National Competitiveness Council

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Any erosion of competitivesness will make Ireland more vulnerable to Brexit

National Competitiveness Council publishes Costs of Doing Business in Ireland 2018 report

The National Competitiveness Council (NCC) today launched its Costs of Doing Business in Ireland 2018 report. This report benchmarks the main business costs across over 100 indicators and focuses on areas where Irish enterprise costs are out of line in those in key competitor countries. The report concentrates on labour, property, energy, communications, credit and business services costs, and considers both price levels, and changes in those levels (i.e. price inflation).

As a small open economy, our cost competitiveness is a major factor in ensuring that Ireland's overall competitiveness performance is strong in an international context, that the growth of the economy is sustainable and that Ireland remains an attractive location in which to do business. The Report finds that our cost base for enterprise continues to be internationally competitive across a range of metrics, including labour cost growth, electricity costs, the cost of starting a business, communications costs and average income taxes. However, Ireland remains a relatively high cost location and growth has resulted in a series of upward cost pressures. Increases in property, business services and labour costs and consumer prices have the potential to undermine recent competitiveness gains

Despite improvements in Ireland's cost competitiveness in recent years, the openness of the economy means that the enterprise sector is particularly vulnerable to negative price and cost shocks which are outside the influence of domestic policymakers. Several downside risks have already emerged that could undermine national competitiveness, growth and living standards. These include unfavourable exchange rate movements, higher international energy prices and imported inflation from our major trading partners. Brexit also highlights the importance of maintaining and improving our cost competitiveness.

Speaking at the launch of the report, Prof Peter Clinch, Chairman of the NCC commented: "Although the outlook for the economy appears positive, Ireland remains an expensive location in which to do business with a price profile described as 'high cost and rising'. Pressures have emerged in key areas. Capacity constraints are again immediate drivers of upward cost pressure. The globally connected nature of Ireland's trade, technological and financial links mean Ireland remains vulnerable to external shocks. Brexit underlines the importance of keeping costs down to mitigate the effects of continuing uncertainty and unfavourable exchange rate movements. This is a key element to facilitating firms to stay competitive in international trade. Increasing business costs reduce the competitiveness of enterprises based in Ireland and our attractiveness as a location for mobile investment, therefore it is imperative that Government continues to place competitiveness at the heart of our Brexit response and prioritises policies and actions that are within Ireland's control to enhance cost competitiveness. As the pressure on costs increases, it is critical that domestic policies do not contribute to overheating."

He continued, "Improving the quality and affordability of life is particularly important for increasing labour market participation rates and ensuring Ireland is an attractive location for talent and investment. In this regard, well planned infrastructure, including sustainable housing, high quality public transport and adequate water infrastructure provides people with the opportunity to live near their work and enjoy a good quality of life, reduces traffic congestion and increases productivity. The return to economic growth and Ireland's high dependence on car usage has demonstrated the inadequacy of the transport infrastructure capacity which manifests itself in increased journey times, traffic congestion and increased emissions. These are emerging pinch points for business which not only affect existing firms, but also impact the State's attractiveness as an investment location and as a location providing wellbeing of its citizens".

High rents affect decisions around labour mobility, entering employment and expansion of operations by enterprises, therefore, they are a significant infrastructure impediment, particularly in urban areas. Prices in Ireland remain relatively high and rents push the cost of living out of line with other developed European economies. Despite an increase in construction activity, strong demand means property price inflation is likely to continue, therefore a significant increase in supply is urgently required.

Prof Clinch added: "A well-functioning property market enhances the competitive performance of our cities and towns, improves quality of life and attracts overseas talent. The availability of competitively priced property solutions is also a key requirement for enterprise. While commercial prices in Ireland fare favourably to comparable cities in the UK and Europe, business faces strong rental growth, particularly in office accommodation. Increasingly, the shortfall and affordability of residential housing affects Ireland's ability to attract and retain talent which, in turn, has an impact on enterprise costs. The delivery of a suite of competitively priced world-class infrastructure, particularly in transport, broadband, energy and water and related housing is critical to support competitiveness".

