National Competitiveness and Productivity Council Bulletin 20-1

- **The National Competitiveness and Productivity Council's new name and revised Terms of Reference reflect the Council's expanded mandate as Ireland's National Productivity Board.**
- **The CSO's *Productivity in Ireland 2018* report provides further valuable analysis of productivity developments in the Irish economy.**
- **More research and analysis is needed to better inform the design of policies to enhance productivity in all sectors of the Irish economy, especially in SMEs, as the economy recovers.**

THE NATIONAL COMPETITIVENESS AND PRODUCTIVITY COUNCIL

On 17 November, the Irish Government agreed that the *National Competitiveness Council* (NCC) should be renamed the *National Competitiveness and Productivity Council* (NCPC). The new name and revised terms of reference are intended to reflect the Council's expanded mandate as Ireland's *National Productivity Board*.

This extended mandate follows on from the European Council's recommendation, in September 2016, that each euro area country should establish a National Productivity Board (NPB). The Irish Government mandated the NCC to take on this role in 2018, becoming responsible for analysing developments and policies in the field of competitiveness and productivity in Ireland.

NPBs across EU countries are independent institutions responsible for providing their governments with recommendations on how to achieve more sustainable economic growth and improved societal wellbeing. The Boards are required to be objective and neutral, and to publish findings and recommendations, based on high quality economic and statistical analysis of national and international evidence. The independent expertise of NPBs and their annual reports are intended for use by governments and by the European Commission in the context of the annual policy monitoring process known as the European Semester.

Following the unprecedented disruption caused by the COVID-19 pandemic, the European Semester will be temporarily adapted to coordinate its processes with the Recovery and Resilience Facility – which will make €672.5 billion in loans and grants available to support reforms and investments by Member States. The aim of the EU recovery plan is to mitigate the economic and social impact of the COVID-19 pandemic and make European economies and societies more sustainable, resilient and better prepared for the challenges and opportunities of the green and digital transitions.

ROLE OF THE NCPC

The NCPC will contribute to public policy debate in Ireland, as done previously by the NCC, by providing independent, evidence-based policy research, and by advising the Government on key competitiveness issues facing the Irish economy. Its recommendations will identify the policy actions required to enhance Ireland's competitive position, and particularly in relation to improving productivity. This will also see the NCPC actively supporting the further development of productivity research in Ireland.

The NCPC will report to the Taoiseach and the Government, through the Minister for Enterprise, Trade and Employment. It will produce an annual report for Government on the key competitiveness and productivity challenges facing the Irish economy and will suggest specific policy actions to address these challenges. The Government will respond to the recommendations made and the NCPC will periodically review the progress being made in implementing the recommended actions[1].

The focus of the NCPC will be primarily on medium to long-term challenges, paying particular attention to actions that will support the competitiveness of Irish enterprises, to the benefit of business, employees and society. For over two decades, the Council has identified key weaknesses in the Irish economy that reduce the competitiveness of business. Factors identified that undermine enterprise productivity include underinvestment in key public infrastructure, research and development, and some skills, such as management.

[1] On 25 November, the NCPC received an official Government response to the recommendations contained in *Ireland's Competitiveness Challenge 2020*. See www.competitiveness.ie for further details.

Other weaknesses include market and institutional failures, that result in high costs of borrowing, insurance and legal services, and additional cost burdens due to failures to reform planning and administrative systems. A focus on competitiveness and productivity is necessary to achieve the Council's ultimate goal of ensuring that future economic growth is balanced and sustainable, leading to improvements in living standards for all.

NCPC Members are appointed by the Minister for Enterprise, Trade and Employment and include representatives from the employer and trade union social partnership pillars, agencies with a remit to support competitiveness and productivity, and academia. Senior officials from eleven Government Departments provide advisory support to the Council and the Secretariat.

WHY IS PRODUCTIVITY IMPORTANT?

Across all advanced economies, there has been a growing focus on productivity in the past decade. Ultimately productivity is the engine of economic growth in the longer term, and as such is key to improvements in living standards, associated with growing and sustainable wage levels, good public services and improved wellbeing.

