Ireland continues to be an attractive location to develop business operations with substance. In addition to current tax and non-tax measures, we believe that

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<sup>57</sup> A particular focus of concern in international tax policy in recent times has been on low effective rates of tax paid by multinational corporations because of trans-national structures leading to base erosion and profit shifting. Essentially, some corporations, operating in certain sectors where much of the profitability derives from internationally mobile intangible assets, have been able to reduce their overall corporate income tax by locating such assets in jurisdictions charging little or no tax (this is often achieved by taking advantage of mismatches between tax rules in different countries). While Ireland has featured in reports of some of these instances, it is the interaction of the different tax regimes of the countries in which the multinationals operate that can lead to reductions in the global effective rates of tax being paid by these companies. Profits arising in Ireland are charged at the 12.5% rate and the very low effective tax rates cited for some corporations are not attributable to the Irish corporation tax system.

measures aimed at making Ireland a more attractive location to hold and exploit intellectual property (IP) in and for key internationally mobile individuals to work from, focusing on where there is a key skills shortage and very limited risk of displacement, should be prioritised.

**Recommendation:** To maintain Ireland's attractiveness for investment, and as part of a wider suite of enterprise policies, the Council recommend that Ireland continue to assert our strong commitment to maintaining the current corporation tax rate and competitive regime.

**Responsibility:** Department of Finance

**Recommendation:** A review of Ireland's intellectual property tax regime should be undertaken to ensure that it remains fit for purpose given international opportunities and challenges.

**Responsibility:** Department of Finance

## 2.2 Increasing and Targeting Public Investment

Ireland's economic growth depends on the ability of businesses to trade successfully in increasingly competitive global markets. The availability of competitively priced world-class infrastructure (e.g., energy; telecoms; transport - road, public transport, airport, seaports; waste and water) and related services is critical to support competitiveness. The availability of high quality industrial and commercial property and the upgrading of our key urban centres to make them attractive places to live and work are also vital to support economic growth and job creation<sup>58</sup>.

While Ireland made significant investments in infrastructure and there has been noticeable improvement in the quality of our infrastructure in the past two decades, particularly in transport and telecoms access, Ireland's Competitiveness Scorecard highlights that Ireland still lags countries with which we compete for trade and investment.

Public capital expenditure has declined significantly since 2008; Government spending has fallen from 5.3 per cent of GDP in 2008 to 1.8 per cent in 2013. In monetary terms, over €9 billion was invested in 2008 compared to a capital expenditure budget of €3.3 billion in 2014, although weaker demand for infrastructural services during the recession (e.g. reduced road traffic, declines in energy demand) has partially mitigated the impact of this reduction to date.

It is important to note, however, that as well as exchequer funds invested through the public capital programme, the stock of infrastructure in the economy can also be expanded through investment by the commercial State bodies and investment financed through public-private partnerships (PPPs).

We need to ensure that we are maintaining infrastructure to optimise the investments already made and minimise the need for costly remedial work in the future. Learning from experience, we need

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<sup>58</sup> Department of Jobs, Enterprise and Innovation, Policy Statement on Foreign Direct Investment in Ireland, July 2014

to ensure that as the economy returns to growth that existing and likely infrastructural bottlenecks which could constrain growth in the economy by dampening productivity growth, increasing costs and limiting sectoral opportunities for foreign direct investment (FDI) and indigenous enterprise development. The Council believes that it is time to reverse some of the cuts to the capital expenditure budget in recent years. Boosting investment would increase aggregate demand in the short term and increase potential growth in the medium term. It will be important that capital expenditure (as a percentage of GDP) mirrors that in competitor countries who are at a similar stage of infrastructural development<sup>59</sup>. Government must also be ambitious in availing of external sources (e.g. EU/European Investment Bank, institutional lenders such as pension funds etc.) to fund infrastructure delivery.

**Recommendation:** As the economy returns to strong growth, some of the recent cuts to capital expenditure should be reversed to support enterprise development and to ensure that capital expenditure (as a percentage of GDP) mirrors that in competitor countries that are at a similar stage of infrastructural development<sup>60</sup>.

**Responsibility:** Department of Public Expenditure and Reform

## Infrastructure Investment Priorities

Continued, targeted investment in economic infrastructure across transport, telecoms, energy and environmental services is required to support future economic growth. A new infrastructure investment framework will be published in 2015 following a review of infrastructure requirements. Well-targeted capital investment can influence economic growth performance through boosting long run potential output; and improving productivity and competitiveness, through efficiency gains and reduced average production costs. Investment must be prioritised to maximise impact - while the short-term stimulus effect of capital spending is welcome, it is critical that the current review prioritises investment based on long-term competitiveness gains. The development of a new national spatial strategy could also support prioritisation. A range of infrastructure priorities, which support competitiveness, have been identified:

- **Water services:** a strategic medium to long-term approach to investment planning is required that balances the need for quality water services with the need for cost competitiveness. In the short term, it is vital that the current water services constraints in Dublin are addressed urgently to ensure that the region has sufficient supply to meet future demand. To support regional development, Ireland needs to deliver sufficient capacity to support expansion plans and new developments, especially in the large regional urban centres. In particular, providing

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<sup>59</sup> The effects of an additional investment of €1 billion annually in productive public infrastructure have been modelled by the Department of Finance. The additional investment would have both demand and supply-side effects: on the demand side, the investment would result in increased demand for goods and services and additional employment during the planning and construction phase. The supply-side effects are realised over the medium to longer term once the projects have been completed. The benefits would include reduced commuting times for workers, lower congestion, and, depending on the projects, reduced freight transport costs. See Department of Finance, Quantification of the Economic Impacts of Selected Structural Reforms in Ireland, Irish Government Economic and Evaluation Service, Working Paper, July 2014

<sup>60</sup> IBEC have previously recommended that the Irish state should look to confront serious long-term competitiveness and demographic challenges by spending 4 per cent of GDP on infrastructure development by 2020. This is below peak values of just over 5 per cent and comparable to levels last seen in the early part of the last decade. See Ibec, Infrastructure 2020: Building beyond the bailout, December 2013

the required water services capacity and quality levels in enterprise agency strategic sites and business parks and strategic development zones should be prioritised. There also needs to be a strong focus on reducing leakage nationally;

- *Telecommunications:* Enhancing Ireland's international and national connectivity is critically important to support the future needs of existing and new companies in ICT and digital media and other data intensive sectors. Ireland needs to prioritise the investment required to deliver the Government's commitment to provide fibre based broadband services to all parts of the country. In particular, we need to accelerate (through market reform and where necessary State investment) the availability of competitively priced, advanced broadband services that offer significant upload capability (including the widespread availability of symmetric services for enterprise), low latency and low contention ratios in all urban centres where they are not or will not be available in the short term. The mandatory sharing of specified infrastructures (such as mobile phone masts) should also be considered;
- *Social Housing:* In the context of rapidly increasing rents and residential property prices, an expansion in the supply of social housing is urgently required. Innovative approaches to funding (including off-balance sheet funding) should be developed, and mechanisms to harness private institutional and charitable investment in social housing should be considered, in addition to enhanced direct provision. The establishment of the Housing Supply Coordination Task Force for Dublin (as outlined in *Construction 2020*), with an immediate focus on addressing supply related issues represents a key milestone in addressing the housing challenge. The Task Force should include Housing Association representatives amongst its membership. The ongoing review of Part V of the Planning and Development Act 2000 is welcome - it is vital that a reformed or revised Part V is fit for purpose and delivers on its objectives;
- *Transport:* An efficient and integrated national transport system with adequate capacity and levels of service is vital to move goods and people quickly, effectively and in environmentally sustainable ways. In this regard, we need to enhance urban mobility in Dublin<sup>61</sup> and the other city regions by ensuring existing resources are focused on providing public transport services that best meet changing customer needs and provide high quality access to, from and within the main cities<sup>62</sup>;
- *Transport:* A number of bottlenecks in the road network should be addressed to capture the full benefits of the significant investment in road and other infrastructures already made, including: improving access between and around the main regional urban centres (in particular the completion of the Cork and Galway ring roads, the N20 Croom-Mallow and the N28 Ringaskiddy-Cork upgrades and the N21 Ballyvourney-Macroom bypass); enhancing connectivity to the north west gateways of Sligo and Letterkenny; and enhancing access to the south west which is critical to support the development of the tourism sector;

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61 Within Dublin, delivery of the actions outlined in the National Transport Authority's (NTA) investment plan for the Greater Dublin Area should be prioritised to fully capture the benefits of existing infrastructure (e.g. Luas Cross City and the re-opening of the Phoenix Park Tunnel) and advance the rollout of measures to promote more walking and cycling.

62 The Department of Transport, Tourism & Sport is currently developing a Strategic Framework for Investment in Land Transport. For more information, see [www.dttas.ie/corporate/publications/english/public-consultation-investing-our-transport-future](http://www.dttas.ie/corporate/publications/english/public-consultation-investing-our-transport-future)

- *Built environment*: The scaling back of public investment in the built and urban environment during the recession has had a notable impact on the quality of place, and of town centres in particular, which in turns impacts on the competitiveness and attractiveness of local and regional economies as places in which to invest, live and work. The potential of a Site Value Tax to contribute to the regeneration of town-centres (referred to previously) should be considered in this regard;
- *Energy*: While energy infrastructure is not funded directly from public capital expenditure budgets, public policy has a critical role to play in ensuring that the private sector invests in a timely manner to ensure the current and future needs of enterprise are met;
- *Waste management*: A range of infrastructures are required along the waste hierarchy and public policy has a key role to play in ensuring that private sector invests in a timely manner to ensure enterprise needs are met; and
- *Intelligent infrastructure*: The delivery of intelligent infrastructure offers significant competitiveness benefits for the economy in terms of increased productivity, reduced costs and sub-supply opportunities<sup>63</sup>. This public capital programme review should explicitly outline the potential for intelligent infrastructures to maximise the value of existing infrastructure and its potential to enhance the value of future investments.

Investment in infrastructure is just one stream of the public capital programme. The Council are concerned that, in some cases, investment in education, skills and labour market support is poorly targeted. For example, while Ireland spends the third highest share of economic output on labour market policies, Ireland prioritises income support (such as Jobseekers Allowance) with a much lower emphasis on labour market services (such as providing information and guidance on jobs and training)<sup>64</sup>.

As highlighted in Ireland's Competitiveness Scorecard, private sector investment has collapsed in Ireland. Given the constraints under which the State is currently operating, policies must also focus on increasing private sector investment and ensuring that markets function properly to maximise the return to both public and private investment.

Increased impetus from the private sector is required in order to support companies to invest and create jobs - to achieve this it is essential that the financial resources are available. Encouraging this type of pro-investment agenda forms the bases on the Access to Finance chapter, later in this report.

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63 "Intelligent infrastructure" or "smart infrastructure" is the application of technology to deliver a more effective and efficient infrastructure service. It uses a layer of technologies, which can be embedded in the design of new infrastructure or applied to existing infrastructure. See Forfás, Intelligent Infrastructure: Delivering the Competitiveness Benefits and Enterprise Opportunities, October 2011

64 ICTU, Labour Market Monitor, Vol. 1, No. 2, Autumn 2014; Eurostat, Labour Market Programme expenditure by type of action, Summary tables

### 3. Developing the Skills Base

Labour and skills challenges are impeding competitiveness and are limiting how the gains from improved competitiveness are shared. The skills of the workforce are a primary driver of productivity and long-term competitiveness. Skills development across all levels of the education and training system must remain a priority for policymakers.

Demand for labour has increased and this is reflected in recent labour market statistics<sup>65</sup>. There was an annual increase in employment of 1.7 per cent (or 31,600) in the year to the second quarter of 2014, bringing total employment to 1,901,600.

High levels of outward migration reduce labour supply. While there always flows of people in and out of the country, continuing high inward migration may indicate that there are issues in relation to the supply of skills available in Ireland, or in relation to the incentives to take up employment. In addition, over the course of the recession, as unemployment and long-term unemployment increased, labour market participation fell (as individuals dropped out of the labour market) - according to the OECD, the decline in participation in Ireland was the largest amongst OECD countries.

OECD data shows suggests that there is a mismatch between skills that are available within the labour force and the skills that demanded by enterprise<sup>66</sup>. In parallel, and even in the face of large-scale unemployment, skills shortages persist in the Irish economy (in niche areas). It should be noted, however, that these shortages continue to be confined to niche skill areas and in most instances are of low magnitude<sup>67</sup>.

