Submission to the Joint Committee on Enterprise, Trade and Employment

1. Introduction

Chair, on behalf of the National Competitiveness Council I welcome this opportunity to engage with the Committee.

The National Competitiveness Council was established by Government in 1997. It reports on key competitiveness issues facing the Irish economy and offers recommendations on policy actions required to enhance Ireland's competitive position. Each year the NCC publishes the two-volume Annual Competitiveness Report.

- Volume One, **Benchmarking Ireland's Performance**, is a collection of statistical indicators of Ireland's competitiveness performance in relation to 17 other economies.
- Volume Two, **Ireland's Competitiveness Challenge** outlines the main challenges to Ireland's competitiveness and the policy responses required to meet them.

As part of its work, the NCC also publishes papers on specific competitiveness issues including energy, cities, productivity and sectoral competitiveness.

Members of the Council are drawn from business, trade unions, government departments and agencies, and academia. They give their time on a pro bono basis. Forfás, the national policy advisory body for enterprise and science, provides the NCC with research and secretariat support.

2. Context

This submission draws on last year's Competitiveness Challenge report and reflects the Council's initial discussions of the priority areas of focus for the 2010 Competitiveness Challenge. The 2010 report will be submitted to Government later in the year.

2.1 Vision: Transcending challenge for economic policy

The overarching goal of national competitiveness is to improve living standards and quality of life through enhancing the capacity of Irish enterprises to trade successfully in international markets. National competitiveness is a broad concept that encompasses a diverse range of factors and policy inputs including education and training, costs, entrepreneurship and innovation, Ireland's economic and technological infrastructure and the taxation and regulatory framework. Further efforts to restore Ireland's competitiveness are critical to enable Irish exporters to compete successfully in difficult international markets.

Competitiveness is underpinned by stable public finances, a working banking system and a broad vision for the economy and society. We have made significant progress in improving our competitiveness in the past 18 months. Costs have fallen, skills availability has improved and the pressures on infrastructure have eased. Developing an inclusive vision for the economy and society is critical.

The challenge which faces us all is to construct a convincing narrative for a prosperous economic future with:

- Robust economic performance;
- High levels of employment and return to prosperity; and
- Capacity to achieve social progress.

The Council wants to play a constructive role, through our advice, in meeting this challenge.

2.2 Review of Current Competitiveness

In recent years, the NCC has warned that despite high rates of economic growth, our international competitiveness was waning. Growth derived from asset price inflation, fuelled by low interest rates and pro-cyclical fiscal policy, reckless borrowing in the private sector and lending and speculation has now been proven an unsustainable and damaging basis for growth both in Ireland and internationally.

While the Irish economy has contracted very considerably in the past two years, we continue to have significant competitiveness strengths. More importantly, our international competitiveness is improving. Key strengths and weaknesses include:

- Ireland's exports remained resilient in the face of a collapse in global trade. During 2009, total exports fell by 1.8 per cent in Ireland compared with 13.6 per cent in the OECD. While Ireland's world share of goods trade has declined, our share of services trade has continued to grow. Ireland's trade performance has offset some of the sharp impact of the domestic recession and it can support a return to sustainable growth. However, it is a concern that our export success is largely based on the performance of a small number of sectors and that foreign owned companies account for almost 90 per cent of total Irish exports.
- Ireland retains important strengths as a location for foreign direct investment - including a long track record as a successful location for overseas investors, a modern internationally trading enterprise base and growing levels of research and development activity. In spite of Ireland's continued success as a location for new foreign investment, indicators suggest that our performance is weakening as the rates of return on US investment here have fallen and as other countries have aggressively targeted new overseas investment.
- Ireland has made significant progress in terms of improving our physical, educational and research infrastructure. In 2009, direct capital expenditure amounted to €7.7 billion. This is set to fall to €6.45 billion in 2010 and €5.5 billion per annum for the years 2011-2013 which represents a significant reduction on funding allocations set out in the National Development Plan 2007-2013. The distribution of the reduction in capital spending is not yet clear. Despite tangible improvements, perceptions of the quality of Irish infrastructure remain relatively low.
- Ireland is regarded internationally as a good location to do business from and the tax environment supports enterprise and work. Many of Ireland's most important internationally trading sectors (e.g. pharmaceuticals, medical devices, fund administration, software) depend on an effective regulatory environment. Although it is not possible to benchmark, the

importance of having a reputable regulatory regime is critical. Ireland's regulatory regime for products such as pharmaceuticals and medical devices is excellent which is a significant competitive advantage. While not unique to Ireland, recent developments in Ireland's domestic financial services sector have damaged our international reputation.

