

# COSTS OF DOING BUSINESS IN IRELAND 2014



## Introduction to the National Competitiveness Council

The National Competitiveness Council was established by Government in 1997. It reports to the Taoiseach and the Government, through the Minister for Jobs, Enterprise and Innovation 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 two annual reports.

- **Ireland's Competitiveness Scorecard** provides a comprehensive statistical assessment of Ireland's competitiveness performance.
- **Ireland's Competitiveness Challenge** uses this information along with the latest research to outline the main challenges to Ireland's competitiveness and the policy responses required to meet them.

As part of its work, the NCC also publishes other papers on specific competitiveness issues. The work of the National Competitiveness Council is underpinned by research and analysis undertaken by Forfás - Ireland's policy advisory board for enterprise, trade, science, technology and innovation.

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## Executive Summary

Competitiveness is a complex concept, encompassing many different drivers. Cost is just one of the elements which determine a country's ability to compete in international markets. In the long run, productivity performance is the ultimate determinant of success.

This report is required under the Action Plan for Jobs 2014. Specifically, Action 94 requires the National Competitiveness Council to "Benchmark key business costs and publish a report highlighting areas where Irish enterprise costs are out of line with key competitors".

The report concentrates on the costs that are largely domestically determined such as labour, property, energy, water, waste, communications and business services. From a competitiveness perspective, it is essential that policymakers focus on reducing costs that comprise a significant percentage of business costs and that are out of line with those in competitor countries.

Based on the summary cost profiles considered in Chapter 2, it is clear that the cost of labour is the most significant driver of business costs for most firms - particularly for services firms. Across manufacturing, a range of other inputs also play an important role - in particular, transport, utilities and property costs.

### Overview of the Costs of Doing Business in Ireland

Ireland's cost base has improved across a range of metrics over the last four or five years. This has made Irish firms more competitive internationally and made Ireland a more attractive location for firms to base their operations in. However, despite these improvements, Ireland remains a high cost location for a range of key business inputs. Addressing Ireland's international cost competitiveness must, therefore, remain a key economic priority for Government.

The Council is concerned that recent price falls in Ireland are largely a cyclical response to the Irish and international recessions (i.e. reduced demand, spare capacity), rather than a response to structural changes in the Irish economy. It is also not clear that cost gains are being driven across the broad economy. Furthermore, the evidence collected in this report suggests that the Irish economy has reached a turning point in terms of cost competitiveness.

The trends evident in the Harmonised Competitiveness Indicators indicate that overall relative cost competitiveness in Ireland is now disimproving, and that a series of upward cost pressures are emerging. Marginal improvements in cost competitiveness (resulting from slightly lower inflation in Ireland relative to our competitors and trading partners) have been offset by the adverse impact of the strengthening euro. Low rates of inflation (or possible deflation) across the whole euro area increase the difficulty of extending improvements in cost competitiveness through price reductions. As a result, productivity performance will assume an even more prominent role in driving Irish international competitiveness. Indeed, in the longer term, productivity growth is the preferred mechanism to improve competitiveness as it can support cost competitiveness in tandem with high and increasing income levels.

At a more micro level, the individual cost indicators reviewed throughout this report identify a range of upward cost pressures across a range of key business inputs. These trends are summarised in the text box below.

## Summary of Business Cost Trends in Ireland

<b>Labour Costs</b>	<p>Gross earnings are the 8<sup>th</sup> highest in the euro area while net wages are the 6<sup>th</sup> highest. Following a number of years of marginal decline, labour costs in Ireland are on the increase (2.4% p.a. in 2012 and 0.5% p.a. in 2013). Whereas in 2012, Irish labour costs increased at a slightly faster rate than rates in our key competitors (euro area average of 2.2% p.a.), in 2013, this pattern was reversed and euro area labour costs grew more quickly (1.4%). Irish unit labour costs increased by 1.4 per cent in 2013 after several years of improvements. Further small increases, which will weaken cost competitiveness, are projected in 2014.</p> <p>The cumulative impact of increases in income taxes, changes to bands, the introduction of the Universal Social Charge etc. have weakened competitiveness since the onset of recession.</p>
<b>Property Costs</b>	<p>Following several years of significant cost reductions - in terms of construction and rental costs - the commercial property market has begun to stabilise. There is a risk of shortages in relation to prime office space which could result in future rent increases.</p> <p>Commercial rates differ significantly between local authority areas.</p>
<b>Transport Costs</b>	<p>Diesel prices are 7 per cent more expensive in Ireland than in the euro area.</p> <p>While it is more expensive to export from Ireland, Irish administrative processes are efficient and compare favourably with processes in our key competitors.</p>
<b>Utility Costs</b>	<p>Electricity costs in Ireland are relatively high - Ireland is the 5<sup>th</sup> and 6<sup>th</sup> most expensive location in the euro area 17 for SMEs and large users respectively. Gas prices in the US are substantially lower than in the EU.</p> <p>Landfill gate fees in Ireland are 5<sup>th</sup> most expensive out of 10 countries, while non-hazardous thermal treatment fees are 3<sup>rd</sup> highest out of 9 countries.</p> <p>At present, Ireland is the 5<sup>th</sup> most expensive location out of 16 for industrial water costs (excluding waste water costs). Water services are currently undergoing a major reform. The impact on costs resulting from these reforms on business costs is not yet clear.</p> <p>Telecom costs are relatively competitive although some concerns persist in relation to the quality (speed) of services available.</p>
<b>Credit Costs</b>	<p>New business interest rates for non-financial corporations are higher in Ireland than in the euro area - rates are 31 per cent higher for loans up to €1 million and are 27 per cent higher for loans above €1 million. In November 2013, interest rates in Ireland for revolving loans and overdrafts were 11.5 per cent above the euro area average.</p>
<b>Business Services and Other Input Costs</b>	<p>Throughout 2012 and 2013, prices for a range of business services (e.g. transport, postal and courier, and computer consultancy services) have been increasing in Ireland. This follows a period of significant price declines over the course of the recession. In Q3 2013, prices are 3.4 per cent above 2010 levels.</p>
<b>Broader Cost Environment</b>	<p>Ireland's current price level and inflation profile can be described as high cost but rising slowly. In 2012, Ireland was the 3<sup>rd</sup> most expensive location in the euro area for consumer goods and services. Irish prices were 14.6 per cent above the euro area average. Irish price levels remain above the euro area average in 10 of the 12 categories.</p> <p>Since the recession, the principle contributors to Irish inflation have been "Miscellaneous goods and services" which is driven by health insurance, "Transport", "Alcohol and tobacco", "Education" and "Health".</p> <p>After significant price falls over recent years, house prices and rents are on an upward trend again with potentially significant consequences for affordability and wages.</p>



