

National  
Competitiveness  
Council



*The* 2000  
**Competitiveness**  
*Challenge*



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*May 2000*



## Foreword by An Taoiseach



The performance of the Irish economy over the past years has been outstanding, and economic growth has brought many benefits to our society. It is our competitiveness, i.e. the ability to win and keep business in domestic and foreign markets, which has underpinned this success. Therefore, in order to build on the success, in order to ensure that living standards continue to rise, it is vital that we maintain and develop the competitiveness of the economy.

Competitiveness is a key focus of Government policy. The Government is determined that the conditions and incentives for enterprises operating in Ireland should be as favourable as possible. This encompasses the skills level of the population, the knowledge capital in the economy, the physical infrastructure, the costs that businesses face, the telecommunications and other services that businesses need, the regulatory environment, the efficiency and effectiveness of public administration and other factors. In these areas, the Government is promoting competitive improvement through strategic thinking, investment and the implementation of forward-looking change. In this regard, the *National Development Plan 2000-2006* represents an enormous investment in the future. Another important initiative from the Government is the on-going programme of liberalisation of the telecom, energy and transport sectors, which is already yielding lower costs for businesses and consumers.

A central element of our success in recent years has been the on-going partnership between workers, employers, the Government and the community and voluntary and farming sectors. The most recent expression of this partnership is the *Programme for Prosperity and Fairness*, to which the Government is fully committed as the best foundation for economic stability and social progress for the future. The National Competitiveness Council was established in 1997 under the previous agreement, *Partnership 2000*. The Council provides a vital input to Government policy on competitiveness through its compilation of comparative data, its overview of the complex of factors that determine competitiveness, its analysis of key issues and its identification of actions required to maintain and develop competitiveness.

I am very pleased to introduce both the *Competitive Challenge* and the *Annual Competitiveness Report 2000*, which is the third in the series. The Government greatly appreciates the work of the Council, and the relevant Ministers will give careful consideration to its recommendations.

An Taoiseach, Bertie Ahern.



## Council Members

The members of the National Competitiveness Council are as follows:

<b>Mr Brian Patterson</b>	Chairman
<b>Mr Kevin Bonner</b>	Partner Business Insight Limited
<b>Mr William Burgess</b>	Managing Director & Chairman IBM Ireland Limited
<b>Mr Donal Byrne</b>	Managing Director & Chairman Cadbury Ireland Limited
<b>Mr Des Geraghty</b>	President SIPTU
<b>Ms Jackie Harrison</b>	Director – Enterprise IBEC
<b>Ms Annette Hughes</b>	Economist DKM Economic Consultants
<b>Mr Billy McCann</b>	Chairman ESB
<b>Ms Áine Mizzoni</b>	Chief Executive Officer E•Smart Limited
<b>Ms Patricia O'Donovan</b>	Deputy General Secretary ICTU
<b>Mr Neil Ormonde</b>	Consultant
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### 1.1 NCC reports to Government on key competitiveness issues

The National Competitiveness Council (NCC) was established in May 1997 under the *Partnership 2000* agreement to report to the Taoiseach on key competitiveness issues for the Irish economy and to make recommendations on public policy actions required to enhance Ireland's competitive position. This statement sets out the Council's recommendations for action to safeguard and further enhance Ireland's international competitiveness. The actions required are identified under the seven competitiveness priorities identified in the Council's work programme for 2000:

- **Social Partnership**
- **People**
- **Costs**
- **Infrastructure**
- **Telecommunications and e-Business**
- **Competition and Regulation**
- **Science and Technology**

### 1.2 Swift and effective implementation is a clear competitive advantage

The two principal steps in responding effectively to the present and future competitiveness threats and opportunities are to:

- identify the actions required to sustain competitiveness and
- efficiently undertake these actions.

The lag between diagnosis, recommendation, decision, and the subsequent implementation is a major obstacle to decisive action to improve competitiveness. In the rapidly changing, technologically advanced and globalised economic environment in which Ireland competes, rapid and flexible adaptation to new economic circumstances is paramount. Swift and effective implementation is a clear competitive advantage.

### 2.1 Reshape competitiveness strategy in light of transformation in environment for enterprise

The overriding competitiveness challenge confronting us is to adapt competitiveness strategy to a transformed economic environment. This environment, currently characterised by huge success, leading to capacity constraints and bottlenecks, must be re-shaped to meet the ongoing sea-change in the environment for enterprise – in particular the impact of globalisation, e-business and technological change.

There are two distinct dimensions to this challenge:

- the alleviation of a broad range of interlinked and intensifying difficulties and capacity constraints now seriously threatening the sustainability of Ireland's economic performance – in particular
  - pronounced skill and labour shortages;
  - the lack of affordable housing;
  - inadequate transportation infrastructure and public transport; and
  - serious gaps in telecommunications infrastructure and relatively high telecommunications costs;
- the development of enduring competitiveness strengths in human and knowledge capital, economic and social infrastructure, entrepreneurship, regulation and competition policy and institutional capacity.

The timely and efficient delivery of accelerated investment under the £40bn. National Development Plan 2000-2006 (NDP) is central to the realisation of these objectives.

### 2.2 Ireland's international competitiveness has been outstanding over the 1990s

Assessed in terms of conventional measures of economic performance, Ireland's international competitiveness over the 1990s has been outstanding. For example:

- the economy has grown 75 per cent larger in size
- the share of total exports (goods and services) in national output (GDP) has risen from 53 per cent in 1990 to 84 per cent in 1998
- the stock of US manufacturing foreign direct investment in Ireland has more than doubled from \$3.8bn. in 1994 to \$8.1bn. in 1998
- large gains in export market share have been achieved
- the profitability of capital has almost doubled.

### 2.3 Competitiveness copper-fastened by a chain of competitive strengths

Ireland's remarkable economic resurgence and competitiveness in the 1990s has been underpinned by a number of core mutually reinforcing factors. These include:

- social partnership and pay moderation
- macroeconomic stability
- strong flows of foreign direct investment

- Ireland's low rate of corporation tax
- rapid expansion of an increasingly skilled and well-educated labour force
- high (albeit diminishing) levels of EU structural transfers.

These factors cannot be expected to deliver sustained economic and social progress in the absence of a programme of action to alleviate the broad range of competitiveness challenges currently confronting the economy.<sup>1</sup>

#### 2.4 Yielding major economic and social benefits

The transformation of Ireland's economic performance, rooted in improved competitiveness, has yielded significant economic and social benefits for all groups in Irish society:

- GNP per head has risen from around two-thirds of the EU average in the late 1980s to in excess of 90 per cent at the present time
- employment has risen by about 40 per cent (465,000 people) over the 1990s to date
- average real take home pay has risen by one third over the same period<sup>2</sup>
- unemployment has declined by two-thirds from over 16 per cent in 1988 to its current level of below 5 per cent
- there has been a turnaround in the public finances, anchoring low inflation (until recently) and low interest rates, culminating in EMU membership and permitting significant real (i.e. inflation adjusted) increases in public expenditure on essential social services and public capital investment
- the burden of taxation has declined significantly.