- Ireland is facing a major debt challenge. The economy is burdened by very high levels of private debt and growing levels of public debt which will continue to limit the degree to which the domestic economy can ignite a return to sustainable economic growth. High levels of private debt are being slowly unwound as net saving rates have increased significantly but with three quarters of household debt mortgage-related, this adjustment will take some time. Public debt levels have grown significantly as a result of a very sharp decline in exchequer tax revenues arising from the collapse in the construction sector (i.e. falling revenue from the property transaction related taxes, Stamp Duties, CGT and VAT) and the general recession (falling revenue from taxes on incomes and sales) while government expenditure, driven by social welfare and interest payments has continued to increase – albeit more slowly. While €1 in every €12 collected in tax went to service the national debt in 2009, by the end of 2014, the Department of Finance estimates that more than €1 in every €5 collected in tax will be required to pay the interest on Ireland's public debt.

- Nowhere is the severity of the recession more evident than in the huge numbers of people who have lost their jobs. Unemployment has risen sharply and is now a key national economic and social challenge. Outward migration is growing and participation rates in the labour force are falling – partially due to people returning to education which is welcome. While the steep rise in unemployment has affected people across society, those with lower educational attainment are more likely to be unemployed. In Q1 2010, 21.5 per cent of people with no more than lower secondary education were unemployed compared to 6.1 per cent of those with a third level degree or above. Unemployment rates are also higher among younger workers. Also of concern is the increase in long-term unemployment – it accounted for 41 per cent of total unemployment in Q1 2010 compared with 22.2 per cent at the end of 2008. From a business perspective, the increased availability of skilled labour is supporting the competitiveness of internationally trading businesses and our efforts to attract new FDI.

- Ireland experienced a significant loss in cost competitiveness (as measured by the real harmonised competitiveness indicator (HCI)) over the past decade reflecting a combination of an appreciation of the euro against the currencies of many of our trading partners and higher price inflation in Ireland. Since January 2008, Ireland has regained some of its competitiveness as domestic inflation remains below that of our main trading partners and the euro weakened. However, cost levels remain high.

- Irish productivity levels (GNP per capita) remain below the OECD average. In addition to the weak performance on productivity levels, Ireland's productivity growth rates are also a cause for concern. Not only were average annual (GNP-based) productivity growth rates significantly below the OECD average over the period 2005-2009, they had fallen considerably from the earlier period, 2001-2005. Irish productivity growth between 2008 and 2009 ranked 24th lowest in the OECD. It is likely that productivity growth will achieve a cyclical boost as the economy comes out of recession but more fundamental changes are required. Productivity is the key to combining competitiveness with rising living standards.

- Access to finance and its cost are critical issues for enterprise as international markets return to growth and exporters require greater access to credit – especially at a time when euro area interest rates may increase. Irish borrowers continue to pay more for lending services than their euro area counterparts. For example, Irish companies face consistently higher interest rates for overdraft facilities than the euro area average. In addition, credit standards in Irish banks have tightened at a time when euro area credit standards are easing.

Recommendations to address these issues are set out in the NCC's Annual Competitiveness Challenge report. The latest report was published in January 2010 – the key topics addressed are outlined in figure 1.

Figure 1: Ireland's Competitiveness Challenge[1]

1. Supporting a Stable Macroeconomic Environment

- Restoring the sustainability of the public finances
- Ensuring the banks are channeling credit to viable businesses

2. Improving Cost Competitiveness

- Incomes and prices
- Property
- Energy
- Waste
- Local authority charges

3. Increasing Productivity

- Restructuring the economy
- Skills
- R&D and innovation
- Capital and technology deepening
- Infrastructure
- Competition and regulation
- State supports
- Workplace development

The report highlighted priority policy actions to restore Ireland's international competitiveness, which included:

- reducing the costs of doing business, especially energy, waste and professional services;
- enhancing the skills of those in employment and improving the employability of those who have lost their jobs;
- the need to ensure open competitive markets in all sectors of the economy and to drive competition in non-traded services sectors in particular through the effective implementation of Competition Authority recommendations;
- fostering innovation at all levels of economic activity including R&D programmes which have strong industry relevance and participation;

1 Full report can be found at http://www.competitiveness.ie/publications/featuredpublications/title,5313,en.php

- developing world class advanced broadband networks and services in key regional centres to support the smart economy; and
- continued action to restore the sustainability of the public finances and ensure credit is channelled to viable businesses.