The Council is also concerned that, while inflation is subdued, this is largely due to currency effects and it is likely to increase in 2018 and beyond. Ireland remains an expensive location in which to do business with a price profile described as "high cost and rising". Largely driven by services inflation, Irish consumer prices in 2017 were over twenty percent cent above the EU average. Persistently high rates of consumer price inflation lead to expectations of further price increases, and can create a vicious circle of increasing prices, reducing real incomes, increasing wage demands and reduced international cost competitiveness.

In terms of labour costs, growth has remained modest in recent years and below the growth experienced in both the UK and the EU. However, this masks considerable divergence at sectoral level, and most likely at firm level. As the labour market tightens further, upward pressures on labour costs can be expected in several sectors as skills shortages have emerged and these, in turn, have some knock-on implications for wage demands. Retaining employees, particularly in SMEs, poses difficulties. Certain skills needs are becoming more pronounced as indicated by increased job vacancy rates in professional, scientific and technical services, financial, insurance and real estate service and ICT. Skill shortages have the potential to create wage inflation and could impact on enterprise competitiveness. Measures to encourage labour force participation levels remain important for alleviating labour cost pressure and increasing the availability of talent.

The cost of credit continues to remain relatively high, particularly for SMEs. The concentrated lending market coupled with higher credit risk premiums are among the factors impacting on the cost of credit in Ireland. The impact of an interest rate shock on borrowing costs and the wider economy could be significant, therefore it is important that debt levels continue to be reduced. Increasing competition in the lending market and further diversifying enterprise funding models remain key medium term challenges.

The Council notes that a range of hidden costs, including costs associated with planning and payment delays, labour law compliance, transaction costs, cost to export and insurance costs, particularly in relation to cost attributable to employer, remain a cost pressure point for business.

Prof Clinch concluded: "It is important that price developments in areas affecting business competitiveness, economic prosperity and quality of life are kept under review and well targeted State measures to address deficiencies in infrastructure provision and market failures are put in place. Measures that ensure price transparency and reforms that enable markets to work more efficiently are the key policy mechanism to realise improvements in cost competitiveness. I cannot emphasise enough that addressing the treatable causes of erosion in cost competitiveness must continue to be an urgent economic priority for both enterprise and Government. Any erosion of competitiveness will make Ireland more vulnerable to external shocks such as Brexit".

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Key Findings

Labour Costs

Overall, despite robust growth in employment, labour cost growth has remained modest in recent years and below the growth experienced in both the UK and the EU. The labour cost index shows that that Irish labour costs have been increasing since 2014 but at a rate less than UK and Euro area labour costs.

- Considerable divergence exists in sectoral labour costs across the EU. Within the business economy (excluding agriculture and public administration), labour costs per hour in Ireland were highest in industry €32.9 compared to €33.4 in the euro area. Labour costs in Irish services were €28.9 compared to €29.3 and €25.2 in the Euro area and UK respectively. Costs per hour were €27.3 in Construction (Euro area €26.7 and UK €25.4).
- Between 2016 and 2017, hourly labour costs in the total economy expressed in € currency rose by 1.9 per cent both in Ireland and the euro area. The hourly labour costs expressed in own currency increased by 2.6 per cent in the UK.

Taxes

- The levels of taxation in Ireland are below the Euro area on average income levels and on marginal income levels for married couples. The corresponding marginal levels are, however, high for single earners earning the average wage and above (The Irish marginal tax rate for employees earning 100% or 167% of average earnings in 2016 was 54.4%, above the OECD average (47%) and UK (49%) respectively).
- Ireland is currently very reliant on taxes on income as a source of revenue and significantly less revenue is generated through social security contributions. Expressed as a percentage of total labour costs, Irish employers' social contributions and other labour costs paid by the employer represented 13.8 per cent, significantly lower than the 25.8 per cent in the Euro area and below the UK figure of 16.5 per cent in 2016.
- Capital Gains Tax (CGT) rates are not easy to compare across countries given differences in tax design and integration with other taxes. At 33 per cent, Ireland's CGT rate is particularly high relative to the UK's 28 per cent.