#### 2.5 External economic environment now being transformed

The next decade provides an opportunity to eliminate the remaining gap in GNP per person that still remains between Ireland and the small, high-income, EU economies. Against this backdrop a complex set of issues is now emerging - as highlighted by the work of the Council - to threaten Ireland's international competitiveness and the sustainability of its economic performance. This fluid mix of opportunities and threats can be best characterised by a number of major themes:

- The **globalisation** of international capital and financial markets, investment and **trade** flows, is accelerating the integration of the world economy. A successful conclusion of the Millennium Round of **WTO** trade negotiations would be of great significance.
- **EMU** is leading, inexorably, to the creation of a truly integrated **Single European Market (SEM)** of almost 300 million consumers. The process of **EU enlargement** is shifting the centre of gravity of European economic development eastward. The competitiveness of the EU economy is gradually being transformed.
- The Communications and Information Revolution, driven by the rapid growth of the **digital economy** and information and communication technologies (ICTs), is creating rapidly evolving opportunities and threats. **e-Business** is changing many of the old patterns - unpredictability is on the increase.

<sup>1</sup> The benign central forecast detailed in the *Medium-Term Review 1999-2005* (ESRI, 1999) is underpinned by the assumption that the risks posed to economic performance by current pressures (i.e. capacity constraints, infrastructural deficiencies, labour/skill shortages, congestion) are successfully overcome.

<sup>2</sup> The average increase does not reflect significant divergences on a sectoral, regional and skill-level basis.

- Ireland's exceptional economic performance is closely tied to the longest ever expansion in the **US economy**. This reflects the contribution of large inflows of high-technology **US foreign direct investment (FDI)** into a small number of target sectors in the Irish economy.<sup>3</sup> There are now, however, serious question marks over the **sustainability** of the current prolonged phase of US economic expansion.
- A sharp and sustained fall in **sterling** would lead to a significant deterioration in Ireland's cost competitiveness vis-à-vis the UK, particularly given the current higher level of labour costs in Ireland. In EMU there is no scope for an accommodating adjustment of the exchange rate at a national level.
- A broad range of competitiveness issues, such as **skill and labour shortages, wage inflation, inadequate transport, telecommunications infrastructure and housing** supply are interacting to erode our competitiveness and the attractiveness of Ireland for internationally mobile investment.
- Urgent action is required to meet Ireland's obligations under the **Kyoto Protocol**<sup>4</sup> to limit growth in emissions of greenhouse gases to +13 per cent of their level in 1990 by 2010.<sup>5</sup>

The competitive forces unleashed by these factors are intensifying competition in trade and for internationally mobile investment. Low-productivity, employment-intensive, low margin traditional sectors of Irish manufacturing industry are very vulnerable.

## 2.6 Competitiveness: the basis for further economic and social advancement

The Council believes that the priority actions outlined in the following sections of this statement would help maintain and enhance the competitiveness of Ireland's economy. Failure to make swift progress in respect of the agenda outlined in this document will increase the likelihood of a 'hard landing' for the economy, wherein progress achieved to date unravels and we move further away from achieving the ambitious goals set out in the NESC strategy statement and the Forfás Enterprise 2010 report.<sup>6</sup>

<sup>3</sup> In particular, chemicals, computers and electrical engineering. According to Central Bank research, up to 40 per cent of Ireland's growth over the 1990s can be attributed to this source.

<sup>4</sup> The Kyoto agreement limits the amount of greenhouse gas emissions that a country can produce in the period 2008-2012 compared to the base level of 1990.

<sup>5</sup> The OECD estimate on the basis of present growth rates that emissions are set to rise at more than double the permitted ceiling.

<sup>6</sup> National Economic and Social Council, 1999, *Opportunities, Challenges and Capacities for Choice*. Forfás, 2000, *Enterprise 2010 – A New Strategy for the Promotion of Enterprise in Ireland in the 21st Century*.



### 3.1 Social Partnership is the cornerstone of Ireland's economic transformation

Social partnership has proved a successful working model, providing a framework and an effective process for developing a shared understanding of the forces and the trade-offs driving economic and social progress. The Council therefore welcomes the new social partnership agreement.

The *Programme for Prosperity and Fairness* (PPF) will:

- protect and consolidate the substantial progress achieved so far, and
- help achieve a new platform of success by securing a balance between competitiveness, further significant gains in real take-home incomes, deepening of social cohesion in Irish society, enhancement of the economy's economic and social infrastructure and protection of the environment.

### 3.2 A new form of social partnership

The new agreement provides scope for a new form of social partnership consistent with the imperative of a more flexible, dynamic and competitive economy and the core social objectives of social partnership. The long-term viability of the social partnership model is dependent on its capacity to evolve in line with the transformation of the economy over the last decade into one that is buoyant and approaching full employment.

### 3.3 New shared goals required for economic and social development

New shared goals for social partnership have been adopted to replace those superseded by such developments as the improvement in the public finances, Ireland's EMU membership and the eradication of high unemployment and involuntary emigration. This new set of shared goals encompasses many of the issues identified by the Council last September as integral to the sustainability of economic and social development.<sup>7</sup>

### 3.4 Partnership must be deepened at enterprise level

The durability of the new partnership agreement and social partnership in general will depend on success in deepening social partnership at enterprise level. This is a major focus of the new agreement in order to ensure that it delivers dynamic, flexible and adaptable enterprises that have the capacity to accommodate to Ireland's EMU membership, varying competitive pressures and structural change at sectoral and enterprise level in the economy. As acknowledged in the PPF, partnership arrangements at enterprise level can be instrumental in addressing critical competitiveness issues including flexibility and innovation, systems of work organisation, skills and lifelong learning and family-friendly working arrangements. This remains a major challenge for the social partnership model, as it requires, in many cases, the adoption of a more participatory approach to the conduct of industrial relations and the management of firms.

#### *Recommendation 1: Social Cohesion*

*Deepen social partnership through sectoral and enterprise-level agreements addressing sectoral and enterprise-level issues (e.g. skill shortages, education, training and lifelong learning, and family-friendly working arrangements, including childcare).*

<sup>7</sup> See the Council's report on Social Partnership (September, 1999).

### 3.5 Wage developments must be related to future economic prospects

Current economic conditions provide good scope for some increase in wage costs to achieve a better balance between supply and demand in the labour market. But if this process overshoots, there is a risk of sharp and sustained deterioration in Ireland's competitiveness. In the Council's view, the pay terms of the new agreement strike the right balance between these requirements and meet the test of ensuring an appropriate degree of wage cost competitiveness in the economy.

Innovative and creative responses to employee remuneration should continue be encouraged for both private and public sector employees. This should include forms of performance related financial incentives. A Consultative Committee has been established under the agreement to prepare proposals in this area for Budget 2001.

In the case of the public sector, the proposed Benchmarking Body<sup>8</sup> must lead to the emergence of a modern and flexible model of pay determination in the public service, closely integrated with the performance management systems replacing the complex (and potentially damaging) relativities approach that has resulted in unsustainable growth in the public service pay bill.

#### *Recommendation 2: Incomes Policy and Tax Policy*

*Secure continued strong growth in real take home pay through the linked programme of moderate increases in gross pay - in line with continuing productivity and performance improvements and also through more extensive use of profit-sharing and gain-sharing mechanisms - and agreement on a programme of continued reductions in tax burden consistent with social equity and a balanced and prudent approach to taxation policy.*

### 3.6 Strike appropriate balance between economic, social and environmental aspects of sustainable development

It is also essential that the operation of the new agreement helps accommodate the diverse strands of the complex interaction of environmental policy with competitiveness policy. This process should incorporate a much stronger focus in the future on the concept of eco-efficiency, which can make a major contribution to decoupling economic growth from environmental damage. Urgent and immediate action is required in relation to climate change. This is essential in order to ensure the consistency of the investment plans of both enterprises and the public sector with the prospective shift in the environmental regime in the economy over the next decade.