We continued to work with government ministers, departments and agencies to progress these recommendations.

3. Future Competitiveness Challenges

Rather than recite previous council analysis and recommendations, this section teases out some of the longer term competitiveness challenges that we need to consider and tackle.

3.1 Are we adequately focused on improving productivity?

"Productivity isn't everything, but in the long run it is almost everything" - Paul Krugman[2]

In spite of moderating price levels, Ireland remains an expensive country. A reduction in our cost base can play an important role in restoring our competitiveness but we also need to increase productivity across the economy. Irish productivity levels, when the effects of multinational companies are excluded, remain below the OECD average. Irish productivity growth rates are also below the OECD average and our historical performance.

Improving productivity growth across all sectors of the economy – private and public, locally and internationally trading, manufacturing and services, indigenous and foreign owned - is central to our future success. A wide range of factors can influence a country's productivity growth rates, and these stem from decisions made both at Government level and at firm level.

- From a Government perspective, its institutional structures and policies must be supportive of investment, entrepreneurship, competition and innovation. This includes the existence of a stable macroeconomic environment with well-managed public finances and price stability, continued investment and reform in education, R&D, technology and infrastructure, as well as a regulatory environment that promotes competition and an adaptable labour market, and which minimises unnecessary administrative costs. The enterprise development agencies can also play a key role in promoting higher value added activity in the domestic economy;
- The Government can also directly influence national productivity through productivity improvements in the sectors where it is an employer. These include in the provision of public services (e.g. health, education, justice and civil service), as well as in transport services and utilities; and
- At the firm level, productivity improvements centre on investment in product and process innovation, the use of technology, and management practices.

2 Paul Krugman, The Age of Diminishing Expectations, 1994.

Krugman highlights that 'a country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker'. Higher productivity is the glue which sustains prosperity, high living standards and competitiveness. Do we adequately incorporate productivity improvement in budgetary and policy decisions? What part of Government is responsible for promoting policies that drive productivity and monitoring progress?

3.2 Are our policies, institutional structures and mindsets rooted in the past?

Ireland's export base has changed dramatically in recent decades. Ireland is increasingly shifting towards services and advanced manufacturing. In 2009, merchandise exports contributed 55 per cent of total exports and services exports 45 per cent. While services exports increased marginally (0.2 per cent), merchandise exports declined by 3.4 per cent. In detail:

- Within merchandise exports, medical and pharmaceutical products now make up 23 per cent of total merchandise exports, having grown by 17 per cent in 2009 to almost €20 billion. The largest declines in goods exports were in electrical machinery (-31 per cent) and computer equipment (-29 per cent). Food and drink accounted for nine percent of Irish exports in 2009. Unprocessed food (live animals, fruit and vegetables) account for seven per cent of total food and drink exports.
- In terms of services exports, business services exports increased by 12 per cent while tourism and travel declined by 18 per cent and financial services by 11 per cent. In real prices, the value of the tourism sector has declined in the past decade and its share of Irish services exports has fallen from 14 per cent in 2001 to five per cent in 2009.

In view of the need to improve the competitiveness of our main exporting sectors, the NCC undertook a study to identify the existing and emerging sectoral opportunities that can drive export growth, the key competitiveness factors affecting them, and the sector-specific actions which are required to improve their competitiveness[3]. While the study found that there are common competitiveness challenges across all sectors (e.g. improving cost competitiveness, availability of higher quality broadband services, etc.), individual sectors face a range of specific challenges. Addressing these specific challenges, which are summarised in the section 4, would result in tangible improvements in the competitiveness of sectors that we already have strengths in.