Earnings

- The average hourly earnings increased by 3.5 per cent between Q1 2013 and Q1 2018 while irregular earnings increased by 14 per cent.
- From a sectoral perspective, the highest increases occurred in the Real Estate (25.8%), Construction (9.7%) and Administrative sectors (8.9%). The highest hourly earnings (€35.22 per hour) were recorded in Education; the lowest earnings were in the accommodation &food sector (€12.76 per hour).
- In absolute terms Ireland has the second highest national minimum wage in the EU at €1,563.25 per month, while the UK has the seventh highest (€1,396.90). The strength of the Irish minimum wage is reduced somewhat when expressed in purchasing power standards,though it remains relatively high (Ireland ranks 6th). As a percentage of the average wage the minimum wage in Ireland is 42 per cent compared to 44 per cent in the UK.
- As the labour market is approaching full capacity job vacancy levels are increasing and certain skills needs are becoming more pronounced. Job vacancy rates have increased with vacancy rates in Q1 2018 highest in professional, scientific and technical services, financial, insurance and real estate service and ICT.

Property Costs

- The last number of years has witnessed a sustained recovery in the Irish commercial property market. There is sustained growth in commercial capital and rental values. Overall capital value growth was recorded at 5.2 per cent in Q4 2017 – this comprised of annual increases of 8.4 per cent, 1.3 per cent and 3.2 per cent in Office, Retail and Industrial values respectively. However, while the capital value index has increased, it remains 38 per cent below 2007 peak value.

- The take-up of office space remained strong in 2017, reflecting the growth of existing businesses. Office rental prices in Ireland in 2017 compare relatively favourably to cities in the UK. However, prices are increasing at a faster rate, due to increased demand.
- In Q4 2017 prime high street retail rents had increased on an annual basis across Ireland. The most expensive location was Dublin (€3,794, +4% year on year). Costs in Galway (1,349, +9%), Cork (€1,265, 0%) and Limerick (€562, +5%) compare relatively favourably to the UK.

Transport Costs

- While the price of oil has been relatively subdued in the period 2014 – 2016, prices were 25% higher in 2017 than in 2016 averaging $53/barrel for the year.
- Irish petrol and diesel prices increased by 6.3 per cent and 7.8 per cent respectively in 2017 compared to 2016. The costs of 1,000 litres of diesel (€1,299) and petrol (€1,399) In Ireland are higher than the Euro area average (€1,247 and €1,358 respectively), ranking Ireland 7th and 6th most expensive in the Euro area. Taxes on diesel range from 49% to 63% across the countries benchmarked (Ireland - 57%) and for petrol from 54% to 67% (Ireland - 62%).
- Nearly 200,000 commuters, representing almost 11 per cent of all commuters, spent an hour or more commuting to work in 2016, with an average travel time of 74 minutes. Nearly 53,000 workers commuted 90 minutes or more. On average, journey times in busy periods take 43%, 34% and 27% more time in Dublin, Cork and Limerick respectively.

Utility Costs

- Ireland remains heavily dependent on imported energy products which represent 82 per cent of the gross inland consumption in Ireland. The high dependence on imported fossil fuels makes Ireland's energy prices vulnerable to substantial oil price fluctuations. Weighted average electricity prices (in purchasing power standard) for non-household consumers in Ireland have declined over 2015-2017 and in the first half of 2017 they were marginally lower than the Euro area. Gas prices also fare favourable compared to the Euro area. However, given Ireland's dependence on energy imports from the UK, Brexit could potentially have a significant impact on Ireland's energy market. The proportion of non-recoverable taxes and levies in the overall electricity and gas prices is lower in Ireland compared to the Euro area.
- Ireland is relatively cost competitive for telecoms, especially for business mobile broadband. However, it is 10% (Q3 2017) more expensive in cost for fixed and mobile broadband than the UK. Concerns persist around the issues of quality (speed) and the regional availability of high speed services.