#### *Recommendation 3: Climate Change*

*While the Council welcomes the proposals set out in the Green Paper on Sustainable Energy to strengthen the framework for energy efficiency, the deployment of renewable energy sources and the allocation of £146 million in the NDP for such measures, there needs to be accelerated planning and actions taken for the achievement of the Kyoto restrictions on greenhouse gas emissions.*

<sup>8</sup> For further details of both the Consultative Committee and the Benchmarking Body See Annex I to Framework I of the *Programme for Prosperity and Fairness*.

#### 4.1 Skill and labour shortages are a critical competitiveness vulnerability

Human capital, embodied in people, is the vital strategic resource in the increasingly knowledge-based modern economy. Pervasive skill and labour shortages are increasing the risk of overheating and a much sharper than expected economic slowdown.<sup>9</sup>

#### 4.2 Address profound weaknesses in further education and training structures

The lifelong-learning agenda must become a focal point for in-company training and human resources management. In this regard, the Council welcomes the establishment of the Task Force on Lifelong Learning under the *Programme for Prosperity and Fairness*. The skill and educational qualification level of low- to medium-level skilled employees in the labour force must be upgraded by addressing profound weaknesses in further education and training structures in the economy and, in some cases, the low priority afforded to skills and human capital development by employers - a key competitive weakness for the Irish economy.

#### 4.3 Track record in providing in-company training is poor

The track record of the enterprise sector in the provision of in-company training and human resource development has been poor by international standards<sup>10</sup>. Investment in employee training renews the enterprise's knowledge base, raises productivity, facilitates innovation and boosts long-term competitiveness. In the absence of a significant improvement in this area it will be impossible to realise the primary objective of industrial development policy<sup>11</sup>: higher-productivity, higher value-added production.

It is essential that substantial new investment planned in this area under the NDP addresses the market failure in the delivery of skills enhancement. The NDP resources should not become a substitute for the responsibilities of employers at enterprise level. Neither should they be appropriated by extended 'make work' schemes with limited training components. The activities/design of agencies/mechanisms should be reviewed to ensure the continued relevance and effectiveness of ongoing programmes.

#### *Recommendation 4: In-Company Training*

*The Expert Group on Future Skill Needs, working with the social partners, should formulate specific recommendations to boost the extent and quality of company training and review the IBEC/ICTU training networks for any insights into best practice or indeed obstacles to progress.*

#### 4.4 Measures to expand labour supply essential to contain wage inflation

Labour shortages across all sectors of the economy are now a serious constraint on the sustainability of growth. The vacancy rate is now likely to be in excess of 6 per cent or 53,700<sup>12</sup> jobs and a majority of firms are now experiencing serious difficulties in recruiting and retaining workers. This is impacting directly on competitiveness by constraining production and increasing wage pressures. Measures to expand labour supply in the economy are essential to forestall excessive wage inflation and to maintain Ireland's attractiveness for mobile foreign direct investment. In this regard, the Council welcomes the recommendations in the *Second Report of the Expert Group on Future Skills Needs*.

<sup>9</sup> Serious labour and skill shortages affecting the construction industry are of particular concern, given the central role of the industry in securing the realisation of the ambitious investment plans set out in the NDP. The *Second Report of the Expert Group on Future Skills Needs* (Forfás, 2000) makes specific recommendations for this sector.

<sup>10</sup> The new National Training Fund announced in *Budget 2000* has a crucial role to play in boosting Ireland's standing internationally in relation to the skills/education level of its workforce.

<sup>11</sup> This strategy is detailed in the recent Forfás publication *Enterprise 2010*.

<sup>12</sup> This based on a total work force of 869,300 in the private non-agriculture sector of the economy.

#### 4.5 Accommodate ongoing transformation of the workforce

Rising levels of educational attainment over the past three decades have been closely associated with increased labour force participation by women<sup>13</sup>. The continuation of this trend is expected to sustain further increases in female labour force participation over the next decade. From a competitiveness perspective, the challenge is to accommodate this ongoing transformation of the workforce and society while respecting the broad diversity of household choices that arise in relation to the employment decision and properly recognising the value for society of work undertaken in the home.

#### 4.6 Employment choices should not be distorted by the tax system

The primary economic consideration affecting the employment decision by women with dependent children is take home pay net of childcare expenses. This in turn is determined by the level of the potential earnings, the cost of appropriate and suitable childcare, and the tax treatment of the household. Continued reductions in the overall burden of taxation and the progressive erosion of disincentives to labour market participation embodied in the tax and social welfare systems (and their interaction) will improve the incentive for taking up paid employment.<sup>14</sup>

#### 4.7 Support adequate provision of childcare facilities

The largest single contribution that the Government can make to support the employment choices of female workers is through continued support for adequate provision of childcare facilities at reasonable cost. Younger women with children are discouraged from seeking or remaining in employment owing to the high cost and inadequate provision of childcare facilities. Further action is essential to ensure greater availability of childcare facilities, increased access to pre-school education and the implementation of more family-friendly policies by firms, building on the commitments made in these areas in the *Programme for Prosperity and Fairness*.

#### *Recommendation 5: Female Participation in the Labour Market*

*Ensure equal access to employment for women with children by designing a plan – sensitive to the existing diversity of childcare arrangements and household preferences – for ensuring, over the period of the next NDP, the availability of comprehensive and affordable childcare provision (including before- and after-school care), proper access to pre-school education and generalised adoption of family-friendly policies by firms.*

#### 4.8 Policy on immigration

International experience suggests that immigration can play a significant role in sustaining strong economic growth through contributing to the availability of sufficient qualified and skilled personnel. The Council welcomes the recent Government decision establishing a new work visa scheme for people outside the European Economic Area seeking to take up employment in Ireland. The Council also welcomes the associated measures to increase the resources available to the existing work permit system to ensure greater responsiveness to demand. Of course, given the rapidly changing environment, the adequacy of these policies should be monitored on an ongoing basis and broader solutions sought.

<sup>13</sup> Economic and Social Research Institute (1999), *Medium-Term Review 1999-2006*.

<sup>14</sup> The decision of the Minister for Finance to ask the social partners to consider the future development of the 'individualisation' decision included in Budget 2000 highlights the need for a continued focus on the ongoing contribution of a much wider programme of tax reform in this area.

**Recommendation 6: Immigration Policy**

*Design a comprehensive and proactive immigration policy – consistent with medium-term economic and social sustainability - drawing on international experience to help address pervasive skill and labour shortages.*

**4.9 Education and training system is confronted with unprecedented challenges**

The education and training system is confronted with unprecedented challenges. While much work has already been undertaken in revising and up-dating curricula, there is an urgent need to continue to re-assess on an on-going basis traditional approaches to education in Irish society. A much greater emphasis is required on promoting capabilities in 'life skills' complementary to academic capabilities (e.g. creative thinking, communication, team-working, flexibility, initiative). A new departure in education must be constructed, supporting the acquisition of the skills and aptitudes essential in the coming years and successfully translating the slogan of lifelong learning into the mainstream of the education system.