At present, weak economic growth continues to moderate inflation in Ireland. Tight fiscal policy will also continue to contain inflation, while recent structural reforms (e.g. changes to sectoral wage-setting mechanism, revisions to the Retail Planning Guidelines, legal services reform, the Haddington Road Agreement) will also help to support cost competitiveness. Looking to the future, further structural or policy induced changes are necessary to ensure that prices do not escalate and erode competitiveness as the Irish economy returns to stronger rates of growth.

# Chapter 1 - How Does Ireland Perform?

## Introduction

Competitiveness is a complex concept, encompassing many different drivers. Cost is just one of the elements which determine a country's ability to compete in international markets. In the long run, productivity performance is the ultimate determinant of success.

This report is required under the Action Plan for Jobs 2014. Specifically, Action 94 requires the National Competitiveness Council to "Benchmark key business costs and publish a report highlighting areas where Irish enterprise costs are out of line with key competitors"<sup>1</sup>.

The report concentrates on the costs that are largely domestically determined such as labour, property, energy, water, waste, communications and business services. *Costs of Doing Business 2014* is structured as follows:

- Chapter 1 summarises the key cost trends for enterprise in Ireland;
- Chapter 2 provides an overview of why costs matter for enterprise, develops cost profiles for a range of firm types which identify the most important cost categories, and explains the high level economic factors that determine costs;
- Chapters 3 to 7 examine the main cost categories in greater detail. The primary costs analysed in these chapters relate to labour, property, transport, utilities, and credit costs;
- Chapter 8 examines data on professional and business services costs - a cost category not captured in the profiles referred to above but still an important input for the vast majority of enterprises; and
- Finally, acknowledging the interlinked nature of all sectors and participants of the economy, Chapter 9 considers the general consumer cost environment.

In each chapter, a range of internationally comparable enterprise-focussed cost indicators are collected for Ireland and a number of key trading partners. We have endeavoured to collect relevant data from high quality sources - caveats on data used are set out in the relevant section. Where possible, Ireland's cost levels are compared to a relevant peer group average (e.g. the OECD and euro area average) or else compared to as wide a group of countries as possible. The report uses the most up to date internationally comparable cost data. As much of the data is collected on an annual basis, there may be a time lag in capturing recent changes in cost levels. Recent changes in Ireland's cost environment, which are not captured in the international data, are reflected in the text where applicable.

## Measures of Overall Cost Competitiveness

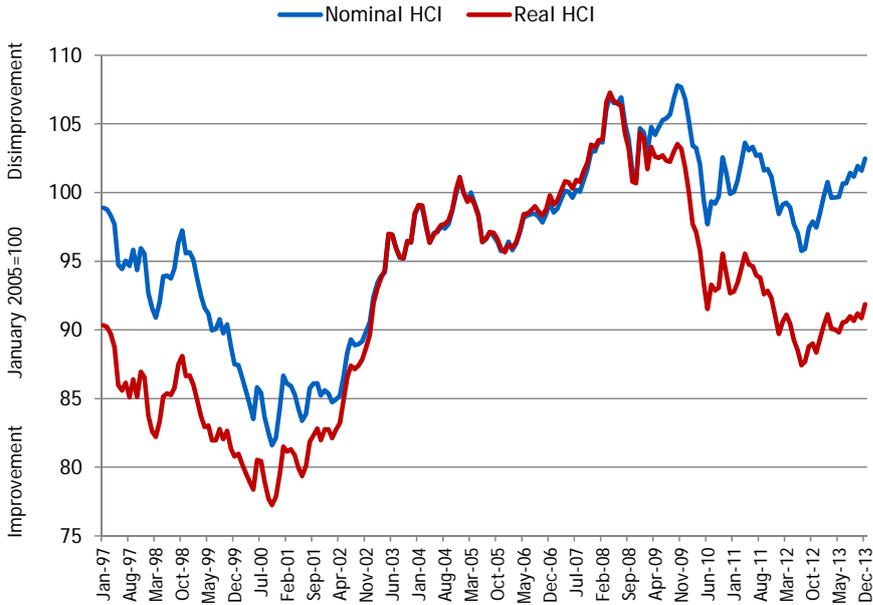
Changes in international cost and price competitiveness depend on a combination of exchange rate movements and movements in relative prices. Much of Ireland's competitiveness story can be illustrated using Harmonised Competitiveness Indices (HCIs)<sup>2</sup>.

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<sup>1</sup> Department of Jobs, Enterprise and Innovation, Action Plan for Jobs 2014, February 2014

Figure 1 highlights that relative Irish competitiveness improved in the period up until late 2000. Between October 2000 and April 2008, however, the real HCI declined by almost 39 per cent (the nominal HCI declined by 31 per cent), reflecting a strong appreciation of the euro against the currencies of our trading partners (nominal HCI) and higher price inflation in Ireland. Since the onset of the financial crisis and the recession, Ireland's competitiveness has improved as a result of reductions in relative prices and favourable exchange rate movements<sup>3</sup>.