Much has been written about the need to achieve agile joined up government. Clearly, no single structure exists that can meet every need, and of course, needs will change over time. However, it is pertinent to ask:

- Do our Departmental structures reflect the changes in our economy? We have Government Department for agriculture, fisheries, tourism, natural resources, etc, despite the fact that these sectors account for a small and declining share of national output. While some of these sectors continue to employ a large number of people, often in less developed areas, how can we

3 Driving Export Growth: Statement on Sectoral Competitiveness. http://www.competitiveness.ie/publications/2009/title,5096,en.php

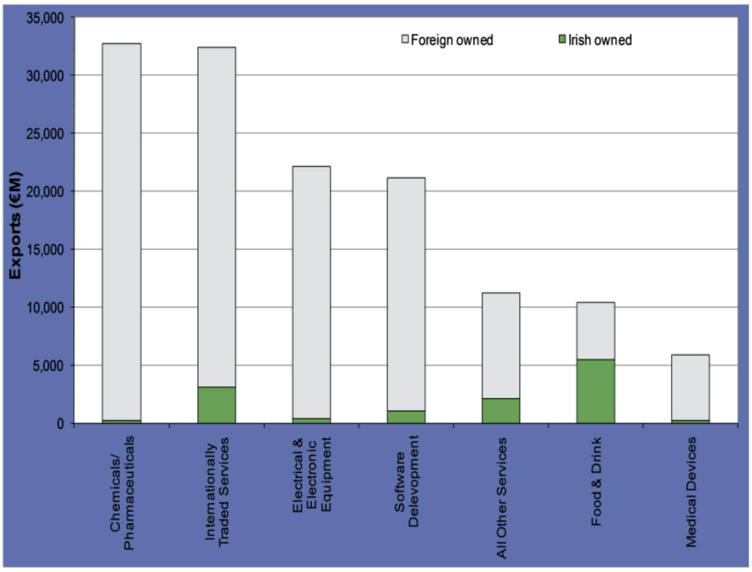
ensure that these limited State resources are employed in developing new national and regional competitive advantages?

- Are we allocating our resources in the right areas? Do we set budget according to historical patterns? Should we be implementing zero based budgeting approaches which reflect current opportunities and challenges? For example, of the total 550 full time equivalent (FTE) PhD and non-PhD researchers employed in the government sector, 308 are employed in agriculture related fields (56 per cent). At a policy level (e.g. trade), do our policies support the key drivers of future economic growth – internationally trading services and advanced manufacturing.
- Are we measuring the right things? While we have detailed statistics on farmyard stock (partially driven by Eurostat reporting requirements), we have limited information on the business services exports which now account for 35 per cent of services exports. For example, the price of pigs increased by 4.8 per cent between Jan and February 2010 – released 30th April. What do companies in the business services sector do in Ireland? How are they performing in February 2010? We don't know.

3.3 Sources of export growth: strength of FDI versus reliance on FDI

A return to export driven growth is increasingly important to restoring the economy to growth.

Exports from Development Agency Assisted Firms by Key Sectors and Ownership



Foreign owned firm account for almost 90 per cent of our exports. From one perspective, this highlights the huge success Ireland has achieved in positioning ourselves as a base for overseas investment. From an alternative perspective, it suggests that indigenous sectors and firms have performed poorly.

A number of challenges arise:

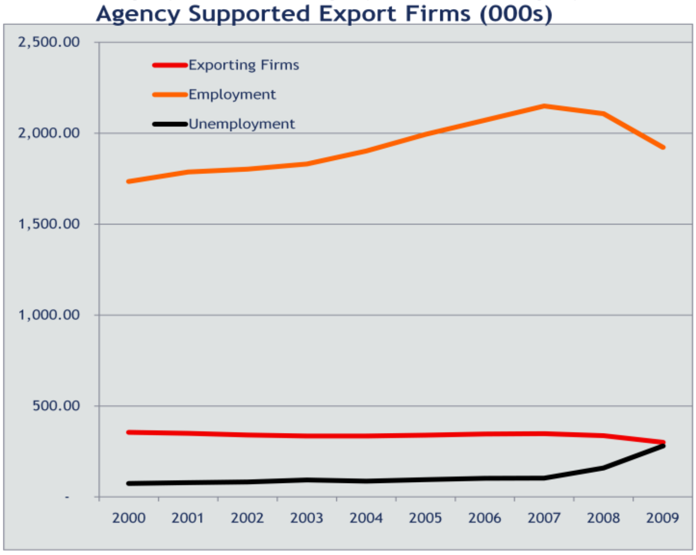
- In spite of Ireland's continued success as a location for foreign investment, a range of indicators suggest that our performance is weakening as the rates of return on US investment here have fallen and other countries have aggressively targeted new overseas investment. Can FDI return to being the engine that drives our economy?
- Should we be concerned that circa 90 per cent of Ireland's exports are driven by a relatively small number of foreign owned firms? Should we be concerned that Irish owned firms predominate only in the relatively slow growing food sector and are generally highly dependent

