Stabilisation does not equate to recovery - Ireland must embrace change and implement a range of structural reforms - NCC

National Competitiveness Council's review of Ireland's competitiveness is published

The National Competitiveness Council (NCC), today (Thursday 19 July 2012) published its annual benchmarking report, *Ireland's Competitiveness Scorecard 2012*. This report, prepared for the Council by Forfás, provides a comprehensive assessment of Ireland's competitiveness performance, using over 125 statistical indicators. The indicators are drawn from data sources such as Forfás, OECD, Eurostat, CSO and others.

Launching the report, Dr Don Thornhill, Chairman of the NCC, emphasising the importance of benchmarking Ireland's competitiveness said, "Benchmarking our competitiveness performance is an essential exercise and these indicators provide the Council with the analytical underpinning to formulate policy recommendations for maximising Ireland's international competitiveness. Noting that the evidence shows that the economy has stabilised and that the Irish economy has made some gains in international competitiveness terms recently, Dr Thornhill cautioned against complacency and recommended, "A relentless and thorough focus on reform – including those structural reforms agreed with the EU/ECB/IMF Troika."

"To achieve sustainable, long-lasting competitiveness gains, Ireland must maintain focus on implementing a range of structural reforms across all sectors of the economy. Such reforms will encompass policies relating to the labour market, competition policy, taxation, education and skills. At the same time, we must ensure that our banking system is appropriately structured to provide an adequate supply of credit for enterprise. Domestic reforms that enhance our competitiveness can, to some extent, shield us from negative international developments in the short term and position us for growth in the medium/long term. We need to pay particular attention to embedding pro competitiveness reforms in sheltered areas such as healthcare and legal services where high costs feed through to the sectors of the economy facing international competition on home and export markets".

Martin D. Shanahan, Chief Executive of Forfás commented, "On balance, the economy appears to be stabilising although the consequences of the recession will be felt for a long time to come. Ireland is now in a phase of transition and restructuring. Many of our traditional strengths, however, have survived the recession intact – our pro-business enterprise regime, our supportive tax regime and our productive workforce - and Ireland remains an attractive location for investment and trading. Ultimately our ability and willingness to deliver reform will determine the pace and scale of Ireland's recovery. To continue our recovery, we must tackle the competitiveness weaknesses highlighted in this report".

Improvements made but further progress required

While the Irish economy grew for the first time since 2007, the last twelve months were very challenging for Irish businesses. Modest growth was fuelled primarily by a relatively strong export performance. Indeed, despite global economic difficulties, Irish export performance has proved quite resilient – reflecting recent improvements in our international competitiveness. There were some signs of stabilisation in the labour market, although employment continued to fall and unemployment continued to increase. Significant consolidation has been achieved in the public finances. Stabilisation, however, does not equate to recovery, and significant competitiveness related risks are highlighted:

- First and foremost, we must continue to restructure our public finances. The consolidation achieved to date has had a positive impact on our current account deficit but further efforts (including broadening of the tax base and reform of the public sector to deliver improved value for money) will be required to return the public finances to a long term sustainable trajectory.
- Despite current budgetary constraints, Ireland must continue to invest in essential infrastructure such as next generation broadband. Investment in capital projects at a time of economic constraints will require innovative financing solutions.
- High levels of debt are not just adversely impacting on the Government's ability to fund public services – debt has repercussions for the competitiveness of all sectors of the economy and for wider society, particularly in terms of demand and investment.
- Largely due to cyclical effects (rising unemployment and falling demand creating a period of deflation), Ireland's cost competitiveness has improved. There is a risk that these effects could be quickly eroded and that costs could increase rapidly again in future without structural reform. These risks are greatest in the parts of our economy which are sheltered from international competition and where costs are already out of line internationally.
- Exports have supported growth to date but Ireland's market share remains at pre-recession levels. As a key driver of growth, Ireland must diversify our export base in order to protect and grow market share.
- Skills mismatches persist despite high unemployment. The bursting of the construction bubble has left Ireland with a major skills imbalance – an excess of individuals qualified to work in sectors no longer demanding labour, and shortages of individuals equipped with the necessary skills to work in growth sectors. Long-term unemployment and youth employment are on the rise in Ireland and pose significant threats to competitiveness.
- Enterprises continue to be challenged by a shortage of credit. Access to credit is essential for enterprises to compete. Unless access to credit improves, firms will be unable to make the productivity-enhancing investments that are necessary if they are to compete successfully in international markets.