Labour and skills challenges are also limiting how the gains from improved competitiveness are shared as certain cohorts of the labour force have difficulty accessing opportunities available. Many unemployed workers, particularly long term unemployed workers, are ill equipped to work in those sectors most likely to experience employment growth (e.g., ICT occupations across all sectors of the economy, export sectors and occupations requiring combinations of multi-lingual and technical skills). Long-term unemployed workers, who have greater difficulty returning to employment, accounted for 57.6 per cent of total unemployment in Q2 2014. Taking action to address high levels of unemployment (particularly structural unemployment amongst certain cohorts such as former construction workers) is an especially urgent challenge<sup>68</sup>.

Skills supply comes through three main channels - through graduates emerging from the formal education and training system; by upskilling the existing workforce; and through immigration from across the European Economic Area and targeted, skills based immigration from the wider, global labour market.

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65 CSO, Quarterly National Household Survey, Quarter 2 2014

66 The data shows that the gap between the skills in the working population and the skills of those in employment widened in Ireland between 2008 and 2011. See OECD, Economic Survey of Ireland, 2013

67 Expert Group on Future Skills Needs, National Skills Bulletin 2014, July 2014

68 The European Commission has noted that the slack ratio (the number of jobseekers with divided by the number of employed people at a given level of skills) is much higher in Ireland for those with low levels of educational attainment than for those with higher levels of attainment. See European Commission, Reindustrialising Europe: Member States Competitiveness Report 2014, September 2014

The Irish education and training system is currently undergoing a significant level of structural reform<sup>69</sup>. In addition to improving education and training outcomes generally, a key objective of this reform process is to ensure that the system supports young people and adults to acquire the skills enterprise needs now and to prepare them to both take up and to create the jobs and workplaces of tomorrow.

Addressing the unemployment challenge and providing targeted responses to meeting skills needs will continue to be key priorities for the education and training system. The Council is focused on two particular challenges:

- Implementing the new Further Education and Training strategy and delivering the structures to provide better high quality, flexible and responsive education and training programmes, with a particular focus on activation for the unemployed; and
- Modernising the apprenticeship system (which crosses further education and training, and higher education) to bring about a greater focus on on-the-job learning and engagement with employers. The development of a wider range of relevant apprenticeships is a key element of the modernisation programme.

### 3.1 Further Education and Training

The Further Education and Training sector is one of four discrete sectors of the Irish education framework that also includes primary, secondary and higher education. In excess of 200,000 people will enrol in Department of Education and Skills funded Further Education and Training this year. A total of €826 million will be spent by the Department to support Further Education and Training provision<sup>70</sup>. Significant changes are underway in the area of FET and in apprenticeship training. SOLAS<sup>71</sup> and the Education and Training Boards (ETBs) are working together, and with other parts of Government and with employers, to ensure that FET programmes are more flexible and responsive to meet the needs of jobseekers and industry<sup>72</sup>.

#### Employer Engagement

There is a need to enhance employer engagement across all the Further Education and Training system. Employer input is critical to ensure that investments are targeted in areas of current shortages and where future demand is forecast, to set strategic direction and assess the continuing relevance of education and training offerings, and to support the development and evolution of

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69 The wider reform programme covers a range of issues, including: the development of the Literacy and Numeracy Strategy to improve the literacy and numeracy skills of children and young people in school; the rollout of Project Maths which is transforming the teaching and learning of Maths in second level schools; ongoing reform of the Junior Cycle programme; the reconfiguration of the higher education sector through the implementation of the Higher Education Strategy; provision for the development of Technological Universities; and the development of an Employer Engagement Strategy for higher education. Work is also being undertaken around transition from second level to Higher Education. For more detail see Department of Education and Skills, Ireland's Education and Training Sector: Overview of Service Delivery and Reform, 2014

70 €640 million will be funded through SOLAS. The balance relates to the teacher pay element of the Post Leaving Cert programme.

71 The Further Education and Training Act provided for the dissolution of FÁS and the establishment of SOLAS - SOLAS operates under the aegis of the Department of Education and Skills and will, in conjunction with the sixteen Education and Training Boards, be responsible for the integration, coordination and funding of a wide range of FET programmes.

72 There has been an overhaul of the structure of the sector including the streamlining of 33 existing VECs into 16 Education and Training Boards (ETBs), and creation of SOLAS, the Further Education and Training Authority.

curricula. Employers can also facilitate work placement and on-the-job learning, enhancing the quality and balance of education and training programmes.

The new strategy explicitly recognises the need to align training provision with the needs of enterprise and learners<sup>73</sup>. The strategy notes that “FET needs to focus on ensuring that graduates/learners possess the relevant level and quality of job-ready skills, or as close as is possible to job-ready that employers need, particularly at local level”.

From a competitiveness perspective, this focus on embedding employment relevant skills is welcome<sup>74</sup>. Likewise, the emphasis placed on employer engagement is a positive step.

The Council remains concerned, however, about how robust employer engagement is secured at local level. In addition to the use of labour market intelligence at a national level, it is vital at local and regional level that employers are involved in identifying the skills and competencies that are required, developing and adapting curricula and, perhaps most challengingly, providing sufficient opportunities for on-the-job training as required through internships, placements, traineeships, etc.<sup>75</sup>

There has been some progress in this regard in specific labour market initiatives, for example, with the development of a Higher Diploma Level 8 Conversion Programme in Computing<sup>76</sup>. Wider adoption of models such as this should be considered where evaluations have found positive outcomes.

There is also more scope to align broader education and training provision with the needs of the labour market<sup>77</sup>. A key challenge is to ensure that investments are targeted in areas currently experiencing shortages and where future demand is forecast.

Finally, it is important that managers are suitably upskilled so that they in turn recognise the value of education and training, and support the upskilling of the entire workforce.

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73 Department of Education and Skills, Further Education and Training Strategy 2014-2019, May 2014

74 In 2013, the Higher Education Authority (HEA) sought expressions of interest from enterprise and higher education institutes wishing to participate in a national pilot to deliver a post-graduate programme in professional practice. The programme aims to provide an opportunity for graduates to acquire cross-disciplinary skills in a work based environment and will examine ways to provide a systemic bridging between education and employment through opportunities for Level 8 graduates to acquire cross-disciplinary skills and a type of structured professional experience, which will boost employability. As a result, the Department of Social Protection, in partnership with the HEA, is introducing a pilot Postgraduate Programme of Professional Practice (PGPP) as part of JobBridge, the National Internship Scheme. Interns will undertake work-based learning with approved host organisations in relevant industry sectors, and on completion will be awarded a Level 9 Post Graduate Certificate in Professional Practice.

75 It is notable that company training spend per person employed has decreased in recent years. Source: Annual Business Survey of Economic Impact, Various years, Forfás.

76 Such programmes directly link higher education places with identified enterprise needs and have significant employer engagement in course development. In the case of the conversion programme, in some instances, companies were involved in the selection of candidates for entry to the courses, delivery of aspects of the programme and the provision of internship placements during the programme. This close education/industry engagement increases the prospects of progression to employment on completion and also encourages better engagement of jobseekers in up-skilling and conversion where progression paths are clearer.

77 In terms of Further Education and Training, a strategic review of the training and education provision offered by Education and Training Boards (ETBs) to guide the strategic work of SOLAS and the FET provision by ETBs is currently underway. The review evaluates FET provision in terms of its relevance for labour activation purposes (i.e. whether it is suited to the needs and abilities of the large pool of unemployed, in particular the long-term unemployed, and to the prospective skills needs of the economy). The review provides an assessment of the existing provision as well as recommendations to enhance their relevance for activation purposes.



**Recommendation:** There should be wider adoption of activation and training programmes that are linked directly to identified enterprise needs. In order to ensure that provision meets the needs of both learners and employers, it is important that robust local and regional structures are developed to facilitate employer (and other stakeholders as appropriate) participation in the identification of the required skills, the development of relevant curricula, selection of candidates and the provision of sufficient internship and traineeship opportunities as appropriate.

**Responsibility:** Department of Education and Skills, Department of Social Protection, SOLAS, Education and Training Boards, Employer Representative Bodies, Enterprise Agencies, Higher Education Authority

### Enhancing the Reputation and Value of Further Education and Training

The new strategy acknowledges that further education and training has a relatively low standing in Ireland relative to higher education. Reflecting the current challenges confronting the Irish economy, the strategy also accords significant focus to meeting the needs of the long term unemployed. While this is a necessary objective, it is important over the longer term that FET is seen as not just a short-term response to unemployment, relevant only to particular labour market cohorts. It needs to be a viable alternative to higher education for school leavers and adult learners, providing clear progression paths to higher education for those willing to avail of them, and supplying relevant and valued skills to enterprise.

While the emphasis on enhancing progression from further education and training to higher education is a positive step, it is neither necessary nor appropriate for all learners and so the stand-alone value of a FET qualification (and progression within FET) must be widely communicated and understood. In this regard, the comprehensive communications campaign proposed in the strategy is of paramount importance.

**Recommendation:** It is crucial over the medium term that Further Education and Training (including apprenticeships) is seen as an attractive option leading to rewarding career opportunities and progression options (to additional further and training and higher education) over the span of an individual's working life. In this regard, the comprehensive communications campaign proposed in the strategy is of paramount importance.

**Responsibility:** SOLAS, Education and Training Boards

## 3.2 Labour Market Activation, Coordination and Evaluation

Activation programmes are essential to prevent the marginalisation of unemployed workers and to minimise the risks of long-term unemployment. Activation programmes also need to facilitate the re-entry into the labour market of those workers who are no longer deemed participants.

Despite the economy's recent return to growth, it will take time before sufficient job opportunities are available to all of those currently seeking work. FET and labour market activation play an essential role in both developing the skills required to support growth (particularly for foundation

and intermediate level skills demanded by employers) and providing a channel to increase labour market participation and improve employability.

Activation measures should primarily aim to improve employability and should be characterised by:

- Identifiable labour market/ enterprise needs - these need to be reviewed and updated on an ongoing basis to reflect changes in needs;
- Ability to target candidates appropriately to programmes based on their abilities, skills and learning requirements - appropriate candidate selection and ongoing guidance and support is vital to ensure that courses are successfully completed and meet the needs and expectations of learners, as well as employers;
- Emphasis on quality assurance and demonstrated progression pathways for the learner - to employment/self-employment, further/higher education and training; and
- Structured internships providing work experience opportunities within enterprise.

In this regard, as noted earlier, employer engagement in programme design and delivery will be an important determinant of success (i.e. in terms of meeting the learners' needs to progress to employment and the employers need for appropriate workplace skills). The ability to target candidates appropriately to meet the needs of both employers and the individual is also critical. A recent report undertaken for the Department of Education and Skills noted that:

*'There is a sizeable cohort of very low-skilled unemployed, distant from the labour market, who will need specialised interventions within FET provision...provision of FET should include programmes tailored to meet the varied needs and aptitudes of the long term unemployed'*<sup>78</sup>.

While the above quote related to the challenges posed by the long-term unemployed, it highlights the importance of tailoring FET solutions to the needs of the individual to the extent possible. To address this challenge will require in some circumstances individualised, intensive intervention and assistance, before, during and after the course, to ensure completion and progression to either employment or more occupationally focused FET. The Council has previously commented on the importance of providing adequate resources to support activation programmes and the work of Intreo<sup>79</sup>. In addition, Intreo and SOLAS will need to deepen collaboration and complement each other to produce successful activation efforts, particularly in guiding the unemployed to effective programmes.

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<sup>78</sup> Sweeney, J., A Strategic Review of Further Education and Training and the Unemployed, NES, Autumn 2013

<sup>79</sup> National Competitiveness Council, NCC Submission to the Action Plan for Jobs 2014, Forfás, December 2013

**Recommendation:** As well as putting in place arrangements to facilitate high level strategic cooperation between SOLAS and 'Intreo' about the design of relevant FET provision and referral arrangements, local protocols should be developed to provide seamless linkages between 'Intreo' offices and local ETBs.

**Responsibility:** Department of Social Protection, SOLAS, Intreo

The Pathways to Work Programme assigns a very significant role to the further education and training sector in addressing activation, with a specific focus on the long term unemployed. The proactive nature of engagement between State agencies and the unemployed set out in Pathways to Work is an important development<sup>80</sup>. A number of new programmes have been designed to up-skill unemployed workers and provide them with practical work-based experience. The presence of clear goals and continuous feedback will add to programme development.