Figure 1: Harmonised Competitiveness Indicators, January 1997 - December 2013 (January 2005=100)



From April 2008 to December 2013, the real HCI improved by over 14 per cent. The nominal HCI fell by 4.3 per cent, indicating that approximately a third of the improvements in Irish cost competitiveness are a result of exchange rate movements with the remainder resulting from lower inflation rates in Ireland compared to our trading partners<sup>4</sup>. Appendix 2 contains a more detailed examination of recent exchange rate trends.

Source: Central Bank of Ireland, Forfás calculations

It is worth noting, however, that since mid-2012, partly driven by a stronger euro, the HCI has deteriorated again (i.e. illustrating an erosion of some of the previous gains). This indicates that the period of relative competitiveness gains has come to an end, and that Irish relative cost competitiveness is currently disimproving.

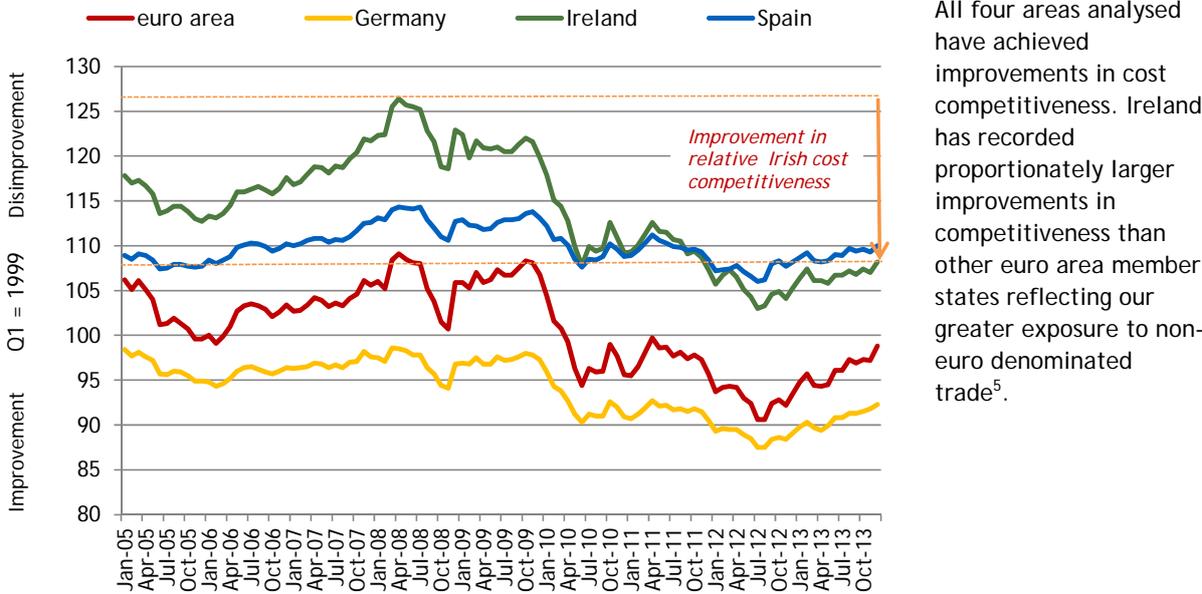
<sup>2</sup> The purpose of HCIs is to provide meaningful and comparable measures of euro area countries' price and cost competitiveness that are also consistent with the real effective exchange rates (EERs) of the euro. HCIs are constructed using the same methodology and data sources as the euro effective exchange rates. The Central Bank of Ireland produces both a nominal and real Harmonised Competitiveness Index. The nominal HCI is a nominal effective exchange rate for the Irish economy that reflects, on a trade weighted basis, movements in the exchange rate vis-à-vis 56 trading partners. The real HCI (deflated by consumer prices) takes into account relative price changes along with exchange rate movements. In Figure 1, an upward sloping line indicates a loss of competitiveness, whilst a downward sloping line indicates improving competitiveness.

<sup>3</sup> See 'Regaining Competitiveness' by Brendan Walsh, 24th July 2012 at [www.irisheconomy.ie/index.php/2012/07/24/regaining-competitiveness/](http://www.irisheconomy.ie/index.php/2012/07/24/regaining-competitiveness/)

<sup>4</sup> The euro appreciated relative to the dollar throughout much of the second half of 2013, whilst remaining relatively stable against sterling. See Central Bank of Ireland, Quarterly Bulletin Q1 2014, January 2014

Figure 2 draws on European Central Bank data to compare the evolution of real HCIs (accounting for relative price changes and exchange rate movements) for a range of selected euro area countries.

Figure 2: Real HCI Movements in Ireland, Germany, Spain and euro area, January 2005 - December 2013 (Q1 1999 = 100)



Source: European Central Bank

In short, since approximately 2008, Ireland has recorded a significant competitiveness improvement, particularly relative to Spain. Euro area and German cost competitiveness has also improved significantly over the period in question. Since mid-2012, however, cost competitiveness appears to be weakening somewhat in the countries benchmarked (including Ireland) and across the euro area.

### Focus on Individual Cost Categories

Macro harmonised competitiveness indicators can be difficult to translate into real world experience. From the perspective of the firm or an individual, in order to fully appreciate changes in prices and costs, it is necessary to examine more tangible indicators such as wage rates, rents, and the prices paid for various utilities and services. In this regard, *Costs of Doing Business 2014* examines over 50 different metrics across a range of business cost categories to provide an overview of the cost environment for enterprise in Ireland. The key messages are summarised below.

<sup>5</sup> The euro area HCI has also improved significantly. This can be explained by the fact that for each individual country the HCI is compiled using weights that reflect the structure of that country's total international trade, but for the euro area as a whole the weights reflect the only the area's trade with the non-euro world.

## Text Box 1: Summary of Business Cost Trends in Ireland

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## Labour Costs

As the major cost component for firms (see Chapter 2), labour costs are a key determinant of both firm-level and national competitiveness. Competitive and sustainable labour costs over the medium term are of particular importance for traditional sectors whose exports tend to be labour intensive. Despite some evidence of reductions in Irish labour costs being recorded over recent years (Figure 5), labour costs have proven relatively sticky. Indeed, over recent years as firms have battled the impact of recession, they have more commonly sought to control labour costs through redundancies and reductions in hours worked, than through wage cuts.