Key Findings

Macroeconomic Sustainability

- Between 2008 and 2011, net exports increased, driven mainly by growth in services and a steep fall in imports (figure 3.3.3). Private consumption, which had fuelled much of Ireland's economic performance over recent years collapsed in 2008 and remains extremely weak.
- Despite the economic downturn, personal incomes in Ireland remain amongst the highest in the OECD when measured in terms of GDP per capita (Figure 3.1). In terms of GNP per capita, Ireland ranks below the OECD-28 and euro area-16 average.

- Since 2007 Ireland's general consolidated debt as a percentage of GDP has dramatically increased (Figure 3.6). This is due to the cost of the significant capital support provided by the State to a number of financial institutions, and the Exchequer running large deficits over the last three years.

Quality of Life

- While national income in Ireland is relatively high by international standards, many members of society remain at-risk-of-poverty: 15.1 per cent of single people in work in Ireland are at-risk-of-poverty, above the euro area-16 average. The proportion of in-employment households with two or more adults with dependent children and at risk of poverty was 8.7 per cent in 2010, level with the euro area average (Figure 3.12).

Environmental Sustainability

- In 2010, 636kg of waste per person was generated in Ireland. This is above the euro area average (543kg). Ireland recycles 34.6 per cent of its waste, compared with 23.7 per cent in the euro area (Figure 3.19).
- Ireland's share of energy derived from renewable resources is approximately a third of the OECD average. Wind, which is not included in the Eurostat definition of primary energy consumption, is making an increasing contribution to Ireland's electricity generation capacity (Figure 3.17).
- By contrast, Ireland is amongst the countries most dependent on oil in the OECD (Figure 3.18).

Business Performance

- The private sector in Ireland has experienced a dramatic decline in investment from over 23 per cent of GDP in 2005 to 7 per cent of GDP in 2011 (Figure 4.1). By contrast, expenditure investment by Government spend has proved relatively resilient (3.3%).
- FDI remains critically important to the Irish economy. Inward investment levels remain amongst the highest in the OECD (Figure 4.2).
- Rates of return on US overseas investment have decreased in many countries as a result of the global economic difficulties. While the rate of return in Ireland has fallen, it remains the highest within the euro area (Figure 4.3).
- Overall Irish firms have performed well in international markets. Significant increases were recorded in merchandise exports from the pharmaceutical sector. Exports of office machinery and processing equipment, however, fell sharply. On the services side, computer services, business services and financial and insurance services all recorded significant growth (Figure 4.10).

Productivity and Innovation

- Irish productivity levels in GDP terms are above the OECD average (Figure 4.14). Using GNP, Irish productivity levels are equal to the OECD average.
- Ireland experienced positive growth in productivity in both GDP and GNP terms in 2010, growing by 2.2 per cent and 2.9 per cent respectively (Figure 4.15).

- The OECD has measured the potential impact of a range of structural reforms that can impact directly upon productivity and can directly improve national fiscal positions while maintaining current outcomes (Figure 4.18). This analysis suggests that Ireland could achieve significant savings (up to 4.8 per cent of GDP) through reform of the health care system.
- Irish firms are more likely to be innovative (45%) compared to the euro area-15 average (40%) (Figure 4.20).

Prices and Costs

- Price levels in Ireland were the highest in the euro area in 2005. Prices in Ireland continued to increase until September 2008. On an annual basis Ireland experienced deflation in 2009 and 2010 as the overall costs of consumer goods and services declined. Prices began to rise again, however, in January 2011, albeit at a slower rate than the euro area average (Figure 4.22).
- Ireland has the 14th highest total labour costs level in the OECD – total labour costs are 2 per cent higher than the OECD average, and are 6 per cent higher than the euro area average (Figure 4.25). Ireland has the 10th highest net wage level in the OECD, over 20 per cent above the OECD average.
- Looking at growth rates in labour costs (Figure 4.26), there has been a significant decline in Irish growth rates from a high of 9.1 per cent in 2001 to -1.7 per cent in 2011.
- Ireland has experienced reductions in many non-pay costs also. Property costs have declined significantly (Figure 4.32-4.34). The gap between electricity costs in Ireland and in the EU-27 narrowed significantly between 2008 and 2010, although the cost of industrial electricity for large energy users has increased more recently (Figure 4.35). The cost of water for industrial users in Ireland has remained relatively static since 2007 (Figure 4.37).
- Over the course of the economic downturn, many business and professional sectors have shown substantial downward adjustment in prices (Figure 4.38). Since 2006, however, legal services prices increased by 12 per cent (Figure 4.39).