Programmes such as Momentum<sup>81</sup>, Skillnets' Job-seekers Support Programme<sup>82</sup>, Jobbridge<sup>83</sup> and Springboard<sup>84</sup> already place significant emphasis on evaluation, targeting, and accreditation. It is important that similar evaluation tools be applied to all mainstream provision.

As noted by the OECD, evaluation is an essential tool to ensure that labour market programmes result in the desired outcome: limited fiscal resources should be focused on *“policies empirically-proven to improve employability; this will require systematic evaluation of labour-market programmes through consistent tracking and randomized trials, followed by decisions to close down ineffective schemes while strengthening successful ones”*.

It is important that all programmes continue to evolve to maintain and improve their effectiveness. The results could be significant. A recent Department of Finance paper modelled the impact of a further improvement in the effectiveness of activation policies and incentives such that the unemployed fill a greater proportion of newly created jobs<sup>85</sup>. By improving the matching process between employers and job seekers, significant exchequer savings are achieved. If social welfare savings were recycled into lower income tax, their analysis indicates that the unemployment rate would fall by over 3 per cent in comparison with a no-policy-change scenario.

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80 The 50 actions in Pathways to Work 2013 are designed to deliver a greater number of places on employment and training schemes for people who are long-term unemployed.

81 Momentum funds the provision of free education and training projects to allow 6,500 jobseekers (who are unemployed for 12 months or more) to gain skills and to access work opportunities in identified growing sectors.

82 A number of Skillnets' training networks provide training and work placements through the Job-seekers Support Programme. These training courses and work placements are solely for people that are unemployed and are focused on areas where Irish companies have skill gaps/needs.

83 JobBridge is the National Internship Scheme that provides work experience placements for interns. The aim of the scheme is to assist in breaking the cycle where jobseekers are unable to get a job without experience, either as new entrants to the labour market after education or training or as unemployed workers wishing to learn new skills. The scheme provides for up to 8,500 work experience placements in the private, public, voluntary & community sectors. Interns receive an allowance of €50 per week on top of their existing social welfare entitlement.

84 Springboard offers a choice of 171 free, part-time and intensive conversion courses in higher education from certificate, to degree, to post-graduate level. All courses lead to qualifications in enterprise sectors which are growing and need skilled personnel, including information and communications technology (ICT); manufacturing; international financial services; and key skills for enterprise to trade internationally. Most courses are part-time, enabling participants to retain social protection supports. A number of courses are full-time one-year ICT Skills Conversion courses.

85 Department of Finance, Quantification of the Economic Impacts of Selected Structural Reforms in Ireland, Irish Government Economic and Evaluation Service, Working Paper, July 2014

**Recommendation:** All labour market programmes should be evaluated on a regular basis with resources focused on those programmes proven to deliver on their objectives.

Furthermore, information on progression paths (e.g. progression rates, first jobs locations, etc.) from further education and training courses should be collected, utilised (e.g. to shape future courses) and disseminated to learners and employers to promote engagement.

**Responsibility:** Department of Education and Skills, Department of Social Protection, SOLAS

Finally, in the context of improving labour market activation and boosting participation rates, it is important to remember that activation is not just about the unemployed. For example, the number of people claiming disability allowance, invalidity pension or illness benefit increased greatly between 2000 and 2014; there was a 47 per cent increase from 150,000 to some 220,000 over this period. Some of this increase may represent a hidden form of unemployment<sup>86</sup>.

Continued engagement with cohorts of the population currently excluded from work because of illness, disability or other circumstances could also have a positive impact upon participation rates, State expenditure and quality of life for individuals<sup>87</sup>. Coordinated, proactive, and timely interventions by the Department of Social Protection, the Occupational Health Services, the various relevant voluntary organisations and employers are required to develop effective approaches to activation for cohorts of people currently disengaged from the labour force because of illness or disability.

### 3.3 Apprenticeships

Following the report of the independent review group on apprenticeship<sup>88</sup>, an apprenticeship implementation plan was published in July 2014<sup>89</sup>. While the review of existing apprenticeships is both necessary and welcome, it is important that this process is expedited to the extent possible.

Two interlinked elements of the plan are of particular interest to the Council, namely

- The welcome expansion of the apprenticeship model into a range of new enterprise sectors and occupations; and
- The recognition that apprenticeships need strong support from employers if they are to meet the needs of enterprise, address future demand, and be relevant in relation to content and curricula - particularly in relation to the development of apprenticeships for new occupations.

Specifically, Phase 1 of the Implementation Plan requires the soon to be established Apprenticeship Council to “*identify the level of interest from industry sectors in developing new apprenticeships*”.


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<sup>86</sup> See PQ [26734/14]

<sup>87</sup> In Ireland, it is estimated that 14 million days are lost each year due to absence and ill health in the workforce. See Fit for Work, Position Paper, April 2013

<sup>88</sup> The report contains a large number of recommendations for the extension of apprenticeship to new sectors and for modernising the existing apprenticeship system. See Apprenticeship Review Group, Review of Apprenticeship Training in Ireland, December 2013

<sup>89</sup> Department of Education and Skills, Apprenticeship Implementation Plan, July 2014



Recognising the resource implications for employers of an expanded apprenticeship model, the manner in which this dialogue with enterprise is conducted will be crucial to the development, rollout and success of new apprenticeships. Indeed, the report acknowledges that

*“Outside of the existing apprenticeship sectors many companies have limited involvement in forms of work based learning. Indeed over time FÁS developed 35 traineeships of which only 8 are currently active”.*

At present, it is planned to issue a call by the Apprenticeship Council in Q4 2014 for proposals from consortia of employers and education and training providers (by Q1 2015) to develop new apprenticeships, supported by a ring-fenced fund. Experience tells us that sustaining work based learning models requires continued commitment from employers over time. It is important, therefore, that the initial consultation and input from employers on new apprenticeships is successful. With the clear timetable for submissions already laid out, employers and their representative bodies need to invest time now to develop coherent, relevant proposals that will meet their needs and which will receive active and ongoing engagement from employers. The Skillnet model may provide one option for employers to collaborate, identify their skills needs, and develop proposals for new apprenticeships.

**Recommendation:** In order to ensure that the Apprenticeship Implementation Plan delivers solutions that benefit enterprise, employers and their representative bodies need to prepare for the Apprenticeship Advisory Council’s forthcoming call for proposals, identifying those skills needs which can best be met through the development of new apprenticeships.

**Responsibility:** Employers, Employer Representative Bodies, Quality and Qualifications Ireland

On an ongoing basis, and to ensure the longer-term relevance of apprenticeships, structures need to be put in place involving employers (amongst others) in the development and evolution of curricula. On the other hand, the successful rollout of new apprenticeships will be dependent on employers providing sufficient on-the-job training to participants. Similarly, trade unions can play an active role in encouraging skills development.

**Recommendation:** When designing new apprenticeships, it is essential that employers engage with and contribute to the development groups on issues such as curricula design. All apprenticeships must adequately equip learners with the skills required necessary for the workplace. Employers must also demonstrate a willingness and ability to provide the necessary on-the-job training.

**Responsibility:** Apprenticeship Advisory Council, Employers, Employer Representative Bodies, Quality and Qualifications Ireland, Trade Unions

### 3.4 Technological Universities

In a related issue, the Council is supportive of the proposed creation of Technological Universities as a means of developing and embedding important enterprise relevant technical skills. According to the Strategy for Higher Education, a technological university will be “distinguished from existing universities by a mission and ethos that are faithful to and safeguard the current ethos and mission focus of the institutes of technology”<sup>90</sup>. Technological Universities will be based on career-focused higher education with an emphasis on provision at NFQ levels 6 to 8 and on industry-focused research and innovation. It is expected that they will play a pivotal role in facilitating access and progression (particularly from the workforce) by developing structured relationships with providers of further education and training<sup>91</sup>.

It is essential, however, that any changes in this space do not adversely affect the supply of vocational and enterprise relevant skills but should enhance their supply. The fields of learning must be closely related to labour market skill needs. Technological Universities must have a distinct mission and Technological Universities should be distinguished by their commitment to engagement in social and economic development and by their ability to work successfully with enterprises through relevant education and training, and through knowledge transfer and development. In order to maintain the diversity of Irish higher education, the Council believes that the role of the Technological Universities should be complementary to the role fulfilled by the traditional universities.

**Recommendation:** Technological Universities must have a distinct mission and character; their fields of learning must be closely related to labour market skill needs and should complement the role of the existing universities.

**Responsibility:** Department of Education and Skills, Higher Education Authorities, Higher Education Institutes

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<sup>90</sup> Department of Education and Skills, National Strategy for Higher Education to 2030: Report of the Strategy Group, 2011

<sup>91</sup> In January 2014, the Minister for Education and Skills announced the publication of the Heads of a Bill, which will allow for the future establishment of Technological Universities and the mergers of institutes of technology. The General Scheme of the Technological Universities Bill is available at: <http://www.education.ie/en/The-Education-System/Legislation/General-Scheme-Technological-Universities-Bill-2014.pdf>

## 4. Developing the Enterprise Base

Ireland's economic growth is dependent on a sustainable, competitive enterprise base encompassing both indigenous and foreign owned firms that trade internationally, those that currently serve local markets with potential to internationalise, and those that will continue to play a key role in serving local demand. To achieve sustainable economic growth and create meaningful jobs, therefore, we need a strong and dynamic range of MNCs, large enterprises, SMEs and a steady flow of new business start-ups.

### 4.1 Promoting Investment

Investment is a particularly important determinant of competitiveness and future growth. The collapse in investment has been a particularly visible trend in recent years. Total investment (i.e. public and private) fell by 71 per cent between 2008 and 2013, the second largest decline in the euro area. While it is encouraging to note that there has been growth in private investment since 2011, the recovery remains fragile, held back in part by the high debt levels amongst domestic enterprise.

Chapter 2 highlights the importance of increasing state investment. The Council believe a strong focus on encouraging private sector investment in productive enterprise is also critical to maintain the existing capital stock and to provide a platform for future growth and job creation. While capital investment in manufacturing is recovering, the level of investment remains below pre-recession levels.

Ultimately, Ireland's relative attractiveness to investors (both indigenous and foreign) is shaped by a combination of factors that determine the environment for enterprise and our international competitiveness. Maintaining cost competitiveness (Chapter 1), restoring macro-economic stability (Chapter 2), ensuring the competitiveness of the taxation regime (Chapter 2), improving the availability of skills (Chapter 3) and funding (Chapter 5) are particularly important in this regard.

In terms of indigenous enterprise, it is essential that Ireland offers a favourable taxation environment to encourage entrepreneurs and business owners to investment in productive activities. Our competitiveness in such matters relative to key competitors (particularly the UK) is of particular concern. In this regard, there are strong concerns that the UK's relative competitiveness has improved significantly in recent years (e.g. reduced capital gains taxes for entrepreneurs), with the risk that entrepreneurs, particularly serial entrepreneurs will invest in the larger UK market rather than in Ireland.

**Recommendation:** The Department of Finance should continue to monitor Ireland's comparative offering to ensure that Ireland's tax system is competitive for entrepreneurs to establish, invest and create jobs in Ireland, and that it supports enterprise investment over speculative activity. A range of specific actions to enhance our ability to support entrepreneurship and business investment should be considered.

**Responsibility:** Department of Finance

**Recommendation:** Step-up promotion and support of productive investment in the regions in manufacturing and international services businesses that will secure additional economic activity, exports and jobs in those locations, within the constraints of EU State Aids.

**Responsibility:** Enterprise development agencies

**Recommendation:** As part of the establishment of the new Strategic Banking Corporation of Ireland (SBCI) and Strategic Investment Fund, ensure that there is a strong sectoral focus and capability to assess and make investments in the key strategic areas of priority for Ireland such as in ICT, agri-food and life sciences.

**Responsibility:** Strategic Banking Corporation of Ireland, Ireland Strategic Investment Fund

Foreign Direct Investment (FDI) has been a key contributor to Ireland's economic development and growth, with Development Agency supported foreign owned companies directly employing 172,000 people (and supporting the employment of a further estimated 124,000 indirectly) in 2013<sup>92</sup>. FDI is the major generator of export earnings. Global competition for the attraction of FDI has intensified significantly in recent years.