**4.10 More positive role required of third-level sector**

Universities and other third-level institutions have a critical role to play in facilitating the up-skilling of the labour force and in promoting the lifelong learning agenda. With current demographic trends leading to a significant reduction in the numbers entering third-level from school,<sup>15</sup> more flexible modes of learning, undertaken in much closer collaboration with employers, will increasingly comprise an important element of mainstream third-level education and skills upgrading. The third level institutions themselves should, with the support of the Department of Education and Science and the social partners, take a lead role in preparing a strategy that will deliver on this objective. The Council welcomes the steps which have been taken to date in improving structures for collaboration/consultation between third level institutions and industry.

**Recommendation 7: Lifelong Learning**

*Energetically encourage the third level sector to re-order its priorities in line with demographic developments, deploying greater resources towards significantly improving the provision of adult education and training programmes in a flexible and user-friendly fashion (e.g. including part-time and distance education), in particular in IT, scientific and technological subjects.*

<sup>15</sup> Numbers at second-level are projected to fall by 12 per cent by the end of the next decade.

### 5.1 Costs are integral to competitiveness

In the intensely competitive, global economic environment for trade and mobile FDI, it is misleading and potentially dangerous to believe that economic performance can be divorced from the economy's cost structure (with labour costs the single largest element<sup>16</sup>). The realisation of self-sustaining growth in the Irish economy since the mid-1990s, with very strong growth in domestic demand and in consumption and investment, should not obscure the pivotal importance of:

- maintaining a strong export performance by continuing to build the competitive strength of the high-growth, high-tech leading sectors of the economy; and
- ensuring a sustainable rate of expansion in the domestic economy given the extent and scale of supply constraints and bottlenecks.

### 5.2 Maintenance of low inflation central to competitiveness

The maintenance of low inflation has been central to Ireland's competitiveness. There are now serious grounds for concern that continued strong economic growth in excess of the economy's potential<sup>17</sup> is threatening the control of inflation. While social partnership has been central to Ireland's growth, wage settlements above the terms of the last national agreement, particularly in the public sector, have serious consequences for wage inflation in Ireland.

The marked deterioration in Ireland's inflation performance is clearcut:

- Consumer price inflation<sup>18</sup> is running at 5 per cent on an annual basis – more than double that of the euro area as a whole – and eroding the real value of the pay increase agreed in the *Programme for Prosperity and Fairness*. However, it should be noted that the recent increases in tax on tobacco in Budget 2000 account for almost 17 per cent of the annual rise in inflation.
- Inflation in the services sector is running above 6 per cent driven by the pressure of demand and labour shortages.
- Wage inflation is accelerating across all sectors of the economy<sup>19</sup> reflecting the very tight state of the labour market.
- While mortgage interest rates are around 3 percentage points lower than in Autumn 1998, house price inflation is continuing at double-digit rates (between 15 and 20 per cent in 1999). House prices have doubled since 1994, and analysts are now forecasting further increases of up to 20 per cent in 2000.
- Manufacturing output prices are rising by 5.2 per cent annually, the fastest rate of increase since the devaluation of the Irish pound in early 1993.

While some further short-term deterioration in Ireland's inflation may be anticipated, recent analysis suggests a moderation of the rate to under 4 per cent by the end of this year and an average closer to 3 per cent for next year. However, inflationary threats remain.

- International oil prices recently hit a ten-year high: annual energy price inflation now stands at 15.3 per cent. Severe oil price increases, if sustained over the medium-term, could have a negative impact on Ireland's competitiveness.

<sup>16</sup> Accounting for in excess of 25 per cent of total input costs.

<sup>17</sup> Ireland's trend or potential growth rate is estimated at about 5 per cent in GNP terms.

<sup>18</sup> On an EU-comparable Harmonised Index of Consumer Prices (HICP) basis, March 2000.

<sup>19</sup> Average manufacturing hourly earnings increased by 5.4 per cent in the year to June last – the increase in the second quarter alone was 2.1 per cent. Average weekly earnings in distribution and services rose by 5 per cent on an annual average basis and by 1.5 per cent alone during the preceding three months over the same period. Earnings in the construction sector are continuing to increase at very high rates.

- Private sector credit growth is increasing at an extremely high annual rate (33 per cent). As private sector indebtedness reaches very high levels (currently 124 per cent of estimated GNP for 1999), vulnerability to unexpected increases in interest rates also rises.
- Real (inflation adjusted) interest rates set for the euro zone as a whole are now clearly inappropriately low for the booming Irish economy.
- The strongly expansionary stance of fiscal policy (tax and public expenditure) is fuelling domestic demand (consumption and investment).
- Inflation in Ireland, as a small highly open economy, is strongly influenced by the level of the exchange rate and international inflationary developments. The weakness of the euro against sterling and the dollar is likely to put sharp upward pressure on consumer prices in the course of the year, exacerbated by internal overheating and the expected inflationary impetus resulting from the strong performance of the global economy.
- Although the Irish economy is highly open<sup>20</sup>, the existence of wholesale, distribution and retail margins implies that there is a significant domestically determined (non-traded) element to retail prices, even if the goods are imported.
- Planned increases in the National Minimum Wage under the new social partnership agreement will add to inflationary pressures in the labour market unless 'knock-on' effects are contained.

There is a risk that the unforeseen acceleration in inflation will spark demands for compensating pay increases in excess of those agreed under the new partnership agreement. This could culminate in a damaging wage-price spiral in the economy, lost competitiveness, reduced employment growth and large job losses. Strict adherence to the pay terms of the PPF, together with fostering greater competition in the economy, is key to price stabilisation and essential to the reduction of future inflation rates to a more sustainable medium-term level.

#### *Recommendation 8: Inflation and Budgetary Policy*

*Given that there is no scope for national monetary and exchange rate policy within EMU, and given the Government's commitments on taxation under the new social partnership agreement, the overall stance of fiscal policy (taxation and public expenditure) should support the control of inflation. This requires firm control of growth in public expenditure, prudent conduct of tax policy and strict adherence to the provisions of the Stability and Growth Pact.*

### 5.3 Improve the return to work for employees in line with productivity

The new partnership agreement recognises that with the economy at full employment there is good scope for improving the return to work (take-home pay) subject to the overriding imperative of protecting international competitiveness and employment. This will help combat skill and labour shortages and support the essential structural shift towards higher value-added production, which the natural functioning of the labour market is already delivering. It is critical, however, that pay evolves strictly in line with what is warranted by productivity.

<sup>20</sup> The value of imported consumption goods was 60 per cent of total personal consumption expenditure in 1998.

#### 5.4 Ireland's tax base narrow by international standards

As highlighted in the *Annual Competitiveness Report*, Ireland's tax base is relatively narrow by international standards. As the tax share declines to among the lowest in the OECD, attention should be focused on the distribution of taxes in the economy, including:

- the low share of capital/property taxes;
- the desirability of wider application of user charges promoting greater efficiency in the use of scarce environmental resources (e.g. water and landfill); and
- the case for social costs, levied at present through the PRSI system, to be more evenly spread across the tax base in the economy (this will also help support the competitiveness of low margin/profit, labour intensive, low value-added traditional sectors which are increasingly vulnerable to foreign competition).

#### *Recommendation 9: Tax Policy*

*Adopt medium-term targets for a more equitable/sustainable/economically efficient distribution of taxes, in particular as between labour/payroll and capital/property/local taxes and assess the impact on competitiveness of the introduction of environmental taxes.*

#### 5.5 Competitiveness of the overall cost base critical

The competitiveness of the overall cost base in the economy is a fundamental requirement for bolstering the competitive strength of the enterprise sector in trade and foreign investment. Tough international competition permits very limited scope for locally controlled manufacturing enterprises to pass on higher costs. Three significant business costs are identified in the *Annual Competitiveness Report* where Ireland is lagging behind its competitors:

- energy costs for SMEs
- business finance
- insurance costs.

