National Competitiveness Council Bulletin

NCC Competitiveness Bulletin 17-2: Benchmarking Competiveness: Ireland and the UK, 2017

National Competitiveness Council

COMPETITIVENESS KEY TO MEETING THE ECONOMIC CHALLENGES OF BREXIT

- **Ireland's economic prosperity is inextricably linked to how competitive we are internationally.**
- **In the run-up to and post Brexit it should be expected that the UK will intensify its investment in infrastructure, enhance and develop its tax and non-tax offerings for enterprise, develop its skills and innovation base and broaden its trade and FDI footprint in new markets.**
- **The challenges posed by Brexit provide urgent impetus to pursue policies that enhance national competitiveness.**
- **The Council considers there is a need to preserve fiscal sustainability, increase investment in infrastructure and talent, maintain cost competiveness, and drive innovation and productivity across all economic sectors. This would enhance the competitiveness of our indigenous enterprise base and our attractiveness as a location for mobile investment relative to the UK.**

Introduction

Ireland's economic prosperity is inextricably linked to how competitive we are internationally. Competitiveness performance reflects the interaction of a wide range of factors that combined determine firms ability to compete successfully in international markets. The purpose of the Council's latest report ***Benchmarking Competiveness: Ireland and the UK, 2017*** is to provide a statistical snapshot assessment of Ireland's current competitiveness performance across areas which are crucial to improving our international competitiveness position. Ireland's performance is considered with specific reference to the UK, to establish areas where policy attention could enhance Iish competitiveness.

Context

While the economy is in its strongest place since the onset of the recession, we are at a critical juncture. The imminent structural shift in the UK's trading relations with EU partners has far reaching implications for Ireland across a range of policy areas– including trade, investment, the labour market, and energy, as well as many sector specific competitiveness impacts – particularly Agri-food, Traditional Manufacturing, Tourism and sectors vulnerable to cross border and e-commerce.

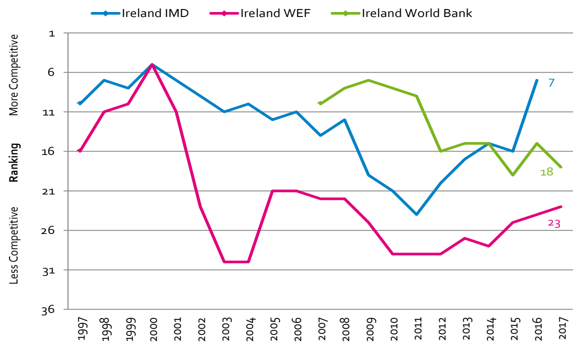
While the UK is and will remain a key trading partner for Ireland it is also a country we compete with for mobile investment and export market share. In the run-up to and post Brexit, we should expect the UK to intensify investment in infrastructure, enhance and develop its tax and non-tax offering for enterprise, develop its skills and innovation base and expand its trade footprint. Moreover, we can expect other countries continue to enhance their competitiveness position. The Council considers it is important that Ireland's strengths and weaknesses relative to the UK are examined. The Report examines Ireland's competitiveness performance across a range of areas.

How Ireland performs

Competitiveness Performance

The World Bank's Ease of Doing Business report ranks Ireland 18th and the UK 7th out of 190 economies. The WEF Global Competitiveness Report ranks Ireland 23rd and the UK 7th most competitive out of 138 countries. The IMD measure of competitiveness ranks Ireland 7th and the UK 18th out of 61 countries. Ireland's strong macroeconomic performance generally improves our competitiveness ranking and may be overstating our underlying position. Brexit is likely to affect UK competitiveness through increases in the cost of trade, declining growth and investment, loss of market size and reduced ability to attract and retain talent.

Figure 1: Ireland's Competitiveness Performance



Source: IMD, WEF, World Bank

Macroeconomic Performance

Economic growth is strong and is reflected in a buoyant labour market, increased tax returns and improvements in the public finances. The short term outlook is positive but with considerable downside risks, particularly Brexit, and uncertain prospects in Ireland's major trading partners. The National Accounts highlight the potential volatility of some rapidly growing sources of recent Exchequer revenues, such as corporation tax receipts. It would be dangerous to rely on potentially transitory revenue sources, to fund permanent levels of public spending.