The recently published *Policy Statement on FDI in Ireland* highlights the important role of policy in attracting and sustaining foreign investment, noting that "effective policy execution is a critical differentiator in boosting FDI performance"<sup>93</sup>. The statement notes the importance of ensuring that there is a strong whole of government approach. With this in mind, the Council is supportive of the policy priorities outlined in the Statement:

- Strengthening of the business ecosystem which will be of benefit to all enterprises;
- Building on Ireland's existing strengths in sectors<sup>94</sup>, activities and markets to realise our full growth potential;
- Positioning Ireland to take advantage of emerging opportunities; and
- Facilitating different modes of foreign direct investment (e.g., mergers and acquisitions, venture funds, sovereign wealth funds, state owned enterprises, etc.).

As noted in Chapter 2, Ireland's corporate tax rate remains an important driver of our international competitiveness. Maintaining international competitiveness in relation to our corporation tax rate, reputation and regime through, continued proactive engagement at international fora (e.g. OECD and EU Commission) will be crucial in enabling us to sustain and build upon the successful FDI performance to date.

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92 Forfás, Annual Employment Survey 2013, 2014

93 Department of Jobs, Enterprise and Innovation, Policy Statement on Foreign Direct Investment in Ireland, July 2014

94 Examples included in the Policy Statement include the targeting of increased levels of FDI from firms in the Food and Beverage sector; and seeking out new FDI opportunities for Ireland - that will emerge from niche areas and new market segments where we have little activity currently.



Skills development is also a key consideration for investment decisions. It is essential that an adequate supply of the skills most sought by enterprise is readily available in Ireland. In this regard, implementation of the ICT action plan is of particular importance.

**Recommendation:** Maintain the current corporation tax rate. Continued engagement at international fora (e.g. OECD and EU Commission) is important to protect Ireland's reputation and to enhance transparency.

**Responsibility:** Department of Finance

**Recommendation:** Ensure that skills requirements of enterprise across the skills spectrum are prioritised, that the ICT skills output is ramped up quickly in line with the ICT Action Plan and that activation measures are specifically targeted at developing skills that will be needed in both exporting and domestically trading businesses.

**Responsibility:** Department of Education and Skills, Department of Jobs, enterprise and Innovation, Department of Social Protection

## 4.2 Promoting Trade Development and Diversification

For a small open economy like Ireland, generating export-led growth is central to securing long-term economic growth and prosperity. In the face of difficult global market conditions, Ireland's overall trade performance has remained largely positive since the recession, although a number of structural weaknesses need to be addressed.

As well as substantial intra-EU trade<sup>95</sup>, Ireland has significant trading links outside of the EU. Ireland's export destinations, however, are very concentrated and over a third of our goods exports go to two countries: the US accounts for 20 per cent of goods exports, and the UK accounts for nearly 17 per cent. Services exports are also concentrated. This concentration makes Ireland vulnerable to country-specific shocks and vulnerable to currency movements. The concentration of our exports in a small number of sectors and the dominance of foreign-owned firms in Ireland's trading activities also creates vulnerabilities. For example, 'Chemicals and pharmaceutical products' accounted for 60 per cent of goods exports in 2012 - up from 51 per cent in 2008.

The Council welcomes the recommendations in the Review of the Government's Trade, Tourism and Investment Strategy for the establishment of a "new market approach" that prioritises a number of high-value markets in Asia, South America and Africa<sup>96</sup>.

Further expansion into new markets and a deepening of trade links with the world's leading emerging economies is required. This necessitates a significant uplift in our international selling and language capabilities within firms and in higher education institutions. The development of a foreign languages strategy by the Department of Education and Skills, which covers post-primary,

<sup>95</sup> Based on Eurostat data, in 2013 Irish merchandise exports to the EU-28 amounted to 30 per cent of GDP.

<sup>96</sup> Department of Foreign Affairs and Trade, Review of the Government's Trade, Tourism and Investment Strategy, 2010-2015, February 2014

further, and higher education is welcome in this regard. The increasing sophistication of international logistics and global value chain management also require new skills and increased use of ICT to ensure products and services can be delivered to market<sup>97</sup>.

Trade and investment agreement negotiations are also an important opportunity for increasing exports, growth, and jobs in Ireland. Trade agreements also improve access to imports with benefits for both enterprise and consumers in Ireland. The EU now has the competence to negotiate agreements and in this context, Ireland needs to continue to ensure its interests are progressed in such negotiations. Negotiations with the US on the Transatlantic Trade and Investment Partnership (TTIP) commenced in July 2013. From a sectoral perspective, it is likely that both risks and opportunities will emerge. Of particular interest to Ireland in the negotiations will be the non-tariff barriers in relation to food, chemicals and pharmaceuticals, and health-related products including medical devices. At the same time, many observers have expressed concerns about a range of issues including the transparency of the negotiations, the degree of parliamentary oversight, the potential for employment displacement, and the potential of any agreement to undermine employment rights and environmental standards. It is important that such concerns be addressed in a timely and open manner<sup>98</sup>.

Tourism is recovering, for the most part driven by recovery in international markets, most notably from North America and Europe. There is positive momentum that we need to continue to build on, reopening and developing new air and sea access routes, investment in product and experience development outside of the main cities and clustering of activities, increased promotion in new markets of Asia, and sustaining improvements in cost competitiveness and perceptions of value for money.

**Recommendation:** A continued focus on implementing Ireland's Strategy for Trade, Tourism and Investment is required, in particular the focus on priority markets and active development of the 'whole of Government' approach.

**Responsibility:** Relevant Government Departments and Agencies

**Recommendation:** Ireland needs to continue to ensure its interests are promoted in progressing the Transatlantic Trade and Investment Partnership negotiations and that opportunities arising from EU negotiated trade agreements are fully exploited whilst simultaneously addressing the concerns of stakeholders (in relation to, for example, transparency).

**Responsibility:** Government

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97 Under the Action Plan for Jobs 2014, the EGFSN will undertake research aimed at identifying current and planned skills and talent needs in the Freight Transport/Distribution/Logistics Sector. The study will also consider how any gaps can be addressed including through the domestic education supply and continuing professional development. It is anticipated this report will be available in Quarter 4 2014.

98 For a more detailed exposition of some of these concerns, see Healy, T., US-EU Trade Deal (TTIP): Separating the Baby From the Bathwater, Nevin Economic Research Institute, June 2014

**Recommendation:** The development of a national foreign languages strategy, formal international selling programmes and modules in international selling in third-level business courses, together with greater promotion of international student placements such as ERASMUS are key priorities to develop our international exports and investment footprint into the future.

**Responsibility:** Department of Education and Skills/higher education institutions

**Recommendation:** Review the costs and efficiencies of key transport links for Irish exporters to international markets and ensure that the future transport and logistics skills needs of the internationally trading sector are adequately planned for and met.

**Responsibility:** Department of Transport, Department of Education and Skills

**Recommendation:** Aggressively implement measures required to achieve the potential of the tourism sector to grow employment by 50,000 over the next decade, including in the areas of air and sea access, skills development and training and experience development.

**Responsibility:** Department of Transport, Tourism and Sport, Department of Public Expenditure and Reform

Over 70 per cent of global trade is now in intermediate goods and services and in capital goods. The growth of global value chains (GVCs) has increased the interconnectedness of economies and led to a growing specialisation in specific activities and stages in value chains, rather than in entire industries. Participation in GVCs is, therefore, a critical component of a country's ability to trade and compete internationally.

GVCs require policymakers to deal with more complex issues than had been the case for conventional merchandise trade. They are part of a new global economy in which connectedness matters more, and in which ideas count as much as physical inputs. This puts new competitive pressure on governments to adopt reforms that enable their producers to find niches in which they may make the most of their capabilities.

OECD data suggests that FDI in Ireland is largely responsible for Ireland's high participation rates in global value chains, and despite some impressive successes in the agri-food sector, domestic inputs to third country exports remain well below the OECD average, reducing the positive spillovers into the economy. Enhancing exports from indigenous firms (see next section) and increasing linkages across the economy offers potential to deepen indigenous firms' links in global value chains.

**Recommendation:** A focus on developing greater linkages between indigenous and foreign owned firms should be progressed as set out in actions (#235 - 239) in the Action Plan for Jobs 2014, and should be developed further in the forthcoming 2015 plan.

**Responsibility:** Enterprise Ireland, IDA Ireland, Department of Jobs, Enterprise and Innovation

**Recommendation:** To achieve the objective of building world-class clusters in areas of strength and opportunity and ensuring that Ireland is effectively linked to global value chains, a more joined-up approach to ecosystem development for key sectors and new activity areas should be developed and rolled out. This should involve business representative bodies, enterprises, development and research agencies and relevant government departments and regulatory bodies.

**Responsibility:** Department of Jobs, Enterprise and Innovation

## Broadening the Enterprise Base

Ireland's enterprise base must continue to evolve. While the resilience of our exporting sector has been one of the economy's greatest strengths since the onset of the recession, this does not obviate the need to develop a more sustainable, broad-based enterprise base. The Development Agencies provide supports to companies across a range of initiatives aimed at building capacity, for example, generating new jobs and increased exports and enhancing capabilities in areas such as innovation, productivity, leadership, entrepreneurship and skills. Supports are tailored based on business needs (such as stage of development and strategic objectives), and ultimately aim to deliver additional economic impact.

Forfás undertook a series of evaluations of agency programmes. In general, the evaluations found that the agency programmes are appropriate and aligned with policy, effective in meeting stated objectives and efficient. Where control group analysis was possible, the evaluations found evidence that supported firms were more resilient over the period of the recession, achieved higher growth levels in employment and exports, realised greater productivity improvements, and experienced higher survival rates. Supported companies also reported increased skills levels and management capabilities, better understanding of overseas markets, greater job satisfaction amongst employees, increased confidence and strategic ambition, and improved sustainability. Sustaining investment in the enterprise agencies is essential to underpin their ambitious growth targets.

**Recommendation:** The capital budgets of the enterprise agencies should be maintained and support for enhanced promotion of Ireland as an export and investment location accelerated where a demonstrable improvement in performance is achieved, such as for the 'Winning Abroad' disruptive reform as part of the Action Plan for Jobs.

**Responsibility:** Department of Jobs, Enterprise and Innovation, Department of Public Expenditure and Reform

**Recommendation:** The lessons and recommendations emerging from the evaluations of the various Enterprise Agency programmes need to be applied across all Agency programmes. Evaluation of State expenditure on Agency programmes should be embedded as part of the development of all programmes and used as a tool to ensure their efficiency and effectiveness. Relevant performance metrics should be monitored on annual basis.

**Responsibility:** Department of Jobs, Enterprise and Innovation, Enterprise Agencies

### 4.3 Enhancing Productivity, Innovation and Research and Development

An economy's productivity performance is the ultimate determinant of success. In a time of austerity and reduced demand, productivity offers significant potential to enhance competitiveness and living standards as it allows for sustainable pay increases without eroding cost competitiveness. While Irish productivity levels improved considerably between 2008 and 2013, previous NCC analysis showed that much of Ireland's performance during this period arose from changes in the composition of employment in Ireland during the recession (i.e. the collapse in the numbers employed in the labour intensive construction sector), rather than broad based productivity growth<sup>99</sup>. Tackling barriers to investment in high growth sectors is vital to support real and sustainable productivity growth leading to increased employment.

The ramping up of world trade as we emerge from the global economic crisis presents the potential for Ireland's productivity performance to be boosted by the increased competition and the diffusion of technology and skills.

In relation to competition policy, significant progress has been made in recent years but there is a risk that progress will falter without the external pressure placed on us by the Troika. There are still a number of sheltered sectors where opportunities exist for further reform. These include banking, energy, professions (e.g. legal), transport (i.e. bus transport), groceries/ retail sector and utilities<sup>100</sup>. In addition, consideration should be given to making service provision to or on behalf of the State more open to aspects of competitive behaviour. The threat of competitors entering a market can enforce good conduct upon incumbents or the threat of losing market share can also promote greater efficiency<sup>101</sup>.

**Recommendation:** Continued and sustained focus on the introduction of greater competition is required across the economy, and particularly in the banking, energy, professions, transport, groceries/ retail and utilities sectors.

**Responsibility:** Relevant Government Departments, Relevant Regulators, Competition Authority

**Recommendation:** Introduce funding procedures (and other competitive mechanisms) to the provision of public services that reflect performance and encourage an output focus (i.e. funding should be linked to performance).