##### 5.5.1 Industrial electricity costs

Industrial electricity costs are higher in Ireland than in the UK for smaller and medium industrial users. UK firms can avail of lower gas prices than comparable plants in Ireland due to the highly competitive market structure and greater economies of scale. Only the largest 370 electricity users in the market will benefit in the short-run from the partial (30 per cent) opening up of the electricity market<sup>21</sup>. The recent announcement to accelerate market liberalisation is welcome. Full market liberalisation should not be delayed beyond 2005.

<sup>21</sup> As of February 2000, all customers have the right to purchase electricity generated from renewable, sustainable or alternative sources.



#### Recommendation 10: Energy Market Regulation

*During the transitional regime to full competition, market regulation should afford a high priority to improving the cost competitiveness of energy prices as compared to international competitors.*

##### 5.5.2 Interest rate spread

The interest rate margin (i.e. the difference between the retail deposit rate and the prime lending rate) charged by Irish banks to SMEs remains very high.<sup>22</sup> High mark-ups on lending by Irish financial institutions and the absence of long-term fixed rate borrowing put Ireland's SMEs at a competitive disadvantage relative to SMEs in other EU countries. Banking services to SMEs engaging in e-business from Ireland (especially first-time performers) are not yet available on a similar basis as in other countries. Recent developments in the mortgage market have highlighted the benefits of greater competition in the banking sector.

#### Recommendation 11: Review of the Banking Sector

*The review of the Irish banking system being undertaken by the Minister for Finance should have a particular focus on measures to improve the level of competition in the provision of finance to SMEs.*

##### 5.5.3 Liability insurance costs

Liability insurance costs are relatively high in Ireland and this presents a difficulty for the enterprise sector and, in particular, small business. The lack of progress, despite consensus among the social partners, in implementing the solutions to this problem identified in the 1996 Deloitte and Touche Report is of serious concern. The high legal-cost component of claim settlements emphasises the need for detailed analysis of the scope for reductions through improved efficiency of the present system or the introduction of a new institutional framework.

#### Recommendation 12: Insurance Costs

*A compensation board/arbitration system, separate from the courts, should be introduced, empowered to decide on compensation in cases where the parties agree to arbitration as an alternative to expensive and cumbersome court proceedings.*

<sup>22</sup> There is a significant premium (between four and seven percentage points) on lending rates to smaller businesses over wholesale rates.

### 6.1 Infrastructural deficit undermining growth potential

The state of the housing market and poor quality transportation infrastructure and public transport services are critical competitiveness issues. These features of Ireland's infrastructural deficit are interacting to undermine competitiveness and future growth potential.

- Poor quality public transport and the congested road network are reducing labour availability and impeding labour market flexibility.
- High house prices are undermining Ireland's attractiveness to continued inward migration, critical to meeting labour force needs.
- The consequent intensification of skill and labour shortages threatens Ireland's attractiveness to foreign direct investment, the motor of Ireland's economic transformation over recent years
- High house prices are also an obstacle to achieving the internal labour mobility required to alleviate skills and labour shortages in particular regions/sectors.
- Increased cost and lower productivity in transport and distribution adversely affects the competitiveness of the enterprise sector, particularly given Ireland's high trade dependency and consequent reliance on competitive transport costs.
- The *Medium Term Review 1999-2005* (ESRI, 1999) is categorical on the need for much improved transportation infrastructure and services, explicitly linking its benign central forecast to successful delivery of improved transport infrastructure.
- Public transport services are not providing an alternative to private car use. Public transport's share of passenger trips in the Dublin area has actually declined.

### 6.2 Proposals on Transport Infrastructure, the Planning Process and Public Transport

The Council's *Proposals on Transport Infrastructure, the Planning Process and Public Transport* published earlier this year set out the key dimensions of the transportation problem and made recommendations for urgent action.

#### *Recommendation 13: Public Transport*

*Promote improved quality of service through regulatory reform and the swift introduction of appropriate mechanisms for competition. Maximise passenger numbers through the design of incentive structures.*

There are no engineering solutions to traffic congestion in urban areas as private car usage is likely to be highly responsive to increased road capacity. More effective utilisation of existing infrastructure can be achieved through the adoption of **demand** management measures.

#### *Recommendation 14: Efficient Use of Infrastructure*

*Promote more efficient use of existing infrastructure capacity through such demand management measures as the introduction of road pricing in heavily congested urban areas, where and when adequate alternative public transport provision is in place.*

The provisions of the draft *Planning and Development Bill, 1999*, to significantly speed-up and provide certainty in the planning, approval and appeal processes for major infrastructural projects are integral to ensuring effective delivery on investment plans within the required timescale.

**Recommendation 15: Planning and Development Bill**

*The key planning provisions of the Planning and Development Bill, 1999, must be enacted, as planned, by summer 2000. The administrative resources required by An Bord Pleanála, relevant Government Departments, local authorities and the courts for the efficient and effective implementation of the provisions of the Bill in respect of major infrastructure projects should be swiftly put in place.*

**Spatial planning** can contribute to more effective use of scarce resources, curtailing the pressure of congestion and ‘overheating’ in urban areas and achieving higher living and environmental standards.

**Recommendation 16: National Spatial Strategy**

*The National Spatial Strategy should be designed strictly within the two-year timeframe set out by Government in the NDP and should fully address the need for the development of detailed transport plans and strategies. Additional resources as required should be provided for the preparation and monitoring/review of such strategies.*

The seriousness of the current transport situation, particularly in Dublin,<sup>23</sup> warrants radical and immediate action. While welcoming the review of the Dublin Transportation Initiative Strategy by the DTO, there is a compelling need for a clearly defined leader organisation with overall responsibility for securing essential improvements in transport and implementing the strategies, plans and measures to achieve this end.

**Recommendation 17: Dublin Transport**

*Consideration should urgently be given to the establishment of an executive overarching body directly responsible to Government for planning and effective implementation of transport improvements in Dublin and the direct co-ordination of the activities of other agencies involved in providing transport services. This organisation could be established as a new body or through empowerment of an existing body.*

<sup>23</sup> Dublin refers to the Dublin journey-to-work area as defined in the ERDO study in 1988 and used by the DTO.

### 6.3 Ambitious plans to address infrastructural deficit set out in NDP

The ultimate value of the NDP, which allocates resources to address the infrastructural deficit, will be dictated by the speed with which it is successfully implemented.<sup>24</sup> Clearly, any serious delays in the implementation of the ambitious plans outlined in the NDP will jeopardise the medium-term sustainability of Ireland's growth performance. Consequently, removal of barriers to implementation and completion of the proposed investment in the transport system must continue to be a key focus of policy.