While Irish gross annual earnings are below the euro area average, net annual earnings remain above the euro area average (Figure 7). While wages represent a cost factor for firms, it is also important to note that they are also one of the main determinants of demand within the economy – indeed, the collapse in consumer demand has been one of the longer-lasting effects of the recession.

Irish labour costs are now on an upward trajectory: in 2012 labour costs in Ireland grew by 2.4 per cent compared with an increase of 2.2 per cent in the euro area. In 2013 Irish labour costs grew by 0.5 per cent compared with growth of 1.4 per cent in the euro area (Figure 5). While the 2013 trend represents a competitiveness gain for Ireland relative to our competitors, it is worth noting that the increases in Irish labour costs are occurring against a backdrop of a still elevated 12.1 per cent unemployment rate<sup>6</sup> and low inflation (Figure 50).

At a sectoral level the story is more complex (Figure 6): in 2010 and 2011, average growth rates in labour costs fell across most sectors in Ireland. In 2012, growth in labour costs resumed, particularly in the manufacturing (+4.1%) and trade sectors (+2.1%). In 2013, the sectoral data demonstrates a large degree of variation between sectors – for example while labour costs in ICT increased by 5.5 per cent, labour costs fell in manufacturing (-0.7%) and public administration (-1.2%).

Real Irish ULC's fell by 5.3 per cent in 2010 and 4.6 per cent in 2011, with a more modest reduction of 0.6 per cent per annum recorded in 2012 (Figure 8). This represents a competitiveness gain. However, Irish unit labour costs are showing signs of deterioration; according to the Central Bank, following an increase in absolute unit labour costs of 1.4 per cent in 2013, unit labour costs are projected to increase modestly in 2014 and 2015 (by 0.3 and 0.2 per cent respectively). The European Commission project that *relative* to the euro area, however, unit labour cost competitiveness will improve slightly in 2014 and 2015<sup>7</sup>.

The rate at which taxation is levied on labour is a major determinant of both an employer's decision to retain or hire individuals, and of the take-home pay of workers. As a result of changes in taxation levels, workers increase or decrease the pre-tax wage they bargain for in wage negotiations,

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<sup>6</sup> CSO, Quarterly National Household Survey, Quarter 4 2013, February 2013

<sup>7</sup> European Commission forecast data refers to European Commission, European Economic Forecast, European Economy 2-2014, February 2014

ultimately impacting upon total labour costs<sup>8</sup>. A competitive income taxation system is therefore a critical component of a competitive economy.

In general, the Irish taxation system has been broadly supportive of labour market efficiency (Figures 11-15). While the indicators analysed herein show that average Irish income tax and social security contributions rates remain below OECD averages, increases in income tax rates and the introduction of the Universal Social Charge have resulted in a diminution of Ireland's international competitiveness in this regard. The combined effect of increases in income taxes and social security contributions has been most noticeable for higher earners (Figures 12 and 14).

## Property Costs

For many firms, property costs represent the second largest cost category. Not surprisingly, the ending of the property and construction bubble, allied to the subsequent reduction in demand for office and industrial space on foot of the recession has resulted in significantly reduced property costs for businesses able to negotiate new agreements (e.g. new businesses). Recent quarterly increases in capital values for a range of commercial property classes (illustrated in Figure 16) suggest a degree of stabilisation has occurred in the Irish commercial property market.

The effect of the recession, however, is still clearly demonstrated both in terms of construction costs which have fallen by between a quarter and a third since 2007 (Figures 17 and 18) and rental costs which have seen office lease costs fall by 47 per cent over the same period (Figure 19). Retail rents have also fallen, although the market is still characterised by limited activity (Figure 20).

Concerns persist in relation to the existing supply of Grade-A office space in certain key locations. As the recovery continues, the dearth of new supply may result in shortages. In the current depressed market, reduced construction costs have in some cases been insufficient to make development viable<sup>9</sup>; for example within the office market in Dublin city, the cost of replacement/expansion of existing premises is often too expensive compared to the prevailing rents available on existing buildings.

Looking at the industrial rental market, the lack of well located, high quality space has resulted in prime rents edging upwards in the quarter up to Q3 2013 - industrial rents average €67 per metre squared a month in Dublin. Despite the lack of larger buildings within the market, there is unlikely to be a return to speculative development in the short term. However, the purpose built ("built to suit") and owner occupation route, particularly for larger buildings is anticipated to be a more favoured option. Consequently, the divergence between prime and secondary rents should continue.

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<sup>8</sup> As noted in a recent Forfás report, higher income taxes also increase replacement rates (i.e. make work less attractive vis-à-vis social welfare), reduce take home pay, weaken domestic demand and risk stimulating the informal economy. For further details, see Forfás, Labour Market Competitiveness 2013, July 2013

<sup>9</sup> A recent report on the outlook for the construction sector in Ireland notes that the cost of building materials and aggregates has increased steadily during the recession. Although some of this is subject to world prices (e.g. steel, oil based products such as tarmac, PVC etc.), increases in locally produced inputs such as aggregates and concrete have a material impact on the level of output deliverable within constrained development budgets. For further details, see Forfás, Ireland's Construction Sector: Outlook and Strategic Plan to 2015, July 2013

While the reduction in rental costs is welcome from a cost competitiveness perspective, such reductions primarily benefit new entrants into the market. Existing firms are not always in a position to renegotiate contracts and thus take advantage of prevailing market conditions.

Finally, the issue of commercial rates is of long standing concern to many enterprises. Issues relating to the manner in which rates are calculated and revised are particularly prevalent. At the same time, the growing dependence of Local Authorities on commercial rates as a source of income is clearly evident in Figure 21<sup>10</sup>.

## Transport Costs

Transport costs tend to be relatively more important for manufacturing firms than firms in other sectors. A recent InterTradelreland survey of SMEs found that rising transport costs (along with energy costs) represent the greatest upward cost pressure for firms in Ireland and Northern Ireland<sup>11</sup>.