**Responsibility:** Department of Public Expenditure and Reform

Government has recognised the importance of investment in science, technology and innovation to Ireland's economic development. Government budget outlays on RDI increased from €504 million in

99 National Competitiveness Council, Ireland's Productivity Performance 1980-2011, Forfás, April 2012

100 Competition Authority, Annual Report, 2013

101 See Thornhill, D., Internal Competition is in the National Interest: Stop the rents!, Speech to the Competition Authority Conference, 13th June 2011

2002 to €801 million in 2011, peaking at €948 million in 2008. However, international research highlights that ‘*innovation leaders*’ (e.g. Denmark, Finland, Germany, Sweden, and the UK) increased public expenditure on research and innovation during the crisis<sup>102</sup>.

To achieve a transition to a new economic model based on innovative enterprises exporting to global markets, further sustained Government commitment to investment in innovation is needed. A renewed innovation investment push presents an opportunity to build on Ireland’s successes to date. Ambitious targets are also in place to drawdown international funding.

In terms of how funding is spent, the implementation of research prioritisation is proceeding; for example in 2013, 94 per cent of the awards from SFI were aligned with the 14 agreed priority areas and six associated platform science and technology areas. Continued commitment over the lifetime of research prioritisation is needed to realise the impacts of this realigned investment.

**Recommendation:** Continued and sustained Government commitment to investment in innovation is needed. It is also essential that the implementation of the 13 systematic recommendations to improve the efficiency and efficacy of the public RDI funding system continue.

**Responsibility:** Department of Jobs, Enterprise and Innovation, Department of Public Expenditure and Reform, Science Foundation Ireland

**Recommendation:** To support the development of innovative enterprises, Ireland should maximise drawdown from available funding sources such as the European Framework Programme for Research and Innovation 2014 - 2020<sup>103</sup>.

**Responsibility:** Department of Jobs, Enterprise and Innovation

#### 4.4 Supporting Entrepreneurship

It is recognised that small start-up firms tend to bring about pioneering ideas and that significant job opportunities come from young firms. Data published by the Central Bank in 2013 concludes that 67 per cent of new job creation comes from companies within their first five years of existence. Complementary but different policies are required for entrepreneurs and SMEs. The overriding objective of SME policy is to strengthen existing businesses, while the focus of entrepreneurship policy is to stimulate higher levels of entrepreneurial activity by influencing a greater supply and quality of entrepreneurs to create new businesses.

The Action Plan for Jobs process has accorded significant focus to addressing issues of concern to potential entrepreneurs, including access to finance, mentoring, etc. Ireland, however, can benefit

<sup>102</sup> Veugelers, R , Is Europe saving away its future? European public funding for research in the era of fiscal consolidation, Katholieke Universiteit Leuven and CEPR

<sup>103</sup> The Government has set an ambitious target for Ireland’s drawdown from the European Framework Programme for Research and Innovation 2014 - 2020, Horizon 2020, of €1.25 billion. As the majority of Horizon 2020 funding is awarded on a competitive basis to international collaborations, a prerequisite for achieving this national target is a national research and innovation system with sufficient capacity in the requisite areas to be able to compete successfully both with and against their EU peers.

from developing entrepreneurship policy more strategically and formulating clear policy targets for entrepreneurship performance. In this regard, the development of a National Entrepreneurship Policy is to be welcomed.

Building on explicit performance targets and objectives, the Statement should outline the actions and policies planned to both increase the quantity of start-ups and the quality of start-ups (i.e. to improve the scaling potential of start-ups). The Statement should also set out the steps required to:

- Promote a can-do culture, mentorship and peer learning opportunities, concentrations of activity hotspots, access to talent (both indigenous and foreign) and finance<sup>104</sup>;
- Promote and remove any impediments to serial entrepreneurship and encourage entrepreneurship amongst specific demographic cohorts including women, migrants and the unemployed;
- Provide timely, clear and concise information to entrepreneurs about the State supports available; and
- Embed entrepreneurship skills throughout the entire education and training system.

**Recommendation:** The finalisation of a National Entrepreneurship Policy Statement should be prioritised and the recommendations progressed.

**Responsibility:** Department of Jobs, Enterprise and Innovation

To facilitate the development of an entrepreneurial culture, it is important that the State's administrative system operates as efficiently as possible and minimises the costs placed on firms. In this regard, the introduction and continuous upgrading of an online e-Registration system to facilitate the prompt and efficient registration of business taxes is particularly welcome<sup>105</sup>. Equally welcome is the development of an integrated licencing regime, the rollout of the businessregulation.ie portal (which brings together in one place information on regulations imposed by over 30 Government bodies), and the simplification of company law obligations which will be achieved through the Companies Bill, 2012.

It remains important that Ireland's performance in this space is continually monitored, particularly vis-à-vis our key competitors, through for example, the World Bank's Doing Business Index<sup>106</sup>. Planned changes to the index, which will place an increased emphasis on the quality of regulations, will challenge all countries, including Ireland, to review and improve their performance.

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<sup>104</sup> Mirroring the work of the Entrepreneurship Forum. See Entrepreneurship Forum, Entrepreneurship in Ireland: Strengthening the Startup Community, Report of the Entrepreneurship Forum, January 2014

<sup>105</sup> The service was significantly enhanced and upgraded in July 2012, and now includes services for the online registration and cancellation of any of the following business taxes: Income Tax; Corporation Tax; Value Added Tax; Employers PAYE/PRSI; Relevant Contracts Tax; and eLevy. In all applications made through e-Registration with the exception of Value Added Tax and Relevant Contract Tax, registration and risk assessment is an automated process, which is completed within a single overnight period. Within months of the July 2012 redevelopment, e-Registration accounted for in excess of 55 per cent of all registration activities nationally.

<sup>106</sup> World Bank, Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises, October 2013

**Recommendation:** Continue to monitor Ireland's entrepreneurship and administrative burden performance in international benchmarking studies such as the World Bank and actively pursue reform in areas of identified weakness.

**Responsibility:** Department of Jobs, Enterprise and Innovation, Department of Finance

## 4.5 Public Procurement

In 2013, public procurement expenditure was approximately €12 billion, making the State the largest 'buyer' in the economy. This is down from €15 billion in 2012. Approximately €9 billion was spent on supplies and general services, of which approximately €2.3 billion (2011 data) was on contracts above the EU thresholds of €134,000. The Irish Government published approximately 7,500 opportunities in 2013.

All of this activity undoubtedly sustains many businesses and supports significant employment. As a result, public procurement represents a crucial lever through which the State can affect national competitiveness.

At the same time, there is a need to manage the fiscal deficit and reduce overall expenditure. In this regard, the demand aggregation associated with central procurement, which will be delivered through the Office for Government Procurement (OGP), has clear benefits. A delicate balance must be struck to ensure that the public procurement process in Ireland remains competitive and value for money is maximised, while also ensuring that the net effect to the economy and society is positive.

In general, SMEs in Ireland have a greater access to public procurement (above the EU-thresholds) than their significance in the wider economy would suggest, and the public procurement process in Ireland is competitive.

- In Ireland, SMEs have secured a sizeable share (43 per cent) of the public procurement market (in value terms - above EU thresholds) when compared to the UK (24 per cent) or the EU-27 average (34 per cent)<sup>107</sup>.
- Data suggests that tenders in Ireland attract many bidders, including international suppliers, relative to many of our peers<sup>108</sup>. Recent data suggests, however, that while 70 per cent of SMEs are registered on e-Tenders (the public service tender portal), as little as 10 per cent of SMEs actively participate in the public procurement process, with particularly low participation rates amongst micro firms. In other words, success in public procurement is concentrated amongst a relatively small cohort of SMEs.

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<sup>107</sup> Statistics for below the EU threshold tenders are not publicly available. However, anecdotal evidence would suggest that a high proportion of below the threshold tenders are awarded to SMEs.

<sup>108</sup> PricewaterhouseCoopers, Public Procurement in Europe Cost & Effectiveness, 2011



## Opportunities Presented by Ongoing Reform

Public procurement in Ireland works within the legislative framework laid down by the EU. In Ireland, the legislation is supplemented by national policy guidance - typically departmental “Circulars” - the most recent of which explicitly targets greater access for SMEs, including micro-enterprises<sup>109</sup>.

Public procurement in Ireland is undergoing a major transformative process as it has been targeted as a key area of reform within the wider public service transformation programme. This is expected to generate €500 million in savings over a three-year period.

The establishment of the OGP as a single agency with responsibility for procurement policy and centralised purchasing arrangements in Ireland is a central tenet of the reform programme. The establishment of OGP will facilitate a more coordinated, predictable, proactive approach to procurement, and will ultimately professionalise procurement across the entire public service.

The OGP will be responsible for approximately 60 per cent of procurement expenditure, totalling €5.4 billion<sup>110</sup>. While the achievement of €500 million in savings is the OGP’s primary goal, a number of initiatives are underway to address the long-standing issues raised by the SME sector (reflecting a range of requirements set out in the Action Plan for Jobs 2014).

## Alignment to Policy Goals

The move to a centralised procurement system will undoubtedly affect SMEs. As highlighted by DG Enterprise and Industry, in general, cross border procurement is higher in countries that adopt a centralised public procurement model<sup>111</sup>. Further, while Irish SMEs currently have a large share of public contracts, this is likely to decrease under the new centralised public procurement model.

While a detailed review of the Irish procurement model and a central procurement model was previously recommended, there does not appear to have been any analysis carried out on the impact on SMEs in Ireland. While cost savings and efficiency gains are necessary, such measures should be fully cognisant of outcomes and benefits being achieved. Balancing the need for savings with expected economic outcomes will deliver sustainable long-term benefits.

Procurement has traditionally been a bureaucratic function rather than a driver of policy. In order to maximise procurement as a driver of competitiveness, the procurement system should be aligned to the Government’s policy goals and priorities. For example, in Scotland SME access is given clear prominence as one of four “key priorities” in the ongoing Public Procurement Reform. Public procurement can (within EU guidelines) be used to achieve socially desirable goals, although a balance needs to be struck between such outcomes and the undeniable need to achieve public sector savings<sup>112</sup>.

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109 Examples include Circular 10/10 (Facilitating SME Participation in Public Procurement) which has recently been superseded by Circular 10/14 (Initiatives to assist SMEs in Public Procurement). The Capital Works Management Framework (CWMF) suite of guidance, standard contracts and generic template documents are set out in Circular 06/10.

110 Four large “sectors” (Health, Education, Local Government and Defence) will retain ownership for their mainly sector-specific purchasing.

111 DG Enterprise and Industry, Evaluation of SMEs’ Access to Public Procurement Markets in the EU, 2010

112 A number of bodies have suggested that there should be specific targets around SME participation in contracts. However, under EU law this would be anti-competitive and could face legal challenge.

**Recommendation:** The procurement system should be aligned to the Government's policy goals and priorities, and not just focus on reducing costs. Other stated government objectives such as supporting jobs, innovation and economic growth should also be considered when planning procurement strategy. An economy-wide understanding of what constitutes value for money should balance cost savings with economic impact.

**Responsibility:** Office of Government Procurement / Department of Public Expenditure and Reform

To date, there has been a lack of accurate and timely procurement data (e.g., breakdowns of suppliers, breakdown of spend on SMEs versus large companies; spend per category; and accurate demand forecasts). It is vital that the OGP address this deficiency.

**Recommendation:** The OGP should put in place robust procedures to capture all of the necessary data on procurement trends in Ireland, including data on the number of contract notices published online, the number of tenders processed online, the level of take-up of e-procurement, the type of contracting authorities engaged in e-procurement, the number and type of suppliers etc. It is also essential that the OGP develop a clear understanding of what is happening in terms of procurement below the EU's €134,000 threshold.

**Responsibility:** Office of Government Procurement

There has been some commentary about the lack of clarity and guidance around legislation governing procurement - the establishment of the OGP will largely address this. However, revised EU Directives on procurement are expected to be finalised shortly and (supplemented in Ireland by local policy guidance) must be transposed into Irish law within 2 years. These Directives emphasise an open market approach to procurement, and contain measures to alleviate many of the administrative burdens and other issues being encountered by SMEs. These Directives should be directly transposed into Irish Legislation in a timely fashion.