Competitiveness and Exchange Rates

In recent years, the weak Euro exchange rate, low interest rates, and low international fuel prices have driven improvements in Irish Harmonised Competitiveness Index . These favourable tailwinds are fading. Through currency effects, Brexit has seen immediate cost implications for exporters. The permanency of the exchange rate shift is a significant competiveness consideration, particularly, in Agri-food, Traditional Manufacturing, Tourism and sectors of the economy sensitive to cross-border trade and online trade.

Trade

A number of employment intensive sectors dominated by indigenous SMEs are highly reliant on trade with the UK. These include Agri-Food, Tourism and Traditional Manufacturing. The UK is a key market for FDI exports, particularly chemicals, ICT and Financial Services. For much of our exports, the UK provides the landbridge to international markets. The implications of extra administrative costs and tariffs, standards, regulations and customs requirements could negatively impact on exporters' capacity to compete internationally.

Enterprise and Entrepreneurship

Supporting enterprise and entrepreneurship is an essential component of increased competiveness. Ireland has a relatively supportive environment for starting a business. Ireland has improved its ranking in terms of Ease of Starting a Business to 10th with the UK in 16th place. The proportion of self-employed in Ireland is above the level in the UK. Continuing to improve the conditions for entrepreneurship and supporting enterprise scale and diversify sustainably and strategically is vital for competiveness.

Inward Investment

In Ireland and the UK Software & IT Services, Business Services, Financial Services and Communications account for the majority of inward investment projects and job creation. The competitiveness and consistency of our tax offerings, our legal, regulatory and administrative environment, cost base, the availability of talent, technology and property solutions are crucial to attracting and retaining inward investment post Brexit.

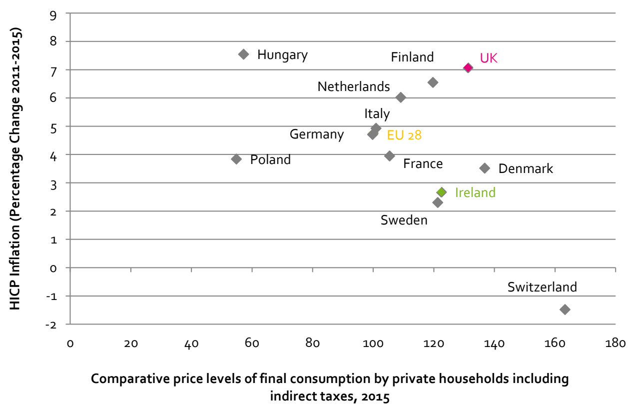
Labour Market

Changes in the flow of labour between Ireland and the UK and changed intra EU migratory flows could have significant labour market impacts for Ireland. Tightening labour market conditions in the UK and Ireland have the potential to lead to skills shortages and wage inflation which would undermine competitiveness. There is considerable overlap with the UK in terms of skills shortages in ICT, Science and Engineering, Financial Services, Health, Craft and Technical occupations. Ireland must ensure it remains competitive in attracting and retaining talent.

Prices and Business Costs

Ireland's current price profile could be described as 'high cost, rising slowly', the UK is "high cost, rising quickly". Price levels in Ireland were 22.5 per cent more than the EU average in 2015; the UK was 31.3 per cent above the EU average. The services sector is likely to remain the main source of upward price pressure in Ireland, with the price pass through exchange rates and expected increases in energy prices. Ireland needs to maintain relative cost competiveness in labour, property and utilities.

Figure 2: HICP Price levels and inflation, 2011-2015



Source: CSO/Eurostat

Productivity

Relative to the UK, Ireland's productivity performance is strong in terms of growth and levels of GDP per hour worked. However, Ireland's overall productivity performance measured relative to GDP is overstated. The narrow base of sectors (ICT and Manufacturing account for the majority of productivity growth) leaves Ireland vulnerable to shocks. Increasing productivity across all sectors of the Irish economy remains a significant challenge.

Tax

Ireland's corporation tax rate remains competitive at 12.5 per cent. Ireland's marginal income tax and Capital Gains Tax rates are high relative to the UK. It is vital that Ireland's tax offering remains stable, transparent and competitive for firms seeking an EU base for operations. Maintaining the competitiveness of our R&D tax credit and Knowledge Development Box are also critical to attract FDI and support Irish enterprises to invest, innovate and compete internationally.