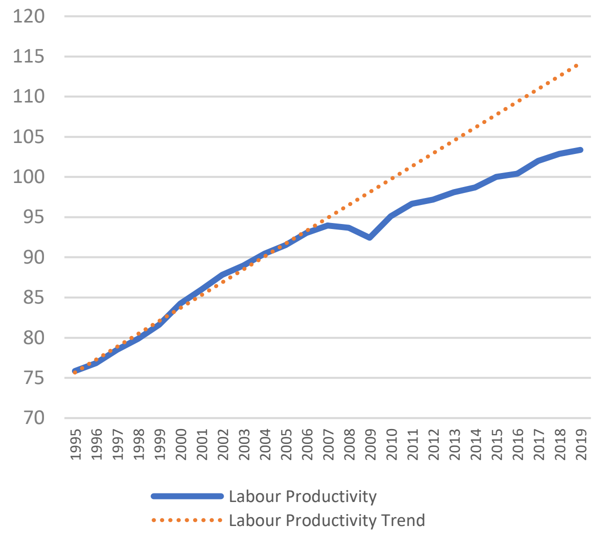
Two measures of productivity are commonly used: Labour Productivity, which is measured as output per person engaged or output per hour worked, and Total Factor Productivity, which measures the efficiency by which both labour and capital are used together in the production process. Measures of Total Factor Productivity, in contrast with measures of labour productivity, control for the capital intensity of firms or capital deepening in the economy (i.e. capital per worker). Since the contributions from labour and capital are subject to demographic constraints and diminishing returns respectively, long-term economic growth is driven fundamentally by Total Factor Productivity, which can also be seen as an approximate measure of innovation or technical change.

THE PRODUCTIVITY PUZZLE

In recent decades, advanced economies appear to be experiencing a trend decline in productivity growth. The global productivity slowdown started in the 1990s but accelerated following the global financial crisis. In the euro area, labour productivity declined in 2008 and 2009 and has failed to recover to its trend rate of growth over the past decade (Figure 1).

This 'productivity puzzle', so-called as this slow growth comes despite rapid technological advancement globally over this period, is a major factor behind the global low growth environment. To the extent that labour productivity growth remains sluggish, it will act as a drag on real wage growth (and hence in living standards) in the years to come.

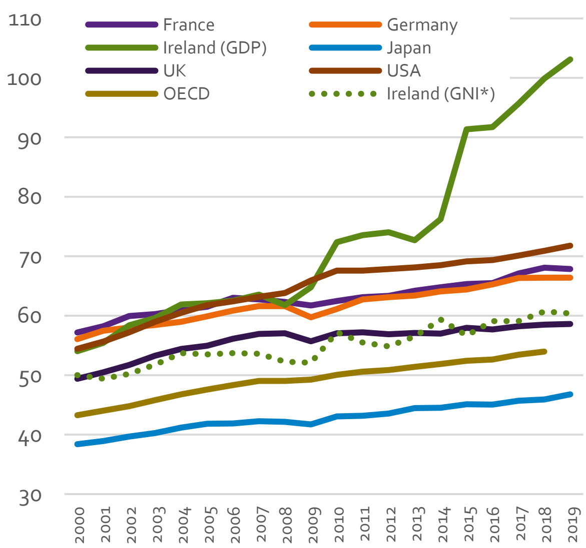
Figure 1: Euro Area Labour Productivity, GDP Per Hour Worked (USD 2010 PPP)



Source: OECD and NCPC Calculations

Despite the global slowdown over the past decade, aggregate labour productivity figures for Ireland continue to show a strong performance relative to other advanced economies. This finding prevails (although to a lesser extent) even when globalisation activities are excluded from the calculations; this is done by using the CSO's adjusted Gross national Income (GNI*) rather than Gross Domestic Product (GDP) to measure economic activity.