## SME Access and Participation

The goal of policymakers should not be to provide preferential access to public contracts to any one sector or class of enterprise, and should not be protectionist in intent. Rather, it is about ensuring that as many firms as possible are provided with an opportunity to compete for public contracts. With this in mind, there are a number of issues related to process and administration which if addressed would reduce the barriers currently preventing SMEs from tendering for public contracts. Putting the guidelines contained in Circular 10/14 into practice is of paramount importance. These guidelines promote the setting of relevant and proportionate financial capacity, turnover and insurance levels for tendering firms and the sub-dividing larger contracts into lots, where possible, to enable SMEs to bid for these opportunities. The guidelines also encourage SMEs to form consortia where they are not of sufficient scale to tender in their own right and to register on the e-Tenders

website to ensure maximum exposure to tendering opportunities<sup>113</sup>. The case for making some of the 10/14 guidelines mandatory should be considered.

Additional steps such as the simplification of procurement procedures, the development and rollout of a common procurement vocabulary, the standardisation of procurement timelines<sup>114</sup> and continued efforts to enhance transparency<sup>115</sup> would all be of benefit.

**Recommendation:** In order to facilitate greater SME participation in public procurement tendering, the guidelines contained in Circular 10/14 should be utilised to the maximum extent possible.

**Responsibility:** Office of Government Procurement

Improved communication between purchasers and suppliers is also required to take full advantage of the current reforms. There is a particular need to increase pre-tender engagement and communications in order to assist in shaping tender / contract scope and specifications, through cooperation with and learning from industry. This would increase the likelihood of best outcomes and avoid poor tender specifications: ‘Meet the Buyer’ events are particularly important in this regard.

There is also a need to increase the post-tender feedback - the use of feedback and debriefing sessions for successful and unsuccessful suppliers should be a required element of the tender process.

**Recommendation:** Improved channels of communication between purchasers and suppliers are required to ensure that centralised public procurement maximises the benefits to the State and the opportunities provided to SMEs.

**Responsibility:** Office of Government Procurement, suppliers, representative bodies


Finally, to maximise their opportunities in the public procurement sphere, SMEs need to be more proactive and ‘up their game’ - SMEs need to take responsibility for improving their tendering skills; register on eTenders to receive email alerts; consider partnering and collaborating with other companies to tender; and avail more regularly of the ‘single market opportunities’ across the EU.

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113 Action 248 in the Action Plan for Jobs 2014 commits the Authority and the OGP to “Produce guidance on consortium bidding (i.e. multiparty tendering) in compliance with competition and procurement law”. Enterprise Ireland and InterTradeIreland are also developing regional consortia building programmes to encourage collaboration between SMEs under the APJ.

114 The duration of procurement processes for various contract opportunities are inconsistent, making it hard for business to plan. In Ireland, the average length of the procurement process is 170 days versus 133 for EEA 30. All parties should benefit from greater predictability in the procurement process (e.g. expected duration for evaluation, anticipated contract award dates etc.). Again, this is determined largely by the nature of the contract and the risk attached.

115 There is still a perception that the evaluation process is not always transparent. Greater transparency is sought. Public sector contracts are still awarded on either lowest price only or Most Economically Advantageous Tender (MEAT). Consultees feel that all tenders should use MEAT. PwC Belgium research found that tenders using MEAT receives more bids. Another suggestion is that there should be a full appeals mechanism put in place, which would help encourage transparency in evaluation.



For example, partnering/networking events would allow tenders to meet potential partners. Representative bodies and relevant state agencies have a role to play in this regard<sup>116</sup>.

**Recommendation:** Firms need to proactively engage with the State's public procurement infrastructure. In particular, representative bodies etc. should work to improve enterprise awareness about procurement procedures and opportunities, encouraging registration on e-Tenders and attendance and participation in 'meet the buyer' events.

**Responsibility:** Suppliers, representative bodies, Office of Government Procurement, Competition Authority

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<sup>116</sup> As part of the 2014 Action plan for Jobs, Enterprise Ireland are facilitating a number of networking events between framework contractors and SMEs and organising regional events on consortia building.

## 5. Access to Finance

Finance is the life-blood of every business. This requirement extends throughout the business lifecycle - from the development of a business concept, to setting up a business and through to the growth and expansion stages. Funding for investment is necessary for firms to establish and expand their operations, to improve productivity, and ultimately grow the economy for the benefit of all. Given the importance of funding, a wide range of actions are being progressed under the Action Plan for Jobs 2014 to improve access to finance for micro, small and medium enterprises<sup>117</sup>.

### 5.1 Bank Funding

While economic growth is possible in the absence of credit, creditless recoveries are on average substantially weaker than normal recoveries - growth is on average one third lower<sup>118</sup>. In their latest review of the Irish economy (May 2014), the IMF notes that:

*“A sustained job-rich economic recovery hinges on reviving healthy lending. Investment is beginning to rebound from depressed levels, largely financed by retained earnings. In the medium term, however, a paucity of credit would impede the domestic demand revival which is critical for job creation”.*

Credit growth is determined by a combination of the financial system’s capability and willingness to provide finance, and demand in the business sector for financing. In Ireland, problems are arising from both weak demand for credit and weak supply of credit. Even before the current financial crisis emerged, a number of longstanding issues were evident in the market for funding in Ireland. This is a particular challenge for start-up SMEs and innovative exporting SMEs that play a crucial role in stimulating employment growth<sup>119</sup>.

The banking system in Ireland has continued to contract reflecting the ongoing deleveraging efforts by the Irish-owned credit institutions, as well as the wider retrenchment of foreign banks in Ireland. The reduction in debt is being driven by the need of the banks to strengthen their balance sheets and by the wider debt dynamics faced by the Irish business and public sectors, which are undergoing their own process of deleveraging<sup>120</sup>.

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117 For example, the Action plan for Jobs includes actions to increase new lending to SMEs drawing on both bank and non-bank sources of funding; increase participation in Government sponsored access to finance schemes and initiatives for SMEs such as the Microenterprise Loan Fund, the Credit Guarantee Scheme, the Seed and Venture Capital Scheme, Seed Capital Scheme, Employment and Investment Incentive Scheme; develop new sources of finance for SMEs including greater use of the European Investment Bank and the European Investment Fund.

118 Abiad et al, Creditless Recoveries, IMF Working Paper 11/58, 2011

119 SMEs account for 99.8 per cent of all active enterprises, 68.6 per cent of employment, 50.1 per cent of turnover and 46.0 per cent of gross value added. The great majority of enterprises in the business economy (90.8 per cent) are micro-enterprises (i.e. businesses with less than 10 employees). A further 7.7 per cent are other small enterprises while 1.3 per cent are classified as medium sized enterprises. Only 0.2 per cent of enterprises are classified as large (i.e., with greater than 250 persons engaged). Data sourced from the CSO, Business in Ireland, 2011

120 Reflecting high debt levels and weak growth in recent years, Ireland has the second highest Non-Performing Loan (NPL) ratio in the OECD, which is undoubtedly hindering the return of banks to health - raising the cost of market funding and draining resources that could be used for new lending. According to the IMF, 41 per cent of non-performing loans in Ireland relate to commercial real estate loans, 34 per cent to mortgages and 19 per cent to business and SME loans. See IMF, Ireland Twelfth Review under the Extended Arrangement and Proposal for Post-Programme Monitoring, Country Report No. 13/366, December 2013

Loans issued by resident credit institutions are an important source of funding for indigenous companies. Central Bank data highlights that credit advanced to the business (Non-Financial Corporations) sector has declined at an average annual rate of 5.1 per cent, to end-January 2014. The supply of loans with a maturity of between one and five years continues to fall more sharply than shorter term loans over the last number of months: while short terms loans are critical to supporting working capital, longer term funding is essential to support investment in productive assets.

The cost of finance continues to be an issue. Previous NCC research highlights that, new business interest rates for non-financial corporations are higher in Ireland than in the euro area<sup>121</sup>. Cost competitiveness may weaken further as the banks need to rebuild profitability and as the business banking market has become highly concentrated (i.e. there is less competition due to the reduction in the number of banks operating in the market). Other terms and conditions are also a concern - in particular, the requirement for personal guarantees - even in the case of limited companies<sup>122</sup>.

Demand for credit is also weak. Many sectors of the Irish economy have significant debt levels and high levels of existing indebtedness affect current demand for credit negatively - Ireland has the second highest Non-Performing Loan ratio in the OECD.

The Department of Finance RedC SME Credit Demand survey (October 2013 to March 2014) indicates that credit demand from the SME sector in Ireland remains low with 35 per cent of SMEs having requested at least one type of bank finance in the period October 2013 to March 2014. Demand has decreased from 40 per cent a year previously. In terms of the success rate of applicants for credit, 81 per cent of credit application requests were granted. The proportion of applications declined has also reduced (from 24 per cent to 19 per cent) and an increasing proportion of applications are being approved fully, rather than partially approved

Disentangling demand and supply side factors is challenging. Research from the ESRI<sup>123</sup> highlights that credit constraints affect a small but important minority of SMEs (between 4 and 11 per cent). The ESRI note that most SMEs do not apply for funding because they do not need it and that those facing credit constraints are mainly young, small firms and firms that have a domestic customer base and a debt overhang. SMEs main response to credit constraints is to reduce investment and numbers employed - a concern given the importance of the sector for employment creation.

Looking to the future, the ESRI expect the total credit stock to return to a stable level of approximately 40 per cent of GDP, similar to the level that prevailed prior to the credit expansion of the mid-2000s<sup>124</sup>. At a sectoral level, while the share of credit expected to go to the property sector is expected to continue to decline, new credit will still be required in this sector. However, overall credit growth driven is expected to be driven by non-property sectors. The ESRI caution that it will be important that the property sector does not “crowd-out” lending to rest of SME sector and their initial analysis suggests that the credit levels available to the manufacturing sector are below desirable values.

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121 National Competitiveness Council, *Costs of Doing Business in Ireland*, Forfás, 2014.

122 Joint Committee on Jobs, Enterprise and Innovation, *Report on Access to Finance for Small and Medium Enterprises (SMEs)*, July 2014

123 Gerlach-Kristen, P., O'Connell, B., and O'Toole, C., *SME Credit Constraints and Macroeconomic Effects*, ESRI, April 2013

124 Lawless, M., McLnerney, N., McQuinn, K., and O'Toole, C., *Credit Requirements for Irish Firms in the Economic Recovery*, ESRI, September 2014

From the Council's perspective, some of the key challenges facing us include:

- Ensuring that the efficacy of measures put in place to improve credit flows through recapitalisation, deleveraging and restructuring of the banks can be assessed and further action taken if required. Addressing mortgage arrears and completing bank repairs is an essential element in ensuring that sufficient credit is available for enterprise investment. In this regard, there is a need to continue to monitor bank lending carefully, particularly as the economy returns to growth and demand for funding increases. A particular focus is required on the SME and manufacturing sectors.
- The State needs to continue to work to ensure that the banking system is aligned with the strategic economic growth targets of the economy. In this regard, a move towards a banking system with a deeper understanding of innovative sectors (e.g. software, telecoms, digital content, med-tech and life sciences) and a pro-active overseas banking network are required in the medium term. More immediately, there needs to be a focus on supporting internationally trading businesses in terms of both the provision of credit and the bank facilities/products (e.g., international invoice discounting, performance bonds and specialised leasing, etc.). A continuing focus on upgrading skills levels within the banks and financial skills in the wider business sector is important.
- A wide range of initiatives have been rolled out to support access to finance. Progress is also being made in terms of communicating these initiatives to stakeholders<sup>125</sup>. Greater potential exists to build links between individual initiatives. For example, mirroring proposed UK legislation<sup>126</sup> which will require the largest UK SME lenders to forward on details of SMEs they reject for finance (where SMEs give their consent) to other finance platforms, potential exists to link rejected SMEs automatically to Irish Government initiatives (e.g. Microfinance scheme, Credit Review Office).
- The scaling back of the domestic bank sector and the withdrawal of many foreign banks highlights issues over the levels of competition in the banking sector as the business banking market has become highly concentrated<sup>127</sup>. A particular challenge exists for those SMEs who currently rely on banks who are withdrawing from Ireland. In addition, a range of initiatives depend significantly on existing banking infrastructures for their success. Attracting/ developing new entrants to the market would be welcome.
- The newly established Strategic Banking Corporation of Ireland will provide approximately €800m of funding to the SME sector. The SBCI has been designed to address both supply and demand side issues and SSBIC will work with existing and new providers of finance to SMEs in the Irish market. A key goal of the SBCI is to facilitate the entry of new providers of SME funding to the Irish market.