Access to Finance

In Ireland, loan rejection rates and the number of SMEs with bad debts continue to decline. Irish SMEs are still heavily reliant on bank loans with limited uptake of non-bank finance sources. In an international context, demand for credit in Ireland is low, and while falling, SME interest rates are relatively high and above those charged to UK SMEs.

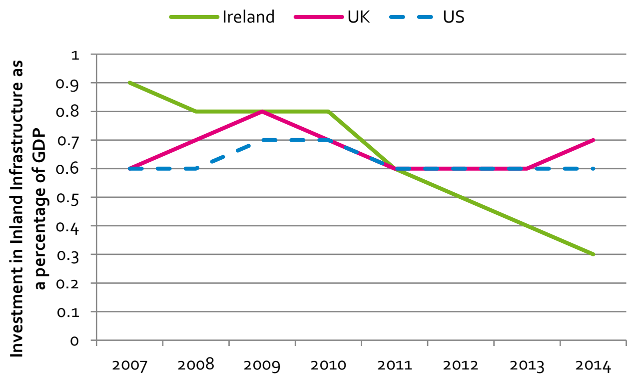
Talent

The attainment profile of those exiting the formal Irish education and training system has been improving steadily. At tertiary level Ireland has a higher attainment rate than the UK. The level of resourcing per student for education is lower than the UK, particularly, at tertiary levels. Ireland has scope to improve participation levels in apprenticeship programmes and lifelong learning. Demographic change means increased investment in the sector is necessary.

Infrastructure

Although absolute levels of Irish investment in infrastructure are recovering, over the medium term, capital investment as a percentage of GDP is likely to remain low relative to pre-crisis levels. Perceptions regarding the quality of Irish infrastructure are low relative to the UK. Developing our infrastructure base, while complying with the EU's fiscal rules, is a fundamental challenge to enhancing competitiveness relative to the UK and others.

Figure 3: Inland Infrastructure Investment 2007-2014



Source: OECD

Innovation

Levels of public investment in R&D in Ireland remain below the UK. The gap in Government expenditure is most pronounced with the UK spending almost two-and-a-half times the Irish rate of expenditure as a proportion of GDP. Enhancing Ireland's innovation performance is essential if we are to increase productivity, diversify and broaden the enterprise and export base, and attract mobile investment.

Energy

The energy implications for Ireland of Brexit could be significant given our dependence on energy imports from the UK. As a small economy, with limited resources, factors outside of our control exert a significant influence on energy prices. While maintaining the trade in secure supplies of energy with the UK must remain a priority, Brexit means diversifying energy sources and supply is critical.

Policies to enhance competitiveness

The challenges posed by Brexit provide urgent impetus to pursue policies that enhance competitiveness. The Council restates 5 key areas for Government action:

1. In regard to the **public finances**, it is important to ensure our fiscal position remains sustainable. While we must compete in terms of our international tax competitiveness we should avoid any narrowing of the tax base and we must ensure the tax system supports and rewards employment, enterprise, investment and innovation.
2. Ireland's **capital investment** level is deficient relative to our competitors. Our medium-term competitiveness is being affected by the restrictions on state spending on capital investment. This will have a negative impact on our competitiveness in the future and damage our potential to secure the benefits of Brexit.
3. A more **diverse export base** can reduce exposure to external demand shocks. Irish-based exporters, particularly in exposed sectors such as Traditional manufacturing and Agri-food, must continue to be supported to scale and diversify sustainably and strategically. There is a need to evolve into new products, markets and sectors, whilst maintaining competitive advantage in existing ones.
4. **Skilled labour** is the key to retaining and winning mobile investment and growing a cohort of internationally-trading indigenous companies. Failure to tackle the under-resourcing of higher education is placing Ireland at a considerable disadvantage internationally and will have a significant medium-term impact on competitiveness.
5. **Innovation and productivity** are critical to enterprise and export competitiveness. Irish enterprise must be at the global frontier of technology and productivity. Investment in productivity enhancing measures such as talent development and innovation must be supported. Facilitating start-ups (particularly those with the potential to scale and internationalise) and supporting high-potential growth companies with scaling opportunities is vital. This must be supported by an administrative and regulatory framework that facilitates enterprise.

Further Reading: The data and policy positions summarised herein are drawn largely from Competitiveness **Benchmarking: Ireland & the UK, 2017.**
See www.competitiveness.ie. The NCC reports to the Taoiseach on key competitiveness issues facing the Irish economy. This Bulletin has been issued by the Chair and Secretariat.