Diesel costs have a particularly direct and significant impact upon haulage costs. In general, while Irish diesel costs are higher than the euro area average - and the 3<sup>rd</sup> most expensive in the euro area - the proportion of costs accounted for by taxation is broadly in line with norms elsewhere (Figures 22 and 23). There is a strong correlation between movements in the world price of energy inputs and domestic diesel and unleaded gasoline prices.

While many aspects of transport costs are beyond the influence of Irish policymakers (e.g. distance to market, international fuel costs), certain cost factors are largely determined domestically. While Ireland performs relatively well in terms of time taken to comply with official procedures for importing and exporting, it is more expensive to do so in Ireland than in the euro area (Figures 25 and 26). The administrative cost associated with exporting a 20-foot container from Ireland is €1,160 compared with a euro area average of €1,044.

## Utility Costs

A large number of services and activities are captured under the utilities heading.

For many firms, energy costs represent their primary utility expense. Electricity and gas prices had been more competitive but some of these improvements have been reversed as a result of developments in 2011 and 2012 (i.e. electricity prices have increased sharply mainly due to increases in the price of gas and the phasing out of the temporary rebate for large energy users)<sup>12</sup>. This reversed the competitiveness improvements experienced between 2008 and 2010.

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<sup>10</sup> The Council has recently published their Submission to the Action Plan for Jobs 2014 which proposes that a Site Value Tax on commercial properties be introduced to replace the current system of commercial rates. For more detail, see National Competitiveness Council, Submission to the Action Plan for Jobs 2014, Forfás, December 2013

<sup>11</sup> According to the ITI survey, 72 per cent of firms cited rising energy costs as a concern, while 56 per cent of firms reported an increase in transport cost over the previous quarter. See InterTradelreland, Business Monitor Q4 2013, February 2014

<sup>12</sup> Some of the factors which affect Ireland's energy costs competitiveness are outside of Ireland's control (e.g. reliance on imported fossil fuels) but there are a number of important cost drivers within its control (e.g. delays in completing the North-South interconnector are negatively affecting the efficient functioning of the SEM and are estimated to be costing approximately €20-30 million per annum, which means higher costs for



In terms of electricity costs (Figures 27 and 28), Irish prices for both large users and SMEs are above the euro area average, although prices showed a slight reduction in the first half of 2013. While gas prices in Ireland are relatively competitive vis-à-vis other EU member states, the availability of significantly cheaper gas in the US represents a major cost disadvantage for European firms (Figure 29)<sup>13</sup>. According to IEA data, natural gas in the US trades at one-third of import prices in Europe and one-fifth of prices in Japan<sup>14</sup>. Measures to control energy costs and enhance energy efficiency are particularly important.

The provision of water services to business in Ireland is undergoing significant reform - on the 1<sup>st</sup> January 2014, Irish Water assumed responsibility for the provision and management of water services in Ireland, while the Commission for Energy Regulation (CER) is responsible for the economic regulation of the sector. From a competitiveness perspective, the challenge facing Ireland is to undertake the necessary investment to provide adequate, reliable and quality water services while ensuring water services cost are competitive. In terms of water costs (Figures 30 and 31), Ireland is the 5<sup>th</sup> most expensive location amongst 16 countries benchmarked for industrial water services - this data does not include the cost of waste water services.

In terms of waste management costs, recent years have seen an increase in both landfill gate fees (Figure 32) and thermal treatment gate fees (Figure 33). Landfill gate fees in Ireland are 5<sup>th</sup> most expensive out of 10 countries, while non-hazardous thermal treatment fees are 3<sup>rd</sup> highest out of 9 countries.

The final utility considered relates to telecommunications. Overall, Irish prices for broadband and telephone services appear relatively competitive - broadband and telephone costs are generally below euro area averages (Figures 34 and 35) although concerns persist about the speed and quality of services available to Irish firms compared with what is on offer in key competitors and market leaders.

## Credit Costs

Access to finance and its cost are critical issues for enterprise. The availability of a flow of affordable capital is essential for the day to day operations of enterprise and to allow firms to undertake productivity enhancing investments. As illustrated, however, Irish businesses continue to pay more for new lending than their euro area counterparts for new loans and overdrafts (Figures 28 and 29).

Revolving loans and overdrafts provide an important source of short term finance for many firms. As of November 2013, interest rates in Ireland for such facilities were 11.5 per cent above the euro area average (Figure 40).

As interest rates on the outstanding stock of loans began to drop across the euro area in mid-2009, interest rates in Ireland began to converge with the euro area (Figure 41). The data suggests that

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Irish electricity consumers). For a more detailed discussion on domestically controllable cost factors, see Forfás, Sectoral Regulation - A Study to Identify Changes to Sectoral Regulation to Enhance Cost Competitiveness, April 2013

<sup>13</sup> According to the IEA, natural gas for industrial users in the US cost \$12.74 per MWh GCV in 2012 compared with \$45.58 in Ireland (GVC stands for Gross calorific value). See International Energy Agency, Key World Energy Statistics, 2013

<sup>14</sup> International Energy Agency, World Energy Outlook 2013, November 2013



Irish interest rates for new loans are generally higher than the euro area average, while the Irish rate for outstanding loans is lower than the euro area average. This is primarily a result of compositional effects (i.e. the outstanding loans interest rate captures the interest rate for longer-term facilities which originated at a time when credit in Ireland was cheaper than in most euro area countries).

The high interest rates charged in Ireland are a concern from a competitiveness perspective given the dependence of Irish SMEs in particular on banks as a source of funding - a recent Central Bank paper found that Irish SMEs are amongst the most heavily reliant on banks for funding across a range of EU countries studied (although since the financial crash there has been an increased move to trade credit and equity for working capital)<sup>15</sup>.