on the UK market (i.e. exposed to euro – sterling exchange rate risks?). Is the indigenous exporting sector failing, can it play a greater role in the future, and what if anything can be done to stimulate this?[4]

3.4 Where will the needed jobs come from?

In Q4 2009, Ireland had the third highest unemployment rate in the OECD at 13 per cent (OECD-28 averaged 8.6 per cent). The ESRI forecasts that unemployment in Ireland will increase to 13¾ per cent by the end of 2010, which means that over a quarter of a million people will have lost their jobs between 2007 and 20105. Younger and lower educated people are particularly vulnerable to unemployment. Long-term unemployment is also increasing – it accounted for 33.3 per cent of total unemployment in 2009 compared with 22.2 per cent a year earlier.

Employment, Unemployment and Employment in Agency Supported Export Firms (000s)



Employment in internationally trading business at 272,053 in 2009 has remained relatively stable over the past decade. However, this is a decrease of 34,000 jobs (11.1 percent) on employment levels in 2008[6]. These internationally trading firms, through wages and expenditure on Irish goods and service, create a similar number of indirect jobs in the broader economy.

Given high levels of consumer debt and growing levels of Government debt, it is clear that a return to export driven growth must be the primary channel to restoring the economy to sustainable growth.

Questions arising:

- Further work is required to determine the potential to grow jobs in exporting sectors. In particular, what is required to enable Ireland to win those labour intensive projects which were more common in the late 1980s and the early 1990s? On the other hand, is this era gone with the arrival of Eastern Europe and Asia (particularly the BRIC countries[7]) into the world trading system?
- While increasing exports will not provide a panacea for all the challenges facing the Irish economy, improving Ireland's attractiveness as a location to do business and export from will be

4 It should be noted that while foreign owned firms dominate our export performance, indigenously owned exporters employ a similar number of people as the foreign owned sector and spend a similar amount on sourcing Irish goods and services.

5 ESRI, Quarterly Economic Commentary, April 2010.

6 Annual Employment Survey 2009, Forfás, March 2010.

7 BRIC countries are Brazil, Russia, India and China.

important for restoring the levels of confidence necessary to halt the decline in domestic consumption and investment seen since 2008. Improving the competitiveness of the domestic economy will also be critical for our future economic prospects for two reasons - its costs impinge on the exporting sectors and its recovery is essential to reduce unemployment and create jobs. Improving the competitiveness of the domestic sectors depends on actions that improve productivity (investment in equipment including ICT, cost reductions, etc.) – rather than temporary measures which promote a spike in consumer spending.

3.5 Cost competitiveness is beginning to improve, but will we address sticking points?

Ireland experienced a significant loss in cost competitiveness over the past decade reflecting a combination of an appreciation of the euro against the currencies of many of our trading partners and higher price inflation in Ireland. Since January 2008, Ireland has regained some of its competitiveness as domestic inflation remains below that of our main trading partners and the euro weakened. However, Ireland's price levels remain high by historical standards.