#### *Recommendations 18-20: Delivery of NDP*

*Priority projects in national transportation infrastructure under the NDP should be identified and their completion established as primary objectives of the relevant Operational Programmes. Progress in implementation should be monitored continually and measured effectively.*

*The appointment of a small number of senior programme managers with powers and responsibility for delivery of priority infrastructure plans should be considered in the context of examination of institutional and administrative arrangements for the implementation of strategic projects in national transportation infrastructure.*

*International consortia should be encouraged to compete for large-scale projects in the national transportation infrastructure under the NDP by maintaining the scale of individual projects to help overcome domestic capacity constraints in construction and civil engineering.*

### 6.4 Housing market critical competitiveness issue

According to official figures, house prices are estimated to have doubled since 1994. The increase in the Dublin area was even greater. There is, as yet, no conclusive sign of a return to more normal rates of increase. Sustained high house price inflation has made private house purchase very difficult for many people on low-to-middle incomes, leading to burgeoning local authority housing lists. The knock-on effect on the private rented sector has led to large increases in rents. Competitiveness is being damaged: immigration and internal labour mobility are being discouraged at the very time that severe labour/skill shortages are putting upward pressure on wage costs in the economy which, in turn, are subject to upward pressure due to rising housing costs.<sup>25</sup>

### 6.5 Potential source of macroeconomic instability

Some commentators, (e.g. IMF, OECD) have expressed concern that low levels of real interest rates, very high money and credit growth and speculative expectations are fuelling house price increases, leading to the emergence of a so-called bubble. If this was deflated, for example through unexpected increases in eurozone interest rates,<sup>26</sup> the international spillover of a US recession or a reversion in housing margins towards their historic norm, it could exert a significant drag on Ireland's economic performance over the medium-term. While most analysts believe that the probability of this outcome is low, great care is still warranted to further diminish the risk, particularly given the likely magnitude of the costs of such a scenario.

<sup>24</sup> The ongoing work of the Cabinet Committee on Infrastructural Development will, as detailed in the recent Framework for Action on Infrastructural Development, play an important role in this regard.

<sup>25</sup> An increase of over 70 per cent (in the number of new houses coming on stream each year) since 1994 has not been sufficient to retard this extremely high rate of house price increase.

<sup>26</sup> The interest rate scenario investigated in the ESRI MTR is a rapid 2 percentage point rise in mortgage rates to 6 per cent. The impact on the housing market, in these circumstances, stems from the uncertainty regarding future prospects and the effect on expectations (the psychology of the market), rather than the absolute level of interest rates, which is still relatively low, even by recent standards.

## 6.6 Inadequate housing supply lies at the heart of the very sharp increases in house prices

There is a broad consensus that very strong growth in housing demand (fuelled by rapid employment, incomes growth, underlying demographic changes and benign monetary conditions) in circumstances of inadequate housing supply lies at the heart of the very sharp rise in house prices that has occurred since the mid-1990s. There is marked disagreement among analysts as to the fundamental factors underlying the 'initial sluggishness of [the] response'<sup>27</sup> of housing supply to very strong growth in housing demand. The less-than-perfect operation of the market for land has been identified by some as a major contributor to sustained double-digit growth in property prices. Land is not intrinsically a scarce resource in Dublin, where the problem is most pronounced but industry opinion suggests that it now accounts for up to 50 per cent of average house prices.<sup>28</sup>

### Recommendation 21: Affordable Housing Strategy

*The Housing Forum established under the new partnership agreement should consider the following set of issues as a matter of urgency and make recommendations to Government as appropriate:*

- *the measures necessary to alleviate severe planning bottlenecks and to ensure the full implementation of the key planning provisions of the Planning and Development Bill through provision of sufficient trained planning staff (and other resources as necessary) to both An Bord Pleanála and local authorities*
- *the role of local authorities in the provision of services for development land should be examined, including the scope for PPPs to speed up the supply of serviced land for residential developments*
- *the obstacles to achieving a decisive shift away from the prevalent low-density model of housing development should be assessed to ensure that full effect is given to the Planning Guidelines in this matter formally issued by the DOELG at end-September 1999*
- *the elimination of significant untaxed gains to landowners from action on behalf of the community to increase the supply of affordable housing (re-zoning, planning permission or provision of infrastructure)*
- *examination of the operation of the market for development land including the extent (if any) to which serviced land, available for residential development, is being withheld from the market (The third review of the housing market by Peter Bacon and Associates will examine this issue)*
- *the possible future role (if any) of public land banking (CPO'ing of land along major arterial routes) to ensure the availability of land at reasonable prices for housing consistent with spatial development policies under the National Spatial Strategy.*

<sup>27</sup> NES (1999) *Opportunities, Challenges and Capacities for Choice*.

<sup>28</sup> Supernormal profits are being earned in relation to building land. From 1990-1998 housing 'margins' (i.e. site cost, profit and interest charges, overheads etc.) rose by 186 per cent, while at the same time labour and material costs in housing rose by one quarter (with all of that increase occurring since 1996). Source: *Building Industry Bulletin*, April 1999.

### 7.1 e-Business revolution is driving a radical transformation

The e-Business revolution<sup>29</sup> is radically transforming all business activities. The most prosperous economies of the next century will be those that successfully manage their competence in the high-growth knowledge-intensive sectors and rapidly adopt e-business in all economic sectors. Superior telecommunications infrastructure and advanced services in tandem with low telecommunications costs are a prerequisite for success. However, Ireland remains in the third tier of leading and competitor countries. Therefore, significant improvement is required if Ireland is to become a hub for e-business:

- access to managed broadband services for all enterprises needs to be put in place within the next two years;
- cost-competitiveness in international leased lines, critical to the attraction of inward investment and the promotion of e-business, needs to improve further (the availability of Global Crossing from mid-2000 will contribute to this improvement);
- connection charges for basic and advanced telecommunications services (e.g. ISDN) remain high;
- the level of investment and use of ICTs in the enterprise sector remains low as is awareness of the threats and opportunities of e-business.

### 7.2 e-Business introduces new rules of the game

Ireland starts with many advantages, for example an English-speaking, well-educated work force. But real momentum is now crucial in establishing Ireland as a location for e-business. The attractiveness of the Irish economy for foreign investment will increasingly be driven by the dictates of e-business. The culture of e-business will be crucial in re-directing indigenous firms into higher value-added, more technologically advanced production of goods and services. Failure to properly prepare, or to adapt to the 'new rules of the game' engendered by e-business, will preclude full realisation in Ireland of the vast potential of the digital economy.

### 7.3 Key mobile e-business projects are in danger of being lost

As Ireland's competitors move ahead at a rapid rate, Ireland is in danger of losing pivotal add-on investments in the high-tech sector. Key mobile e-business projects, including some by major companies already located in Ireland, are in danger of being lost to other European locations that offer more competitive broadband services. If this trend becomes embedded, the demonstration effect in mobile foreign investment that has worked enormously to Ireland's advantage in FDI over the 1990s could go into reverse. Ireland can achieve a leadership position in the critical factors for success in the digital economy, but immediate action is required in the following areas to maximise success.

#### *Recommendation 22: Telecommunications Cost and Regulatory Environment*

*The Office of the Director of Telecommunications (ODTR) must ensure price competitiveness from operators, including that for local calls (among the highest in Europe), internet usage and calls to continental European destinations, through a proactive and pro-competitive approach. In this regard, maintaining low tariffs and interconnect rates (currently among the lowest in the EU) is critical. The ODTR must be empowered and appropriately resourced to fulfil this role.*

<sup>29</sup> The prospective large-scale migration of business to the platform provided by the Internet.

**Recommendation 23: Telecommunications Infrastructure**

*The highest priority must be given to the rapid and effective implementation of investment plans in the regional broadband network (£120m committed in the NDP) in order to deliver managed broadband services to all enterprises and to support regional development strategy.*

**7.4 Continue to strengthen Government's leadership role in e-government**

The Government must lead by example in the adoption and application of ICTs through the more rapid development of e-Government. While some progress has been made, Ireland is still falling behind world leaders in putting public services online. Putting all public services (including public procurement) online would provide enormous impetus for enterprise to reorient to e-business. The resources required to develop more rapidly online public services need to be made available in key Government Departments that interact with business.