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<sup>125</sup> For example, see <https://www.localenterprise.ie/smeonlinetool/businessdetails.aspx>

<sup>126</sup> Help to match SMEs rejected for finance with alternative lenders, August 2014.

<sup>127</sup> ESRI research has also found 'when testing the effect of bank market competition on access to finance, we find that as market power increases, and the degree of competition falls, SMEs face higher financing constraints.' O'Toole, C., Ryan, R., McCann, F., Does Bank Market Power Affect SME Financing Constraints?, ESRI Research Bulletin March 2014

**Recommendation:** A range of actions are required to enhance access to credit, particularly for SMEs, including:

- A move towards a banking system with a deeper understanding of innovative sectors (e.g. software, telecoms, digital content, med-tech and life sciences) and a pro-active overseas banking network is required. There needs to be a focus on supporting internationally trading businesses in terms of both the provision of credit and the bank facilities/products (e.g., international invoice discounting, performance bonds and specialised leasing, etc.). A continuing focus on upgrading skills levels within the banks and financial skills in the wider business sector is important.
- Provision needs to be made to address the challenges which are arising for Irish firms (particularly SMEs) who currently rely on banks who are withdrawing from Ireland. Attracting/ developing new entrants to the market would be welcome.
- A pro-active focus on legacy debt and loan restructuring is important.

**Responsibility:** SME State Bodies Group, Central Bank of Ireland

## 5.2 Other Non-Banking Funding Sources

Bank finance, while important is just one source of finance. Other important sources of non-bank funding include:

- Equity finance (which comprises business angels and private investors, venture capital, private equity and government equity)<sup>128</sup>;
- Accounts receivable/ payable (which can entail businesses relying excessively on their suppliers to help finance their businesses)<sup>129</sup>;
- Loans from family, friends or others;
- Off-balance sheet financing sources such as lease financing, hire purchase and factoring; and
- Government financial support through the State Enterprise Agencies.

Since 2008, there has been strong growth in the use of ‘share and other equity’ and the use of ‘other accounts receivable’ by Irish firms. Diversifying sources of finance offers significant competitiveness advantages. From the Council’s perspective, some of the key challenges facing us include:

- Actions are required to support firms to seek equity investments, encourage potential investors to invest and support the development of equity networks/ markets. The EIIS/ SCS should be reformed to ensure that they deliver on their potential to support the funding needs of growing businesses<sup>130</sup>.

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<sup>128</sup> Forfás published ‘A Review of the Equity Investment Landscape in Ireland’ in January 2013. A number of actions have been progressed and the SME State Bodies Group - equity finance subgroup, is examining this area further.

<sup>129</sup> The Department of Jobs, Enterprise and Innovation are supporting the development a Code of Conduct on Prompt Payments for Business and are progressing a national information campaign to raise awareness of Late Payment Directive.

<sup>130</sup> The Employment and Investment Incentive Scheme (EIIS) provides an income tax incentive to private investors in companies. The Seed Capital Scheme (SCS) provides a refund of income tax paid to those who establish and work full time in their own company.



- The State can also support other forms of funding. There is strong potential for the State to provide a supporting environment, potentially including regulation, to alternative sources of finance such as peer-to-peer lending.
- Dealing pro-actively with legacy debt issues is important for growth. The effectiveness of loan restructuring is important to strengthen company balance sheets, thus facilitating external investment.

**Recommendation:** A range of actions are required to enhance access to credit, particularly for SMEs, including:

- Actions are required to support firms to take on equity investments, encourage potential investors to invest and support the development of equity networks/ markets. The EIS/ SCS should be reformed to ensure that they deliver on their potential to support the funding needs of growing businesses.
- The State should also support other forms of funding. There is strong potential for the State to provide a supporting environment to alternative sources of finance such as peer-to-peer lending.

**Responsibility:** Department of Finance, Department of Jobs, Enterprise and Innovation, State Bodies Group

## 6. Social Capital, Corporate Governance and Data Protection

Many of the difficulties of the last few years have arisen to one degree or another through the failure of individuals and organisations to live up to the expectations of citizens. We must address the failures of the past and rebuild the trust of citizens in the ability and willingness of public and private bodies in Ireland to adhere to the highest international standards.

Given the direction in which the Irish economy is evolving, away from a more traditional goods and services economy, and towards the oft-mentioned knowledge economy, trust in public and private bodies is becoming ever more central to Ireland's ability to compete.

While trust is intangible, it is an important international currency. A reputation as a secure and responsible location in which to do business is central to competitiveness. Likewise, countries with high levels of trust are better placed to manage economic and social change, to achieve societal goals without excessive regulation, and experience higher levels of wellbeing. Trust is also important as we pursue economic opportunities in areas such as international financial services, data analytics and other big data sectors. Our data protection infrastructure assumes ever more importance.

The realm of trust, social capital and corporate governance in general, is not an area that the Council has commented upon in detail previously. This Chapter represents an initial discussion on a range of interlinked factors and principles, which will no doubt be the focus of further discussion in the months and years ahead.

### 6.1 Social Capital and Corporate Social Responsibility

Social capital refers to the value of connections between people and/or organisations in a society. Networks, based on shared norms or values that facilitate cooperation, can have many positive economic effects such as:


- Promoting the efficient functioning of markets, as social capital reduces transactions costs and improves information flow;
- Reducing the need for extensive rules, contracts, litigation and bureaucracy, as interactions can be based on trust; and
- Improving social inclusion and social mobility.

However, social capital can also have negative implications for competitiveness, if high levels of consensus stifle debate, risk-taking and openness to new ideas and change.

While there are many (difficult to measure) facets to social capital - for instance the level of volunteering and active citizenship<sup>131</sup>; the role of migration, integration and cultural diversity; the

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<sup>131</sup> According to The Wheel, the community and voluntary sector clearly makes a big contribution to sustaining what is often referred to as 'civil society' in Ireland - those parts of our society that are neither the state nor the private sector. Two-thirds of Irish adults (over two million people) engage annually in the social, cultural and humanitarian activities offered by 19,000 community and voluntary organisations, and the sector contributes over €2.5 bn. to the economy each year. The sector also employs over 63,000 full-time and part-time staff and volunteers provide the equivalent work of a further 31,000 people.



quality of our living space and our investment priorities etc. - perhaps the most immediate challenge from a competitiveness perspective to the level of trust between business and citizens. Corporate Social Responsibility (CSR) is a concept whereby enterprises integrate social and environmental concerns into their mainstream business operations on a voluntary basis. CSR goes beyond compliance with legislative requirements - it ensures that the interests of enterprises and interests of wider society are mutually supportive.

The Government's recent National Plan on Corporate Social Responsibility recognises the importance of this dimension for continued economic success noting that "good CSR practices are distinguishing the best companies from their competitors"<sup>132</sup>. The Plan specifically draws attention to the economic returns that accrue to individuals, companies and the wider economy when enterprises go beyond what is required by legislation alone. From a company perspective, benefits arise through improved customer relations, better risk management, efficiency and costs savings, greater innovation capacity, and enhanced attractiveness to investors. The key objectives of the National Plan include:

- Increase awareness of CSR, its value to businesses and to society as a whole.
- Encourage enterprises to develop and implement CSR policies and practices and mainstream them into their core business operations.
- Encourage more small and medium-sized enterprises to build CSR capacity.
- Increase transparency and reporting of CSR activity by enterprises operating in Ireland.
- Anchor CSR practices in public bodies in the context of their own operations.

Ireland's drive to improve CSR practice also reflects EU developments, such as the European Commission's proposal for a Directive enhancing the transparency of certain large companies on social, employee, human rights and environmental matters, commonly referred to as "Non-Financial Reporting".

Key to fulfilling these objectives is the establishment of the proposed CSR Stakeholder Forum, which will comprise representatives from the business sector, the public sector and the community sector<sup>133</sup>. The Forum will inform further development of the CSR policy framework in Ireland and ensure that the Plan remains relevant to evolving international best practice and thinking. Likewise, the actions to raise awareness of CSR and disseminate best practice will be essential in ensuring that the CSR principles and practices are fully and successfully embedded.

It will be important that the forum tackle tangible issues. This forum, for example, could be a useful mechanism to deal with the late payments challenges. It has been suggested that "one out of

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<sup>132</sup> The National Plan on Corporate Social Responsibility sets out the general framework within which CSR operates in Ireland and outlines the key principles and objectives which underpin the Government's approach to CSR. It also seeks to communicate a common understanding of CSR by outlining the Pillars on which CSR is based in Ireland. The Pillars are workplace, environment, marketplace, community and the public sector. See Department of Jobs, Enterprise and Innovation, Good for Business, Good for the Community: Ireland's National Plan on Corporate Social Responsibility 2014-2016, April 2014

<sup>133</sup> Action 188 of the Action Plan for Jobs 2014 states that a CSR Stakeholder Forum will be established to "inform further development of the CSR policy framework in Ireland. The Forum will comprise representatives of the business sector, key Government Departments and agencies, and the community sector".

three companies which has failed in Europe has done so due to problems related to late payments”<sup>134</sup>.

**Recommendation:** It is important that the National Plan on Corporate Social Responsibility is implemented and that data is collected to support the planned review in 2016.

**Responsibility:** CSR Stakeholder Forum, Department of Jobs, Enterprise and Innovation

## 6.2 Corporate Governance

The financial and banking crises revealed severe shortcomings in corporate governance, particularly in relation to the financial services sector, which is of systematic importance to the wellbeing of an economy. Reforms to corporate governance are, therefore, central to enhancing public trust and enhancing our international reputation.

As with wider social capital issues referenced above, good corporate governance practice provides benefits to enterprise whilst simultaneously protecting citizens. The more ingrained the system of corporate governance in a business community, the less the need for detailed regulation to ensure effective compliance with good standards of business behaviour<sup>135</sup>. Strong corporate governance should also reduce the cost of capital as perceived corporate risks fall.

A range of corporate governance reform initiatives are underway at national and EU level:

- The Companies Bill 2012 will be a significant milestone in the history of company law, as the Bill, the largest substantive Bill in the history of the State, will modernise our company law code and consolidate legislation from 1963 to the present<sup>136</sup>. In terms of specific corporate governance measures, the Bill will introduce the "directors' compliance statement". The Bill will also bring together and give a statutory footing to all the existing directors' duties. While these duties already exist, putting these into statute will enhance clarity.
- As part of the process to develop a White Paper on Crime, the Department of Justice and Law Reform has conducted a consultation exercise on white-collar crime<sup>137</sup>. In the responses received, stakeholders highlighted a range of concerns including the apparent lack of parity of treatment by the criminal justice system between white-collar criminals and other criminals; the need for comprehensive protections for whistle-blowers; and equipping the various regulatory and enforcement agencies with a range of effective investigative and prosecutorial powers to deal with white-collar crime<sup>138</sup>.
- In parallel, the Law Reform Commission is also planning to undertake a review of corporate offences and regulatory enforcement that will examine the regulatory and enforcement powers

<sup>134</sup> Joint Committee on Jobs, Enterprise and Innovation, Meeting of 11 June 2014 with EU SME Envoy Daniel Cajella Crespo, transcript.

<sup>135</sup> Financial Reporting Council, The UK Approach to Corporate Governance, 2010

<sup>136</sup> The Bill was published in December 2012 and was passed by Dáil Éireann in April 2014. The Bill is expected to be enacted by the end of the year.

<sup>137</sup> Department of Justice and Equality, White Paper on Crime: Organised and White Collar Crime, Discussion Document No. 3, October 2010

<sup>138</sup> Department of Justice and Equality, White Paper on Crime: Organised and White Collar Crime, Discussion Document No. 3 - Overview of Written Submissions Received, April 2011

of the Central Bank of Ireland and other comparable bodies. The project will examine criminal law enforcement mechanisms for corporate offences, including whether the range of existing corporate offences are sufficient, the range of sentences available on conviction for corporate offences and the use of deferred prosecution agreements. It will also examine civil law mechanisms, including the imposition of administrative sanctions<sup>139</sup>.