Improving our relative cost competitiveness requires the cost of doing business in Ireland to fall relative to that of our trading partners. Although prices in Ireland have moderated in the past year, particularly property and energy prices, a range of key business inputs in Ireland remain relatively expensive. The data suggests that prices have remained high in sectors that are not exposed to international competition and are sheltered from the full rigours of domestic competition (e.g. administered prices such as waste water costs, legal fees, education and health costs). Looking at key costs factors in turn:

- Unit labour costs measure the average cost of labour per unit of output. Declining unit labour costs mean that productivity has increased faster than earnings – thus indicating an improvement in competitiveness. While the rate of growth in Irish unit labour costs significantly exceeded the OECD and euro area averages between 2005 and 2008, unit labour costs in Ireland fell by 1.5 per cent during the first three quarters of 2009. Meanwhile, average OECD and euro area unit labour costs continued to grow, albeit slowly. Therefore, at an economy wide level, Irish labour wage rates – when adjusted for productivity – are becoming more cost competitive. Again, the data highlights that unit labour costs are improving fastest in the internationally trading manufacturing sector rather than more closed sectors of the economy.
- There have been significant declines in the cost of constructing or renting a prime industrial site or prime office space in Ireland since 2008. While the cost of renting prime office space in Ireland is relatively competitive, other property related costs remain among the highest of the benchmarked countries – as property costs have fallen in many countries.
- The gap between the industrial price of electricity in Ireland and the euro area average has narrowed significantly in 2009; it is now five per cent above the euro area average. This downward adjustment is largely due to the steep decline in global fuel prices (i.e., gas and coal) and temporary subsidies by Government for large business users which are to be phased out by the end of 2012. The cost of water services in Ireland compares favourably with our main trading partners. However, waste water services costs increased by 18.8 per cent during

2009. The cost of high speed broadband also compares poorly with the EU-14 average. Landfill costs are the highest of the countries we benchmark.

- Based on experimental data from the CSO, the cost of accounting services fell significantly from their Q1 2008 peak[8]. There have only been marginal declines in legal fees in Ireland during 2009. While it is difficult to accurately compare legal fees internationally because of different national legal systems, based on the cost of enforcing a contract following a commercial dispute, Ireland ranks fourth most expensive.

For the most part, recent price falls in Ireland are a cyclical response to the Irish and international recession (e.g. reduced demand leading to spare capacity, falling interest rates, falling international fuel and food prices) rather than a response to structural changes in the Irish economy. How can we improve cost competitiveness?

- Are we willing to tackle sheltered sectors? How can we tackle these embedded costs?
- What tools exist to manage costs and are we utilising them fully – competition policy, NDP investment, advanced broadband and ICT, skills development, etc?

3.6 Seek to compete to win

Despite the severe recession, Ireland remains a high-income country. Irish living standards in terms of GNP per capita (the most relevant measure of living standards) remain close to the euro area average.

Given different historical contexts and economic, political and social goals of various countries, and their differing physical geographies and resource endowments, it is not realistic for any country to seek to outperform other countries in all areas. However, improving living standards requires that we excel in key areas that impact upon international competitiveness. Being average only works when you want average living standards.

- How can we engender a culture that seeks to be world class at everything we do – education, infrastructure (broadband, transport, etc.), R&D, innovation, etc?
- Who should we be seeking to learn from – who should we be seeking to beat! Who has been improving their competitiveness while we were building houses?

  → Finland in primary and secondary education? Finland topped the 2006 PISA rankings of the performance of students at 15 years of age. Finland was not only the best performing country but belonged to the countries showing the least variation in performance both within and between schools. A closer analysis of the PISA results revealed that the strength

8 Given the small sample size used to create the sub-indices for accountancy and legal costs caution should be used when analysing the results. CSO, Services Producer Price Index, March 2010.

of relationship between student's performance and socio-economic background was very low in Finland. Reasons include:

- Resources matter, but they do not drive performance. Classroom organization, innovation, methods do;
- The attraction of high quality people into teaching based on the status of the profession. Entry to teacher education is highly competitive;
- The quality of teacher training; and
- A decentralised culture of evaluation.

→ Israel/ United States in promoting high tech start-ups? Since the 1990s, Israel has seen the emergence of an indigenous world-class, export-based high-tech sector specialising in computer hardware and software, medical technologies and pharmaceuticals. Israel has the highest per capita concentration of start-ups in the world and over 100 Israeli companies have joined the NASDAQ in the past decade. Reasons include:

- High spend on research and development – almost five per cent of GDP;
- Strong science and technology skills in part driven by a large pool of researchers in the Jewish Diaspora;
- Highly active enterprise policy; and
- Availability of venture capital.

→ Denmark/ Germany in building a strong base of knowledge intensive domestically owned exporters? The Danish economy has a relatively high number of medium sized companies. A number of Danish multinational firms that are leaders in their field of specialisation. For example, three of the top six hearing aid manufacturing companies are Danish.