Industry has also expressed concerns about increases in bank charges: according to data from the European Central Bank, 68 per cent of Irish SMEs felt that the costs of financing (other than interest rates - i.e. charges, fees and commissions) had increased in the six months prior to September 2013. By comparison, 43 per cent of euro area SMEs felt costs had increased<sup>16</sup>.

### Business Services and Other Input Costs

All enterprises engage a range of professional services providers in order to conduct their business. These services include a disparate set of inputs including, computer programming and consultancy, accountancy and legal services. Although business and professional services account for a relatively low proportion of the enterprise cost base - certainly compared with labour costs and property costs, they have a direct impact on the overall cost base and efficiency of firms.

The primary concerns in this sector relate to the recent upward trend in costs across a range of business services (Figure 42). Focusing specifically on the cost of legal services, CSO data suggests that solicitor fees have not adjusted to the same extent as some other business services (Figure 44). In terms of the efficiency of the legal sector, the length of time taken to enforce a contract is significantly longer in Ireland than in the OECD with consequential knock-on effects for overall legal costs (Figure 45).

While the available data on non-life insurance premia suggests that Ireland is relatively competitive, enterprise is expressing concern about the emerging upward trend in prices.

It is also interesting to note that manufacturing products sold within Ireland have increased at a significantly faster pace than both services and manufacturing products traded internationally (Figure 43).

### Broader Cost Environment<sup>17</sup>

As noted previously, all sectors of the economy are interlinked - for example, consumer costs influence labour costs, which in turn impact on overall business costs and so on. It is appropriate,

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<sup>15</sup> Lawless, M., McCann, F., and O'Toole, C., The importance of banks in SME financing: Ireland in a European context, Economic Letters Series Vol. 2013, No. 5, Central Bank of Ireland, October 2013

<sup>16</sup> European Central Bank, Survey on the Access to Finance of Small and Medium-Sized Enterprises in the Euro Area April 2013 - September 2013, November 2013

<sup>17</sup> Sourced from Forfás, Consumer Costs and Inflation 2013, February 2014

therefore, to consider the broader consumer cost environment when assessing the enterprise cost base.

While consumer prices in Ireland have adjusted downwards in recent years, prices remain elevated relative to GDP and particularly GNP, and relative to most other euro area countries (Figure 47). In 2012, Ireland was the 3<sup>rd</sup> most expensive location in the euro area for consumer goods and services. Irish prices were 14.6 per cent above the euro area average. Ireland remains within the top three most expensive euro area countries in five out of twelve categories of goods and services; Alcoholic Beverages and Tobacco, Health, Restaurants and Hotels, Food and Non-Alcoholic Beverages and Miscellaneous Goods and Services. Irish price levels remain above the euro area average in 10 of the 12 categories of goods and services.

In determining the broader cost environment, it is necessary to consider both changes in prices (inflation) and price levels. As illustrated, Ireland's current price level and inflation profile can be described as high cost but rising slowly (Figure 50). Since the onset of recession, prices in Ireland have increased at a significantly slower rate than in the euro area. Despite a return to inflation in 2011-2013 following a period of deflation, Irish HICP inflation in 2013 (0.5%) remains below the euro area average (1.4%), indicating an improvement in relative cost competitiveness.

Since 2008, the principal contributors to Irish inflation have been "Miscellaneous goods and services" which is driven by health insurance, "Transport", "Alcohol and tobacco", "Education" and "Health" (Figures 52 and 53)<sup>18</sup>. This increase in health insurance costs represents a significant cost factor for many employers as well as for individuals.

Housing costs have a direct impact on wage demands and standards of living. Since their peak in 2007, Irish house prices have experienced a major downward adjustment - in 2013, house prices (on a mix-adjusted basis, i.e. controlling for quality to compare on a like-for-like basis) were 45 per cent below 2007 peak levels, leading to improved affordability (Figure 54)<sup>19</sup>. Based on analysis undertaken by Fitch, house price affordability in Ireland (measured in terms of the ratio of house

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<sup>18</sup> "Miscellaneous Goods and Services" covers a wide range of items including hairdressing and other grooming, goods for hygiene, hair and body care; personal goods such as jewellery, handbags and wallets, childcare and other social protection services; insurance, financial services and other services including funerals, weddings, legal and professional services.

"Transport" includes the purchase of new and second hand vehicles, spare parts, car maintenance, fuels and lubricants, public transport and services such as parking, motor association subscriptions, car wash, toll charges, driving lessons, driving tests, driving licence and car hire.

The "Alcoholic Beverages and tobacco" category includes alcoholic beverages purchased in off licenses and supermarkets but excludes alcohol consumed on or within licensed premises (which is captured in the 'Restaurants and Hotels' category). It also includes tobacco products.

The "Health" category includes medical products, appliances and equipment, hospital charges and outpatient services supplied by doctors, dentists, opticians, physiotherapists and practitioners of alternative and complementary medicine.

The "Education" category covers all aspects of education including pre-primary and primary, secondary, third level and other education and training such as night course and examination fees.

<sup>19</sup> Non-mix adjusted data (house price data that does not adjust for quality) suggests a smaller decline in prices. Comparison of mix-adjusted and non-mix adjusted data suggests that the quality (in terms of size, location, etc.) of the properties transacted since the crash has improved (i.e. more proportionately more 'premium' properties are being sold).

prices to GDP per capita and in terms of the debt-to-income ratio<sup>20</sup>) compares favourably with the range of European economies benchmarked and is broadly similar to ratios in the UK.

Recent quarters, however, have seen a significant shift in Irish house price trends, with a return to house price growth. In Q3 2013, Irish house prices grew by 3.7 per cent on an annual basis; by comparison, house prices in the euro area fell by 1.3 per cent<sup>21</sup>. House price growth has been particularly strong in Dublin. This will have an adverse effect on affordability and could have a knock on impact on wage costs.

In terms of the rental market, rents nationally were 4.8 per cent higher on average in Q3 2013 than a year previously. The increase was particularly striking in Dublin which recorded an increase of 7.6 per cent annually (Figure 55). This also has a significant impact upon the cost of living with subsequent impacts on wage expectations and cost competitiveness.