Figure 2: Labour Productivity, GDP and GNI* Per Hour Worked (USD 2010 PPP)



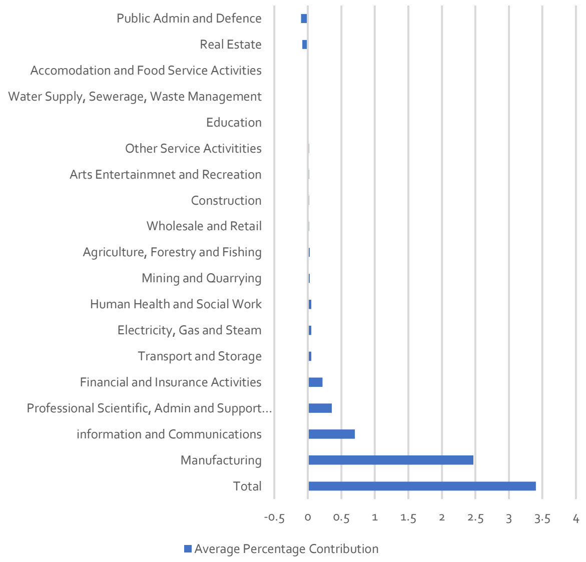
Source: OECD, CSO and NCPC Calculations

According to the latest OECD[2] and CSO data available, Ireland's GDP per hour worked in 2019 is significantly above the OECD average and some of the world's most advances economies (Figure 2). On a GNI* basis, Irish labour productivity remains above the OECD average and above the UK, but below the USA, France and Germany.

PRODUCTIVITY TRENDS IN IRELAND

On 28 July 2020, the CSO published its latest productivity report: '*Productivity in Ireland 2018*'[3]. This is the CSO's third productivity report, and it provides a valuable analysis of productivity developments in the Irish economy. The report presents a wide variety of productivity statistics, ranging from basic labour productivity to productivity measures based on experimental but comprehensive KLEMS (Capital, Labour, Energy, Materials and Services) and QALI (Quality Adjusted Labour Input) related output. The new report also includes an analysis of the labour share in various individual sectors of the Irish economy.

Figure 3. Sectoral Contribution to Labour Productivity Growth: 2000-2018 (average percentage contribution)



Source: CSO

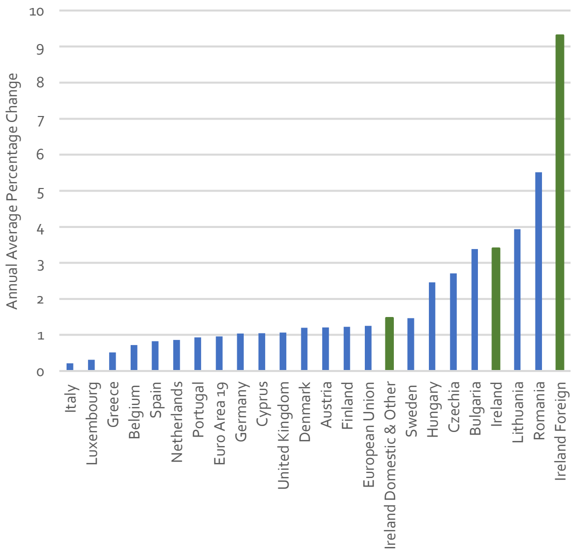
The CSO report also confirms that Ireland's strong performance can, to a significant extent, be attributed to the operations of large enterprises in specific sectors[4]. This finding was also highlighted in previous NCC publications[5]. The latest CSO data show that the manufacturing sector made by far the largest contribution to overall labour productivity growth over the period 2000-2018. This was followed by Information and Communication; Professional, scientific, administration and support services; and Financial and insurance activities (Figure 3).

A key feature of the Irish economy is its internationalisation. This is reflected in the ownership of production. The CSO data on labour productivity are presented for two ownership sectors: the 'Foreign MNE-dominated' sector and the 'Domestic and Other' sector[6]. The labour productivity growth rate of the Foreign MNE-dominated sector was on average 9.3 per cent per year between 2000 and 2018, significantly above the European Union average of 1.3 per cent per year. However, the labour productivity growth rate of 1.5 per cent per year during the same period for the Domestic and Other sector was just above the EU average (Figure 4).

The Foreign or Domestic and Other sectoral classification used by the CSO entails some simplifications in terms of the actual divide between foreign-owned and domestic-owned entities operating in the Irish economy[7]. Nevertheless, the CSO's approach delivers a mechanism whereby the productivity performance of these two ownership groups can be compared. When the CSO undertook detailed micro analysis in the compilation of the Institutional Sector Accounts[8], a key finding was that, for a number of critical economic indicators, the performance of these foreign-dominated sectors was highly correlated to the performance of all foreign-owned entities operating in Ireland. This finding supports the use of the foreign dominated groupings as proxies for all foreign owned activity in the economy.