- High business R&D intensity in Denmark – particularly in smaller companies;
- High levels of innovativeness in Danish firms, especially of smaller and medium-sized companies;
- Strong industry networks and history of collaboration; and
- Strong science and technology skills.

→ Sweden in delivering of advanced broadband? Sweden has a strong track record as a front-runner in broadband availability and use – 83 per cent of the population had a broadband connection in 2009. In 2009, it revised its broadband strategy and set new targets for the delivery of speeds of 100 megabits 90 per cent of the population by 2020 to ensure that Sweden remains ahead of the pack in the development of next generation networks. Reasons for Sweden's world class broadband infrastructure include:

- Significant investment in high speed networks by private and public sectors (municipal city networks and the National Rail Administration);
- Regulatory framework that promotes infrastructure competition and removes bottlenecks;
- Clearly defined role for public sector players at national and local level both as owners of broadband infrastructure and users of technology; and

- Access to spectrum for new wireless technologies.

4. Initial Conclusions

The NCC will be undertaking further research in these areas and will report to Government towards year end. However, at this point in time, a number of issues are emerging.

4.1 It is difficult to see any alternative to a high reliance on a small number of firms and sectors as generators of growth for medium term future. Are we addressing their concerns as outlined in the NCC Report on Sectors? Key issues include:

- the provision of specialised courses for particular sectors such as ICT, financial services and environmental goods and services;
- enhancing the clinical trials process is key to increasing the size of the pharmaceutical and medical technologies sectors; in particular we need to consolidate and streamline approval processes for new products and technologies;
- ensuring that various Government departments and agencies work together to implement coherent strategies for their sectors (e.g. food, tourism);
- upgrading the road infrastructure in and to the west is critical for the medical technologies sector to enable easier access to international markets;
- the strategic and timely implementation of impending EU environmental legislation to develop markets for indigenous green companies and create first mover advantage for Irish companies; and
- coordinating public spending on tourism related investment across Government departments and agencies to ensure that the attractiveness of Ireland's international tourism profile and offering is enhanced.

4.2 We must bring essential infrastructures up to being the most competitive in the world – education, research, broadband, waste, etc. While the crisis in the public finances necessitates cuts in capital expenditure, it is critical that capital expenditure is not excessively reduced to avoid difficult decisions on current expenditure cuts. In addition:

- While it is accepted that the public capital investment programme is now more limited than envisaged under the NDP, it is vital that the infrastructure projects likely to have greatest impact in terms of attracting overseas investment and supporting firms in Ireland to compete successfully in global markets are front-loaded in the revised capital envelopes. Developing world class advanced broadband networks and services is essential to enable Ireland to support the smart economy.
- Given the central role that Dublin and our other cities play in driving national competitiveness, the re-prioritisation of capital expenditure should focus resources on their development.
- Consideration also needs to be given to the potential to coordinate the rollout of different infrastructures such as roads, broadband, water, electricity and gas. Not alone would this facilitate the provision of infrastructure in an integrated framework, it also has the potential to deliver significant cost savings particularly where projects are

undertaken simultaneously; for example, civil works account for 80 per cent of the cost of rolling out fibre for advanced broadband services. A strengthening of existing institutional arrangements to enable the sharing of investment rollout plans across Government departments and agencies needs to be established immediately.

- Continued investment in research and development is critical to the development of the smart economy. Given the need to reduce Government spending, the NCC recommends that public R&D funding prioritise programmes which have strong business relevance and participation, leverage private sector investment and drive consolidation in existing research infrastructures and centres.

4.3 Public sector reform. Strained public finances have potentially acute implications for public services. We need to rise to the challenge of delivering better public services with fewer resources. The alternative is a reduction in the services provided to the public. The public sector has the capacity to be at the forefront of the adjustment process in the economy in moving to higher levels of productivity growth and innovation. A range of recommendations from the OECD and others remains outstanding.

- Recommendations to reform the public sector need to be implemented immediately. In particular, a greater focus on improving productivity and flexibility, better integration in delivery, improvements in management capabilities and an effective redeployment of existing resources are central to delivering better public services with reduced resources.