Employment and Labour Supply

- Employment peaked in Q3 2007 when almost 2,150,000 people were employed (Figure 4.41). From Q3 2008 unemployment increased rapidly and by Q4 2011 unemployment had reached 302,000 (averaging 14.4 per cent in 2011).
- Long term unemployment as a proportion of total unemployment began to increase significantly from Q4 2008 and accounted for 60 per cent of those unemployed by Q4 2011.
- The construction sector has seen the largest decline in employment (by 60 per cent or 158,500) between Q3 2007 and Q4 2011 (Figure 4.42). There have also been significant declines in industry (-62,600), and wholesale and retail (-41,400).
- Ireland's standardised rate of unemployment is now amongst the highest in the EU (Figure 4.43). Indeed in 2011 in the euro area, only Spain (21.6%) and Greece (17.7%) had higher standardised rates of unemployment than Ireland (14.4%).

Business Environment

- As a result of significant falls in tax revenue, the Irish Government is expected to run a deficit equivalent to 8.3 per cent of GDP and 10.3 per cent of GNP for 2012 (Figure 5.1). Since 2007, the largest declines in tax receipts have been recorded in capital taxes and stamp duties – both are closely related to the property market (Figure 5.3).
- As a result of increased taxes on labour, the gap between labour costs and net pay has risen considerably since 2008. For a married couple with two children on a combined income of 100 per cent of the average wage, the difference is 11.4 per cent, up from 6.7 per cent in 2008. For a married couple with two children on a combined income of 167 per cent of the average wage (i.e. a two earner family), the difference is 19 per cent, up from 14 per cent in 2008 (Figures 5.6 and 5.7).
- Access to affordable credit is essential to keep the wheels of enterprise turning. Irish firms, however, have generally faced above average interest rates when it comes to getting loans (Figure 5.10) and overdraft facilities (Figure 5.11).
- Ireland's generally pro-enterprise regulatory environment is reflected in relatively low barriers to entrepreneurship (Figure 5.21), a competitive product market regime (Figure 5.20), and a legislative approach which maintains labour market flexibility (Figure 5.24)

Physical and Economic Infrastructure

- Considerable improvement has been made in improving the quality of our physical infrastructure over the last decade and a half, with Ireland's net capital stock growing by 4.9% per annum between 2000 and 2010 (Figure 5.26). However the value of the stock of fixed assets in Ireland declined in 2010, primarily as a result of falling asset values for new dwellings and other buildings (Figure 5.25).
- Despite the sustained investment over the course of recent National Development Plans and the resultant improvement in infrastructure, perceptions of quality remain poor (Figure 5.27).
- Ensuring a secure, environmentally sustainable and economically competitive energy supply is a major global challenge. Ireland's overall energy import dependency was 86 per cent in 2010, which compares unfavourably with the EU-15 average of 57 per cent (Figure 5.29).
- In the context of climate change, water management is becoming increasingly important. Dublin compares relatively poorly to other European cities on a composite index which includes total annual water consumption, the percentage of water lost in the distribution system and policy measures to improve the efficiency of water use (Figure 5.28).

Knowledge Infrastructure

- The proportion of the working age population with tertiary level education has increased from 26 per cent in 2003 to 36 per cent in 2009 (Figure 5.35). Despite these advancements, older cohorts of Ireland's population aged 25-64 remain less qualified than the OECD average.
- Looking at primary education in Ireland, in 2009, Irish 9-11 year old students received fewer hours of tuition in maths and science than students in most other OECD countries (Figure 5.38).
- While 86 per cent of 25-34 year olds had attained at least upper secondary education, just 72 per cent of 25-64 year olds had at least this level of education (Figure 5.39).
- Irish 15 year olds performed poorly in the 2009 PISA tests in maths and reading but scored above the OECD average in terms of science. Irish proficiency in reading and maths declined sharply compared with results from 2006 (Figure 5.41).

- Younger age cohorts in Ireland enjoy significantly higher levels of tertiary attainment than older cohorts (Figure 5.46)
- Ireland ranks below the euro area average in terms of lifelong learning and its performance in this measure has fallen since 2005 (Figure 5.49)
- In 2010 Irish expenditure on R&D was 1.79 per cent of GDP. Business expenditure on R&D (BERD) in Ireland accounted for 1.17 percentage points of this (Figure 5.50). Foreign-owned companies undertake most business expenditure on R&D in Ireland (68%).