- A Criminal Justice Act 2011 was enacted in August 2011, which aims to address delays in the prosecution and investigation of complex crime by improving certain important procedural matters and strengthening Garda investigative powers.
- The Competition and Consumer Protection Act 2014 will also play an important part in combating white-collar crime (e.g. breaches of competition law) as additional criminal investigation powers are being provided to the new Competition and Consumer Protection Commission in this area.

Conclusion of these work streams is essential - the proposed White Paper is due to be published in 2014 and will provide a high level statement of Government policy, its rationale and the strategies to give effect to that policy.

**Recommendation:** The completion of the White Paper on Crime should be prioritised. It is important that the White Paper include a clear timeline for the development and implementation of additional actions designed to tackle white-collar crime.

**Responsibility:** Department of Justice and Equality

At EU level, several Green Papers and proposals for reform have emerged in recent years, tackling a range of corporate governance issues.


- In June 2010, the Commission published a Green Paper on possible ways forward to improve corporate governance in financial institutions and on remuneration policies<sup>140</sup>. In March 2011, the European Parliament approved a report on corporate governance in financial institutions.
- A Green Paper consultation on the reform of statutory audit in the EU was published in autumn 2010<sup>141</sup>. Following consultation on the Green paper, proposals were issued by the Commission in November 2011. Key measures include strengthening the independence of statutory auditors, making the audit report more informative, and improving audit supervision throughout the Union. Stricter requirements will apply to public-interest entities. The measures must be transposed into national law by mid-2016.
- In April 2011, the European Commission published a Green Paper consulting on possible improvements to corporate governance in European companies<sup>142</sup>. The Green Paper contains

139 Law Reform Commission, Fourth Programme of Law Reform, LRC 110 - 2013, November 2013

140 European Commission, Green Paper: Corporate governance in financial institutions and remuneration policies, COM(2010) 284, June 2010

141 European Commission, Green Paper: Audit Policy - Lessons from the Crisis, COM(2010) 561, October 2010

142 European Commission, Green Paper: The EU Corporate Governance Framework, COM(2011) 164, April 2011



three chapters: boards, shareholders and the comply-or-explain principle. Following up on this, the European Commission adopted an Action Plan in December 2012 outlining future initiatives in the areas of company law and corporate governance<sup>143</sup>. The initiatives, which will be both legislative and non-legislative, follow three main lines: enhancing transparency between companies and investors; encouraging long-term shareholder engagement; and improving and simplifying the framework for cross-border operation of companies. In addition, the European Action Plan also launched a process of codification of most company law directives.

In reforming both national and EU corporate governance frameworks, the Council believe policy makers should consider a number of principles.

- Companies listed on the Irish Stock Exchange's main market are legally obliged to comply with the Corporate Governance Code (formerly the Combined Code)<sup>144</sup>. A listed company choosing to depart from the Corporate Governance Code has to explain which parts of the code it has departed from, and the reasons for doing so. Mirroring the sentiments expressed in the EU green paper on corporate governance, the Council believes there is a need to introduce more stringent requirements on companies departing from the code. Companies should be required to explain not only the reasons for departure from a given recommendation, but also a detailed description of the solution applied instead<sup>145</sup>.
- Boards and audits also need to be more effective. The board of directors is the highest governing authority within the management structure of any publicly traded company or organisation. Accordingly, the composition and activities of the board of directors need to be re-examined. The Commission has recently proposed revisions to the existing Shareholder Rights Directive (Directive 2007/36/EC) would tackle corporate governance shortcomings relating to listed companies and their boards, shareholders (institutional investors and asset managers), intermediaries and proxy advisors (i.e. firms providing services to shareholders, notably voting advice). The proposed revisions reflect the Commission's belief that too often, as the recent financial crisis showed, shareholders supported excessive short-term risk taking and did not monitor closely the companies they invested in. In this regard, consideration should be given to ensuring stakeholder interests are adequately represented.
- The OECD have already put forward proposals relating to disclosure of information by multinational corporations, noting that "clear and complete information on enterprises is important to a variety of users ranging from shareholders and the financial community to other constituencies such as workers, local communities, special interest groups, governments and

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143 European Commission, Action Plan: European Company Law and Corporate Governance - A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies, COM(2012) 740, December 2012

144 Currently companies listed on the Irish Stock Exchange's main market are legally obliged to comply with the Combined Code on Corporate Governance. As for other "listed companies" (i.e. on Irish markets other than the main market, such as IEX), Stock Exchange rules require all companies to report on how they have implemented the provisions of the Combined Code on a comply or explain why.

145 In April 2014, the Commission published a recommendation on the quality of corporate governance reporting ('comply or explain' principle) which aims to improve corporate governance reporting by listed companies. Most corporate governance is soft law and it is thus essential that the 'comply or explain' approach, whereby a company that chooses to depart from the applicable corporate governance code must give reasons for the departure, works well. This approach offers companies an important degree of flexibility, as it recognises that, in certain circumstances, non-compliance with some recommendations might correspond better to the company's interest than 100 per cent compliance with the code. However, companies that depart from the applicable corporate governance code often fail to provide appropriate explanations for the departure, which makes it more difficult for investors to take informed investment decisions.

society at large”<sup>146</sup>. It is worth considering how best to enhance levels of disclosure without placing unreasonable administrative or cost burdens on enterprises. Likewise, enterprises cannot be expected to disclose information that may endanger their competitive position unless disclosure is necessary to fully inform the investment decision and to avoid misleading the investor.

**Recommendation:** The Council recommends that listed companies be required to provide more transparent and detailed information justifying any departure from the Corporate Governance Code (where applicable).

In the context of the European Commission’s ongoing work on corporate governance, there is a need to examine the role and composition of Boards of Directors to make them more effective.

Measures to reform Ireland’s corporate governance regime, however, must also be cognisant of the need to maintain a pro-enterprise regulatory regime and avoid the imposition of unnecessary administrative burdens on firms.

**Responsibility:** Department of Jobs, Enterprise and Innovation / Central Bank / Department of Finance / Irish Stock Exchange

### 6.3 Privacy, Data Protection and Data Analytics

Over the next five to 10 years, another 2 billion people will be online, connected devices will exceed 50 billion and industries will be transformed by new means of gathering and sharing data<sup>147</sup>.

Big Data refers to the enormous databases of digital data, controlled mainly by private companies, which contain information on customers or clients and their activities and which, when analysed using computer algorithms (“data analytics”), can be used to identify previously unknown or unforeseen linkages and trends.

The Big Data disruptive reform agenda set out in the Action Plan for Jobs sets an ambition for Ireland to be one of the leading countries in Europe in Big Data and data analytics. As well as R&D investments and provision of skilled graduates, the data protection regime in Europe and the efficient operation of data protection in Ireland are critical elements that underpin the economic opportunities associated with Big Data.

Data analytics is driving innovation, economic activity and job creation worldwide; the sector is expanding rapidly in Ireland with significant scope for further employment creation. The employment potential in data analytics and Big Data comes in the form of the very highly skilled jobs for data analysts/data scientists proficient in areas such as mathematics, statistics, management science and with the associated IT skills required to mine and analyse the data concerned. Secondary employment impacts also arise in firms that use data analytics to create new products and services thereby protecting existing employment and creating new job opportunities.

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<sup>146</sup> OECD, Guidelines for Multinational Enterprises, 2011

<sup>147</sup> World Economic Forum, Digital Infrastructure and Applications 2020+.

Indeed, many of the sectors currently being targeted for growth in Ireland operate at the confluence of competitive data protection, research and development, and taxation regimes. Only by ensuring that Ireland's data protection regime offers best in class regulation, can we continue to win highly mobile international investment in the data analytics sector.

While big data has the potential to create exciting and valuable opportunities for individuals, communities, organisations and societies, it also introduces new challenges when it comes to data capture, management, security and privacy. Big data can pose significant risks for the protection of personal data and the right to privacy; these risks are the subject of ongoing discussions in the context of the current EU data protection reform package<sup>148</sup>. The balancing of the anticipated benefits of data analytics with risks to data protection and privacy rights poses a challenge for data protection law<sup>149</sup>. It is also important that policymakers are cognisant of avoiding, to the extent possible, the creation of unnecessary additional administrative burdens on firms or other negative unintended consequences.

## EU Engagement and Resources

There is broad agreement at EU level on the need for reform to take account of ICT developments and the new business models that have emerged since adoption of the Data Protection Directive in 1995 and a new draft Regulation is currently being discussed at European level. The proposed Regulation is intended to both reduce administrative burdens and associated costs for business and increase individuals' control over their own personal data by strengthening data protection safeguards.

Unless citizen confidence and trust in the digital environment is improved, the full potential of the digital economy - and the economic growth, new jobs and dynamic innovation which it can deliver - may not be realised.

The proposed Regulation will also increase legal certainty for businesses by replacing the current patchwork of national data protection laws in Member States with a uniform set of rules applicable throughout the entire EU: one digital market subject to a uniform set of data protection rules. The proposed Regulation contains derogations, which will continue to permit 'further processing' of personal data for 'compatible' purposes, including specific provisions for historical purposes (including archives), statistical purposes and scientific purposes.

In negotiations to date (like many other Member States), Ireland has sought to achieve an appropriate balance between permitting further processing of personal data for legitimate

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148 The centrepiece of the existing data protection regime is the 1995 Data Protection Directive (Directive 95/46/EC). It is an internal market measure, which seeks to reconcile the protection of personal data with the free flow of such data within the internal market and to countries outside the EU. The 2008 Data Protection Framework Decision (Decision 2008/977 /JHA) which provides safeguards for personal data in the context of police and judicial cooperation in criminal matters complements this Directive. The Lisbon Treaty contains a new legal base (article 16) which provides for strengthening EU data protection safeguards. In early 2012, the European Commission published proposals for a General Data Protection Regulation to replace the 1995 Directive, and a Directive to replace the 2008 Framework Decision. These proposals are still under discussion in the Council's expert group. The European Parliament adopted a position on the reform package earlier this year. The proposals are subject to co-decision between both institutions.

149 The risks include the vast scale of data collection; a lack of transparency concerning the creation and use of profiles; the combination of personal data from diverse sources; low levels of data security on the part of those holding the data; possible discrimination or exclusion based on inaccurate or out-of-date data.



purposes, including for purposes of research and innovation, on the one hand, and the data protection and privacy rights of individuals on the other.

As it stands, the Regulation currently contains a proposal for a ‘one-stop-shop’ mechanism; under such an approach, the Irish Data Protection Commissioner would have primary responsibility for application of the Regulation in respect of all companies with their main, or only, EU establishment in this jurisdiction. The manner in which this is implemented will be an important part of the ecosystem for data-intensive companies operating in Ireland.

Regardless of the evolution of the EU reform agenda, it is also important that Ireland continues to identify those aspects of data protection that are within our immediate control, and that appropriate resources are applied and action is taken to protect or further improve the environment for data-intensive companies operating in Ireland.

**Recommendation:** The Department of Justice and Equality should continue to engage on an ongoing basis with relevant stakeholders as negotiations on the proposed European data reform package progress.

**Responsibility:** Department of Justice and Equality

Ireland’s reputation in this space is and will continue to be a significant determinant of success. Effective enforcement of the current and future data protection obligations on companies, including assessment of the adequacy of safeguards in the case of data analytics, will require the allocation of appropriate resources (both the level of resources and the expertise) to the Office of the Data Protection Commissioner.

**Recommendation:** The Office of the Data Protection Commission needs to be resourced in a manner that ensures effective and efficient enforcement of data protection regulations, and at a level that supports Ireland’s ambition to become a leading European data analytics centre.

**Responsibility:** Department of Justice and Equality

The Government can play a direct role in encouraging corporations to locate data-intensive activities in Ireland through its own use of data analytics to improve public services and through its willingness to release non-personal and/or anonymised datasets for public good and industry use. Good progress is being made on the legislation to underpin this and through the work programme associated with Ireland’s membership of the Open Government Partnership.

**Recommendation:** The Department of Public Expenditure and Reform (DPER) should continue to spearhead “open data” initiatives in Ireland and the Government’s own use of data analytics and ensure that an appropriate legislative framework is in place. DPER can play an important coordinating role to ensure that all public bodies allocate appropriate resources to deliver on the Government’s stated ambition in this area.

**Responsibility:** Department of Public Expenditure and Reform

NCC Secretariat  
Department of Jobs, Enterprise & Innovation  
Kildare Street, Dublin 2, Ireland

Tel +353 1 631 2865

[www.competitiveness.ie](http://www.competitiveness.ie)

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