4.4 Incentivise enterprise and resources into externally traded activities. Investment in the economy has fallen dramatically due to the property collapse and the prolonged drop in consumer and business confidence. Private sector investment (including households) in Ireland was the lowest in the euro area in 2009, representing a significant decline since 2005. Restoring investment levels in productive assets (rather than property) is a major challenge.

- Investment in technology can play a key role in reducing costs and improving productivity growth. Given the increasing limitations at EU level on government aid for capital investment, it is critical that tax incentives are reviewed to incentivise investment in productive sectors to support sustainable economic activity and employment rather than in property. For example, under the current R&D tax credit system, the credit in foreign owned companies often accrues to the corporate headquarters and is therefore not captured in the costs and revenues of the Irish plant. Reforming the operation of the tax credit so that it is applied to the cost of employment in Ireland could increase the volume of R&D activity taking place here without changing the value of incentives offered; and
- We need to remove all remaining incentives and tax expenditures which favour non-traded economic activity.

4.5 The strategies to restore balance to the public finances must be consistent with the need to improve competitiveness. In addition to reducing Government expenditure, broadening the tax base is central to repairing the public finances. Additional Exchequer revenues will be needed and should be raised by broadening the tax base rather than increasing marginal rates. As set out in detail in previous statements, the NCC believes that additional revenues should be raised by broadening the tax base. These include:

- Introducing a valuation based residential property tax; and
- Introducing user service charges for treated water, third level education, etc.

These measures must be introduced quickly – we are concerned with the slow pace of implementation. In the absence of measures to broaden the tax base, taxes on income will inevitably have to rise further in the future. Higher taxes on income increase the so called tax wedge i.e. the difference between the cost to an employer of employing someone and the take home pay of the employee. A high tax wedge is a disincentive to employment creation: it also acts as a disincentive to people to remain in or return to the labour market. In contrast, a residential property tax does not increase the costs of employment or the rewards from holding a job.

4.6 Limited competition in locally traded sectors of the economy, particularly in the professions, has serious implications for the costs of doing business in Ireland. Ensuring that competition law applies to all sectors of the economy and removing barriers to competition in sheltered sectors is critical. A systematic process is required to address these barriers. In addition, the State should use its purchasing power to exert downward pressure on professional fees.

4.7 The price of land, office and factory space and housing in Ireland are important determinants of competitiveness. Disproportionately high commercial and industrial property costs damage competitiveness and high housing costs puts upward pressure on pay rates. For a number of years property costs became uncompetitive internationally and an adjustment to the levels justified by their underlying potential and affordability was inevitable. In this context, it is important that the actions taken by the banking sector and the National Asset Management Agency (NAMA) support appropriate adjustments within the property market and in particular are supportive of export led economic growth and enhanced competitiveness. This is a higher priority than securing an "accounting positive rate of return" from NAMA.

4.8 We must ensure that we never again have a property speculation bubble:

- Stronger banking regulation and closer supervision is required to ensure that banks do not reengage in reckless lending. More effective macro-prudential policy instruments should be developed and applied;
- The taxation of property should also be progressed to limit future housing boom and bust cycles, in particular, a valuation based tax should be introduced quickly. Ireland is one of the few developed countries in the OECD which does not raise significant revenues from a recurring property tax on residential property;
- There is a need for better fiscal planning and control mechanisms, once the economy gets back onto a sustainable growth path. In particular, the OECD outlines the need to

create a budget framework that has the rules and institutions to protect the budget against outcomes where revenues are spent even when they are transitory[9]. Specifically, the OECD highlights the need to evaluate spending programmes before implementation to ensure that their objectives are being achieved at the lowest cost to present and future taxpayers. It also suggests that an independent expert institution such as a fiscal council could be established to produce recommendations on the appropriate overall fiscal policy; and

- Falling land and property prices do not reduce the necessity for structural change in respect of land planning. An integrated approach to land use and transport policies is critical to allow the efficient movement of people and goods and to improve the viability of public transport. Increasing density in Irish cities is critical. Carefully located and designed high density developments, with social, educational and recreational facilities, together with world class transportation connections offer the possibility of increasing the supply of both commercial and residential property in a more cost effective and environmentally sustainable manner.

9 OECD, Economic Surveys: Ireland, November 2009.

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