Finally, the hotels and restaurant sector<sup>22</sup> forms an important sector of the domestic economy and strongly influence broader consumer cost trends. Prices in this sector also impact on the competitiveness of the tourism sector and business travel costs to Ireland. While the cost competitiveness of the Irish “Restaurant and hotels” sector has improved since the recession, in 2012 Irish price levels remained 21.8 per cent above euro area-17 average. Alcohol in “Licenced premises” and “Restaurants, cafes, fast food and take-away food” are the two main elements driving inflation in this category. “Accommodation services” in Ireland have seen a notable improvement in relative cost competitiveness.

## Conclusions and the Role for Policy

Ireland’s cost base has improved across a range of metrics over the last four or five years. This has made Irish firms more competitive internationally and made Ireland a more attractive location for firms to base their operations in. However, despite these improvements, Ireland remains a high cost location as evidenced across a range of factors identified herein. Addressing Ireland’s international cost competitiveness must, therefore, remain a key economic priority for Government.

The Council is concerned that recent price falls in Ireland are largely a cyclical response to the Irish and international recessions (i.e. reduced demand, spare capacity), rather than a response to structural changes in the Irish economy. It is also not clear that cost gains are being driven across the broad economy i.e. the relatively small internationally trading manufacturing sector has recorded significant competitiveness gains, while costs in large domestically trading services sectors

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<sup>20</sup> The debt-to-income ratio calculates mortgage payment on average-priced dwellings financed by mortgages with typical loan-to-values and interest rates, as a proportion of an average-sized household’s average gross disposable income. See Fitch Ratings, Fitch Residential Mortgage Briefing - Global Market Outlook for Housing and Mortgage Lending, January 2014

<sup>21</sup> Eurostat, Third quarter of 2013 compared with third quarter of 2012 Euro area house prices down by 1.3 per cent, EU down by 0.5 per cent, Press Release STAT/14/9, 21st January 2014

<sup>22</sup> The “Restaurants and Hotels” COICOP includes meals in restaurants and hotels, fast food and takeaways; cafes; canteens; alcohol consumed on or within a licensed premises and accommodation services supplied by hotels, guesthouses or hostels.



such as health and education remain high<sup>23</sup>. Furthermore, much of the evidence collected in this report suggests that the Irish economy has reached a turning point in terms of cost competitiveness. While positives persist - for example, communications costs remain internationally competitive, and prices for a range of business services continue to decline (e.g. architecture, advertising and employment services) - the trends evident in the Harmonised Competitiveness Indicators indicate that overall relative cost competitiveness in Ireland is now disimproving, and that a series of upward cost pressures are emerging.

Over the last 12 months, a slight deterioration has been recorded in the nominal HCI, while the real HCI has remained relatively static. This suggests that marginal improvements in cost competitiveness (resulting from slightly lower inflation in Ireland relative to our competitors and trading partners) have been offset by the adverse impact of the strengthening euro. Low rates of inflation (or possible deflation<sup>24</sup>) across the whole euro area increase the difficulty of extending improvements in cost competitiveness through price reductions (i.e. the differential between Irish inflation and the euro area is negligible). As a result, productivity performance will assume an even more prominent role in driving Irish international competitiveness.

Looking forward, expected currency movements over the coming year are likely to intensify recent trends. As the euro is forecast to strengthen further vis-à-vis the dollar, Irish exports will become relatively more expensive, and thus less cost competitive (on the other hand, a stronger euro will reduce the costs of imports from outside the euro area)<sup>25</sup>. Ireland's greater exposure to non-euro area trade than many other EU member states leaves Irish exporters particularly vulnerable to such adverse currency fluctuations.

Elsewhere in the economy, we have seen a resumption in labour cost growth. From a competitiveness perspective, it is vital that such growth is underpinned by productivity improvements.

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<sup>23</sup> O'Brien and Scally have found that aggregate competitiveness data masks significant differences in sectoral adjustments. Indigenous firms, for example, are much more exposed to the domestic and UK markets and were quite adversely affected by the sharp depreciation of sterling during the early phase of the crisis. Foreign-owned firms, which account for a very large proportion of total exports, tend to be more acyclical in nature. However, given that the foreign-owned firms are generally less labour intensive, the overall employment performance in the exporting sector was much weaker. For more detail see O'Brien, D., and Scally, J., Cost Competitiveness and Export Performance of the Irish Economy in Central Bank of Ireland, Quarterly Bulletin Q3 2012, July 2012

<sup>24</sup> Deflation is a situation in which the low level of inflation combined with the inertia of nominal interest rates leads to an excessively high level of real interest rates relative to growth. Inflation and expected inflation in the euro zone remain low, but positive; the real long-term interest rate of the euro zone as a whole exceeds 2 per cent, due to disinflation; this is probably too high relative to growth and so the risk of euro area deflation continues. Deflation is a problem in a modern economy because it increases the real value of debt, and may aggravate recessions and lead to a deflationary spiral. A deflationary spiral is a situation where decreases in price lead to lower production, which in turn leads to lower wages and demand, which leads to further decreases in price. It is worth noting that while short- and medium-term expectations are for low rates of inflation, long-term inflation expectations remain anchored at close to the 2 per cent that is defined as being consistent with price stability in the euro area as a whole.

<sup>25</sup> European Commission, European Economic Forecast - European Economy 7|2013, November 2013



In terms of property costs, there are concerns about the shortage of Grade-A office space (particularly in Dublin) which could quickly result in escalating rental costs; the sudden take-off in the residential property market serves as a warning in this regard.

Upward pressures are also evident in relation to a range of utility costs, notably energy costs (with expectations that international energy prices will continue to rise, based on forecast gas-price trends). In terms of water costs, there is a degree of uncertainty - there will undoubtedly be winners and losers from the introduction of a single water national charge. The need for significant investment in infrastructure, however, allied to the cost associated with meeting environment targets has the potential to result in increases prices (offset to a degree through potential efficiency gains which may arise as a result of the reforms).