Credit and Financial Costs

- The concentrated lending market coupled with higher credit risk premiums in Ireland are important factors in determining the cost of credit in Ireland. The Irish SME lending market is highly concentrated with the three main lenders accounting for approximately 80 per cent of market share.
- The supply and demand for credit has improved significantly since the height of the crisis. However, the cost of credit, while falling continues to remain relatively high. The divergence between Irish and Euro area interest rates for enterprise is particularly noticeable for loans of up to €0.25 million, where the interest rate on new business loans in Ireland was more than double the Euro area average rate in 2017. Interest rates on outstanding amounts were significantly higher in Ireland compared to the Euro area, and the interest rate gap between the two jurisdictions is widening.

Business Services and Other Input Costs

- Services prices in Ireland have risen continuously since the beginning of 2012 and the magnitude of the increase has been higher than the Euro area average during this period also. In the year to Q3 2017 business services prices increased by approximately 4%. The biggest increases in prices in 2017 were recorded in Postal and Courier (8.9%) and Computer services (5.8%).

- Over the five years to 2017 Ireland has maintained its competitive position in terms of the cost to register a business as a percentage of gross national income. In 2017 Ireland ranks first in the Euro area and joint-second in the EU. Regarding legal costs, enforcing a commercial contract in Ireland is estimated to cost more and take relatively more time than the OECD average. Ireland is ranked 98 out of 190 countries and rates poorly relative to the UK (31st). The total cost of contract enforcement in Ireland amounts to 26.9 per cent of a claim, compared with 21.5 per cent in OECD high income countries. It also takes longer to enforce a contract in Ireland (650 days) than in the OECD (551).
- Motor insurance has moderated in recent months, however, in the period 2014-2016, prices as measured by the CPI increased by approximately 40 per cent.

Broader Cost Environment

- Ireland remains an expensive location in which to live and do business with a price profile which can be described as "high cost and rising". Irish consumer prices in 2017 were 23.7% above the European Union average and increasing at an annual rate of 0.2%.
- The annual average rate of inflation in 2017 was 0.4%. The price of goods decreased on average by 2.1%. The price of services (which includes mortgage interest) rose by 2.1%. In the last 18 months, the rate of consumer inflation has been increasing at a faster rate in the Euro area and the UK than in Ireland.
- There has been a downward trend in HICP and administered price inflation over the period 2011-2016. In 2016, mainly administered prices in Ireland decreased by 1.9%, a rate lower than the UK and Euro area rates.

Residential Property

- Despite an increase in construction activity and planning permissions, residential property supply remains constrained. Continued strong demand means property price inflation is likely to continue in the short term without additional supply becoming available. On a year-on-year basis, rents for houses increased by 8.2 per cent in 2017 Q3. This represents acceleration from 6.3 per cent in the previous quarter. Apartment rents increased by 11.5 per cent on a year-on-year basis. House price growth in Ireland remains high. Year-on-year house price growth reached 12.8 per cent in September 2017, up from 8 per cent a year earlier.
- In terms of residential sales, overall, the national index is 23.7 per cent lower than its highest level in 2007. Dublin residential property prices are 24.7 per cent lower than their February 2007 peak, while residential property prices in the Rest of Ireland are 29.6 per cent lower than their May 2007 peak.

Childcare Costs

- Insufficient access to affordable, full-time childcare in Ireland is a factor in deterring female labour market participation. In terms of childcare-related costs and benefits (as a percentage of average wage), for couples, earning 167 per cent of the average wage, Ireland is the second most expensive location in the OECD. For lone parents (67% of the average wage) Ireland is the most expensive OECD location.

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The full report is available at **www.competitiveness.ie**

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