[2] OECD (2020), GDP per hour worked. doi: 10.1787/1439e590-en
[3] CSO (2020), Productivity in Ireland 2018
[4] Papa et al (2018) Patterns of Firm Level Productivity in Ireland
[5] NCC (2019), Productivity Statement 2019
[6] Foreign-owned Multinational Enterprise (MNE) dominated NACE sectors occur where MNE turnover on average exceeds 85% of the sector total. These sectors are Chemicals and chemical products (NACE 20), Software and Communications sectors (NACE 58-63) and Reproduction of recorded media, Basic pharmaceutical products and pharmaceutical preparations, Computer, electronic and optical products, Electrical equipment, Medical and dental instruments and supplies. The domestic and other category includes all sectors excluding those listed as part of the Foreign-owned Multinational Enterprise (MNE) dominated sectors. These include the Wholesale and Retail sector including the sale and repair of motor vehicles; Administrative and support service activities; Construction; Accommodation and food services; and the Manufacture of Food, beverages and tobacco.
[7] Foreign-owned Multinational Enterprise dominated NACE sectors occur where MNE turnover on average exceeds 85% of the sector total.
[8] CSO (2020): Institutional Sector Accounts April 2020.

Figure 4: Labour productivity annual growth rate, 2000-2018, foreign and domestic sectors



Source: CSO

However, it should be noted that the productivity performance of the Domestic and Other sector is also likely to be influenced by a number of traditionally domestic industries (e.g. Food & Beverages) which over time have shown an increasing share of foreign value added or turnover, according to the CSO Structural Business Statistics[9]. Since these foreign-owned enterprises have relatively higher productivity than the Irish-owned enterprises in this broad sector, the productivity growth of Irish-owned enterprises in the 'Domestic and other' sector could be lower and possibly below the EU average.

While there is no doubt that aggregate productivity in Ireland is strong (compared to other advanced economies) and that its strength primarily derives from a highly-concentrated group of high-productivity MNEs, there is less known about the productivity performance of the increasingly diverse domestic sector, where both high- and low-productivity performing Irish SMEs co-exist[10]. Further research and analysis is needed to understand more fully how policies can be designed to enhance productivity growth in all sectors of the Irish economy. Supporting closer economic links between MNEs and SMEs across and within industries (via trade linkages, labour mobility and innovation cooperation) could help raise productivity levels in SMEs. Stronger links between research institutions and SMEs could also enhance productivity growth.

The Council has acknowledged in previous publications the need to design policies to enhance Irish productivity growth that are comprehensive and tackle the many related elements within enterprises (e.g. digitalisation, upskilling, innovation and knowledge-based capital), between enterprises and across industries (e.g. infrastructure, diversification) to ensure a more resilient, widespread and sustained growth of productivity in Ireland.

The NCPC is committed to supporting research on the drivers of productivity in Irish enterprises, so that we have solid evidence on which to base recommended actions to improve enterprise productivity. The CSO will continue to support researchers on access to data in this area. The COVID-19 pandemic has forced enterprises and employers, in both the private and public sector, to adapt their operations at record speed, and in many cases transition to an online working platform and service delivery. While the abrupt move to new ways of working came with many technical and organisational challenges, there were also opportunities to adopt new work practices and methods of providing services to consumers in innovative and efficient ways, which have the potential to boost productivity in some sectors. While it is still too early to evaluate the overall impact of the evolving changes to working environments, it will be important to take stock of the most beneficial innovations in each sector that have arisen during this crisis and learn lessons as to how they might benefit the broader economy.

Further Reading: The Council's annual flagship publication, *Ireland's Competitiveness Challenge 2020*, was published in September 2020 and makes 20 targeted and actionable recommendations to Government on how best to address the challenges facing the Irish economy. In November 2020, the Government published an official response to the Council's recommendations for the first time, signalling their commitment to continued dialogue with the NCPC on competitiveness and productivity matters. The *Challenge* report and Government response are available at: www.competitiveness.ie.

This Bulletin has been issued by the Chair, Dr Frances Ruane, and prepared by Tamsin Greene-Barker and Linda Kane in the NCPC Secretariat.

[9] CSO (2020): Structural Business Statistics 2018

[10] OECD (2019): SME and Entrepreneurship Policy in Ireland