**Recommendation 24: e-Government**

*The provision of a wholly electronic interface with the enterprise sector and the general public must become an overarching priority in the ICT plans and resource allocations of all Government Departments/State Agencies. Explicit targets are essential to assess progress. For example, all Government procurement should be online by mid-2001.*

**7.5 e-Commerce: The Policy Requirements**

The Forfás report to the Tánaiste *e-Commerce: The Policy Requirements* sets out for the enterprise sector the required operational and strategic responses to the implications of e-business (including those arising at a sectoral level). It also details the policy actions that are required in the business environment to facilitate the development of e-business. The main recommendations highlighted in the report, in respect of which action is required by Government, include, in particular, the following:

**Recommendation 25: Digital Content and Intellectual Property Management**

*Ensure that the legislative and regulatory framework for the protection of intellectual property provides a secure environment in which to create and distribute intellectual property and content.*

**Recommendation 26: Regulatory and Legislative Framework**

*The legal and regulatory framework to enable secure and certain electronic transaction needs to be quickly put in place. This includes the legislative proposals published in the Electronic Commerce Bill, 2000, the Copyright Bill, 1999, and an accreditation system for certification services.*

### 8.1 Greater competition and regulatory reform can enhance dynamism of the economy

The Council believes that greater competition and regulatory reform (i.e. changes in the laws and administrative regulations governing *all* economic activities) are a major potential source of competitive advantage for the Irish economy.

- Consumers should benefit from lower prices and improved quality of service.
- The removal of barriers to innovation and entrepreneurship should help bolster the economy's adaptability, flexibility and dynamism.
- The burden of red tape on business would be streamlined.

However, regulatory reform must be appraised in terms of its likely results in meeting specified economic and social goals and not something to be pursued for its own sake.

### 8.2 Regulatory regime must be certain, stable and predictable

A certain, stable and predictable regime for regulation in the economy creates a business environment supporting investment, wealth creation and productivity growth. The credibility of the regulatory structures is the second critical component of a successful regime. These goals demand the construction of transparent, open and accessible regulatory procedures, decision-making and enforcement framework. However, a correct balance must be secured between the trade-offs implicit in many of these objectives, consistent with the competitiveness needs of the economy.

### 8.3 Regulation must be pro-competitive

The Council is planning to publish a statement shortly on the key actions required to strengthen competition and improve the regulatory environment in the economy. The primary objective must be to equip the Irish economy with a regulatory system strongly oriented towards consumer rather than producer interests. A systematic programme to eliminate regulations unnecessarily restricting competition<sup>30</sup> should be urgently initiated. Longer-term economic performance is strongly influenced by the broad structure of economic incentives, which in turn is determined by the conduct of competition and regulatory policy.

The legislative framework for regulation policy should provide strong guidance on fundamental principles but remain flexible to changing circumstances (i.e. market and technological developments). It should establish clear rules and processes for the work of the competition authorities and that of sectoral regulators that limits the scope for potential conflict or duplication. Formal, transparent and open consultative and co-ordination mechanisms for accommodating areas of shared/overlapping interest/jurisdiction between competition and regulatory agencies are essential.

<sup>30</sup> i.e. not outweighed by larger social gains for society.



#### 8.4 Action programme on regulatory reform

The Government has published an *Action Programme on Regulatory Reform*, which has set out a number of important steps towards reducing the administrative burden on enterprise, and a number of other initiatives have also been taken, including the publication by the Minister for Public Enterprise of a discussion paper on governance and accountability in the regulatory process. Moreover, the OECD has been invited by the Government to conduct a review of the existing regulatory regime in Ireland and the requirements for reform. All these initiatives provide a useful basis for the development of a comprehensive framework for regulation and the encouragement of a competitive business environment.

##### *Recommendation 27: Regulatory Reform*

*A consistent and comprehensive legislative and policy framework for regulation in the economy should be developed based on an agreed set of principles and objectives.*

### 9.1 The Irish economy suffers from serious weaknesses in research and development (R&D) and innovation

The technologically advanced sectors of the economy have provided the driving force for vigorous economic performance over the 1990s. The Irish economy has thrived as a production base for foreign multinationals by attracting large inflows of investment in target high-growth, high technology industries. However, the fundamental drivers of the competitiveness of these sectors – the core knowledge assets in human capital, R&D and innovation, and global management expertise – reside abroad. Ireland must now seek entrenched competitive advantage by building-up its own capabilities in core knowledge assets.

### 9.2 Technology Foresight highlighted serious gaps in Ireland's technological capabilities

Both the international competitiveness benchmarking reported in the *Annual Competitiveness Report '99* and the results of the Technology Foresight<sup>31</sup> exercise brought to the fore serious gaps in Ireland's technological capabilities. The country trails behind world leaders in key dimensions of the knowledge economy (e.g. telecommunications, skills and R&D), lacking the scope for a wholesale leap into high-value added, more knowledge intensive activities in line with the industrial development strategy detailed recently in the Forfás report *Enterprise 2010*. Failure to address these weaknesses casts a shadow over the sustainability of many jobs in the leading sectors of the economy over the next decade.

### 9.3 Major expansion in RDTI planned under NDP

A focus on infrastructural deficiencies and capacity constraints inevitably overshadows required investment in the capabilities that are imperative of building in the 21<sup>st</sup> century. The importance, therefore, of strengthening the knowledge infrastructure of the economy cannot be overstated. A major expansion is planned under the NDP in the area of Research, Technological Development and Innovation (RTDI) with annual average expenditure over the Plan period amounting to a near trebling in real terms of estimated 1999 expenditure and cumulative total expenditure amount to almost £2bn, of which over £1.1bn is specifically allocated for fundamental research - £560m through the Technology Foresight Fund and £550m to be channelled through the Department of Education and Science for third level institutions.

### 9.4 Control, monitoring and delivery mechanisms critical

In order to maximise the return to the economy overall from this very substantial allocation of resources, serious attention should be devoted to the institutional mechanisms and processes for the distribution, monitoring, control and evaluation of these funds. The Irish Council for Science Technology and Innovation (ICSTI) has set down a number of criteria to govern the allocation of R&D funds. These have been endorsed by the ESRI. The Council welcomes this framework which should help to ensure the effective use of scarce investment resources.

#### *Recommendation 28: Delivery of RTDI spending in NDP*

*Ensure that the structures and mechanisms established for the delivery of the substantial investment planned in RDTI under the NDP work effectively to resolve the serious weaknesses in existing programmes.*

<sup>31</sup> Technology Foresight undertaken in 1998/99 by the Irish Council for Science, Technology and Innovation (ICSTI) brought together scientists, engineers, industrialists, Government officials and others to identify areas of strategic research and the emerging technologies likely to yield the greatest economic and social benefits.

### 9.5 Ireland's ranking in BERD poor

While Ireland's international ranking in business R&D expenditure (BERD) is improving, there is still a large gap to the best performing countries (such as Finland and Sweden) despite very strong growth in profitability over recent years. The composition of R&D expenditure is also a particular cause for concern. The bulk of BERD is carried out by a small number of largely foreign-owned firms. At present, efforts at leveraging increased BERD is pursued through grant assistance. However, the rationale and efficacy has recently been questioned on the basis that if the research has sufficient potential it does not need state support. It is increasingly recognised that grants alone will not be sufficient to encourage private sector investment in R&D. Both indigenous and foreign-owned firms will choose to perform R&D in Ireland only if the environment is right in terms of access to researchers and centres of excellence and a tax system that encourages innovation.

### 9.6 Appropriate balance must be struck between public and support of private spending

An appropriate balance should be struck between basic R&D expenditure and equally valuable developmental or commercial R&D expenditure. A major programme of publicly funded investment in basic/fundamental R&D will not yield a good return unless it underpins a major expansion in commercial/applied R&D and innovation. However, this will depend on a much broader range of factors, only some of which can be influenced by government policy. Public investment in R&D must generate an adequate market interaction. The litmus test for the investment is the extent to which it raises the technological capability of the private sector.

#### *Recommendation 29: Investment in RDTI under the NDP*

*The following broad principles should inform the design of the major programme of state funded investment in RDTI under the NDP:*

- *build on existing strengths in research/technological capabilities*
- *carefully scrutinise the prospective return on major new departures/ambitious strategies in basic/fundamental research*
- *focus investment on collaborative activities*
  - *strengthening the links and supporting strong interaction between industry and the 3rd level institutions*
  - *increasing the 'embeddedness' of the existing R&D base*
  - *strengthening mechanisms supporting technology transfer*

### 9.7 Entrepreneurial capacity of research community

It is also vital that the entrepreneurial capacity of the research community is strengthened so that the commercial exploitation of new RTDI output in Ireland, engendered by the investment under the NDP, is carried out in Ireland and not lost abroad. A vibrant venture capital market is a prerequisite to this objective. At present, there are clear weaknesses in the provision of venture capital at the seed capital and early start-up stages.

#### *Recommendation 30: Financing of Technologically Advanced Firms*

*Strengthen entrepreneurial capacity in exploitation of RTDI output in particular by addressing weaknesses in the provision of seed and early-stage venture capital to high-technology firms.*

## Institutional Capacity: Speed of Implementation and Effective Co-ordination

### 10.1 Rapid and flexible adaptation to changing circumstances paramount

In the rapidly changing, technologically advanced, globalised economic environment in which Ireland competes for trade and foreign direct investment, rapid and flexible adaptation to changing circumstances is paramount. Swift and effective implementation by public agencies of required changes and measures gives a clear competitive advantage.

### 10.2 Demanding competitiveness agenda for co-ordinated action

Ireland is confronted with a demanding agenda across a broad range of interlocking competitiveness priorities. Structured, co-operative co-ordinated strategies are required to address the complex of competitiveness weaknesses. The danger of a piecemeal approach, driven by distinct agencies and/or focused on individual issues, is that spillovers such as planning bottlenecks and poor co-ordination could worsen the overall situation. The existence of these spillovers has important implications for the design and implementation of policy responses.

### 10.3 Time lag between diagnosis, recommendation, decision and implementation major obstacle to competitiveness

For the vast majority of these issues the solutions are already largely known. But it is taking too long to get action, indicating a clear need for dynamic leadership and political will to drive change. For example, the NCC's recent publication *Proposals on Transport Infrastructure, the Planning Process and Public Transport* highlights the pervasiveness of this problem in securing essential transport improvements. In coming to grips with these problems the main difficulty is in planning, managing effective implementation and co-ordination, especially where the issues straddle a range of public bodies. In the Council's opinion, unless they are fully addressed, the weaknesses in institutional capacity will make it impossible to deliver the objectives detailed in the National Development Plan and the new partnership agreement.

### 10.4 Institutional capacity is a core competitiveness issue

Ireland's institutional capacity is therefore a core issue in the continued strengthening of competitiveness. The legislative/regulatory/administrative regime must be able to respond quickly, effectively and flexibly to ever-changing market and policy developments. Failure to act swiftly is a competitive disadvantage no matter how good the quality of inputs. Acceleration in the modernisation of the public service through the Strategic Management Initiative (SMI)<sup>32</sup> as detailed in the *Programme for Prosperity and Fairness* is therefore critical to sustaining competitiveness.

There is a clear danger, as is the case in undertaking change management in any large organisation that the process becomes an end in itself. This can be avoided if the next phase of reform translates quickly into tangible and quantifiable improvements in the delivery of public services. The adoption of detailed objectives clearly measuring performance relative to explicit targets must be an integral component of change. Notwithstanding Freedom of Information there are major gaps in the quantity and quality of information available to the public on the delivery of public services. This obscures the real progress that is being made in reform and does not contribute to the incentive for public service managers to prioritise improvements in public service quality and delivery.

<sup>32</sup> The Strategic Management Initiative launched in 1994 is an ambitious and wide-ranging process of reform to improve the management of the public service. It includes such important initiatives as the Delivering Better Government Programme (1996) and the Public Service Management Act (1997) that creates the legal basis for new management and accountability structures in the civil service.

**Recommendation 31: Information on Quality and Delivery of Public Services**

*Upgrading the quality of information available to clients on the results/value-added of public service providers should be a priority for the implementation of performance management systems in the public service. The information should relate to tangible and quantifiable performance measures highly relevant to consumers of the services concerned. A specific Government website could be designated to disseminate the information. The performance indicators should be taken into account in the development of performance management systems in the public service.*

### 10.5 Sustainable growth and development rooted in entrenched competitiveness strengths

Long-term sustainable economic and social progress must have deep roots in embedded competitiveness strengths including:

- knowledge and human capital;
- technological and innovative capabilities;
- enterprise and entrepreneurial culture;
- quality social and economic infrastructure; and
- pro-competitive regulatory regime.

As detailed in the Council's *Annual Competitiveness Report*, Ireland lags behind world leaders for many of these elements of enduring competitiveness success.

### 10.6 Despite progress to date, Ireland remains at catch-up stage of development

It is vital to guard against a false sense of security regarding the permanence of the current economic success. In wealth terms, despite the massive income growth over the 1990s, Ireland remains at a 'catch-up' phase of economic development, when benchmarked against leading advanced economies. This is evident using either a narrow, financial, or broad definition of wealth including economic and social infrastructure, knowledge and human capital. A decade of economic and progress provides the foundations for further advances, but is no guarantee of continued success in the future.

### 10.7 Maintenance and intensification of competitiveness must remain a competitiveness priority

The projected 'soft landing' or slowdown in Ireland's economic growth to around 5.5 per cent over the next three years represents an appreciable slowdown from what has been achieved during the 1990s. Normal cyclical factors would give rise to even lower growth in some years. The risk of a much sharper slowdown in the economy is increasing as evidence of overheating grows.

The competitiveness policies discussed in this report must move centre stage if we are to avoid this risk. The focus of policy must switch to enhancing the efficiency with which scarce economic resources are used. In the context of accelerating changes in the world economy, the maintenance and intensification of Ireland's international competitiveness must remain a policy priority. Competitiveness policy must go beyond remedying existing weaknesses to building long-lived competitiveness strengths.



## List of Publications

Annual Competitiveness Report 1998 & The Competitiveness Challenge Summary Statement	March 1998
Statement on Telecommunications: A Key Factor in Electronic Commerce and Competitiveness	November 1998
Statement on Skills	December 1998
Annual Competitiveness Report, 1999	May 1999
Report on Costs	June 1999
Statement on Social Partnership	September 1999
Proposals on Transport Infrastructure, the Planning Process and Public Transport	March 2000
The Competitiveness Challenge	May 2000
Annual Competitiveness Report, 2000	May 2000