Finally, while the threat of deflation in the euro area will keep interest rates at (or below) current historically low levels in the short term, rates will inevitably increase over the longer term.

At present, weak economic growth continues to moderate inflation in Ireland. Tight fiscal policy will also continue to contain inflation, while recent structural reforms (e.g. changes to sectoral wage-setting mechanism, revisions to the Retail Planning Guidelines, legal services reform, the Haddington Road Agreement) will also help to support cost competitiveness.

Looking to the future, further structural or policy induced changes are necessary to ensure that prices do not escalate and erode competitiveness as the Irish economy returns to stronger rates of growth. The NCC will outline detailed recommendations addressing many of the major cost factors in its *Competitiveness Challenge* report to be issued later in 2014.

## Chapter 2 - How Costs Impact on Enterprise

### Why Costs Matter

Generating sustainable broad based export-led growth is essential to rebuilding the Irish economy. To achieve such growth, Ireland's international competitiveness must be maintained and enhanced relative to our key competitors.

As noted earlier, competitiveness is a complex concept, encompassing many different drivers. Notwithstanding the evolution of the Irish economy and the growing complexity of the goods and services produced here over the past decade, cost competitiveness remains a critical determinant of success. Indeed, in the absence of a currency devaluation policy lever to manage short term cost competitiveness pressures, a combination of cost reductions in key business inputs and enhanced productivity growth must provide the foundations for growth<sup>26</sup>. In the longer term, productivity growth is the preferred mechanism to improve competitiveness as it can support cost competitiveness in tandem with high and increasing income levels.

The ESRI have modelled the impact of a potential improvement in Ireland's cost competitiveness. They found that industrial output would increase by 1.7 per cent when faced with a one percentage point improvement in competitiveness. Services activity would also increase, but by a smaller amount. The ESRI suggest that the increase in output would feed through to an increase in total employment of 0.2 per cent by 2018<sup>27</sup>. Overall, GNP would increase by 0.5 per cent in volume terms by 2018 while GDP would be up by around 0.8 per cent. Higher exports would also lead to a significant improvement in the current account of the balance of payments.

A high cost environment weakens competitiveness in a number of ways.

- High costs make Ireland less attractive in terms of foreign direct investment;
- High costs can make firms which rely on domestically sourced inputs less competitive when they are selling into foreign markets - this is a particular concern for large indigenous exporting sectors such as the food and drink sector; and
- A high cost environment can impact on firms which may not export, but which rely on the domestic market - their customers (consumers and other firms) may source cheaper inputs from abroad, rather than from within Ireland, leading to a loss of market share for Irish based enterprises.

More broadly, all sectors of the economy are interlinked and interdependent - high business costs have implications for the costs of living. Current Forfás research shows that despite reductions in Irish price levels, Ireland is the third most expensive country in the euro area for consumer goods and services - consumer prices in Ireland in 2012 were 13.6 per cent above the euro area average<sup>28</sup>. High consumer prices have knock on implications for wage demands, and so the cycle continues.

While reductions in business costs are difficult and sometimes painful to achieve, such reductions are essential to boost competitiveness, and can deliver significant opportunities for enterprise.

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<sup>26</sup> National Competitiveness Council, Ireland's Productivity Performance, 1980-2011, Forfás, May 2012

<sup>27</sup> FitzGerald, J., and Kearney, I. (Ed), Medium-Term Review 2013-2020, Number 12, ESRI, July 2013

<sup>28</sup> Forfás, Consumer Costs and Inflation, February 2013

Improved cost competitiveness makes Ireland more attractive to foreign investors to base and develop their operations here, and allows Irish firms to compete more effectively in foreign markets and in our home market. More broadly, a reduced cost base can help to create a virtuous circle between the costs of living, wage expectations and cost competitiveness.

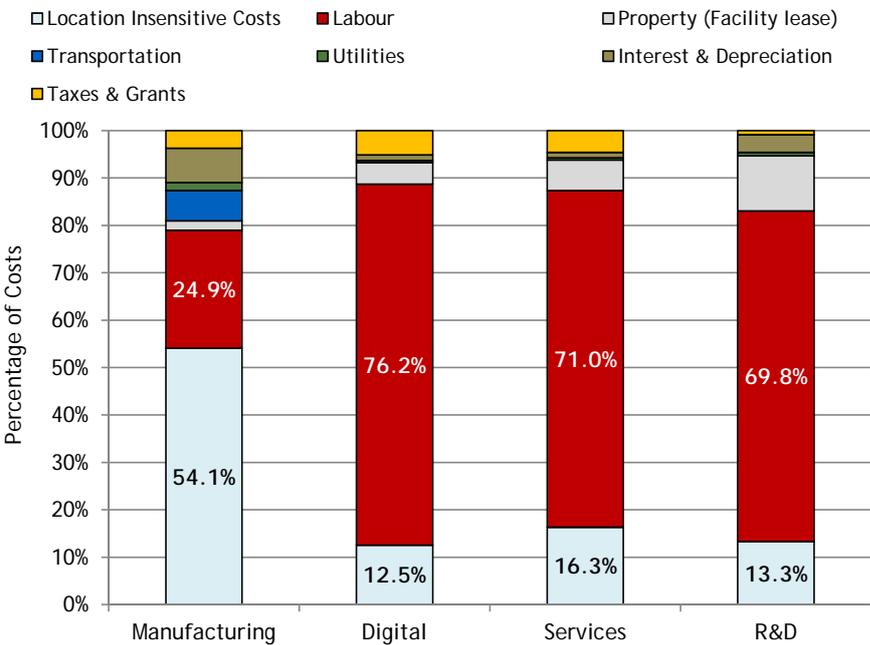
### Which Costs Matter Most?

From a competitiveness perspective, it is essential that policymakers focus on reducing costs that comprise a significant percentage of business costs and that are out of line with those in competitor countries. Figures 3 and 4 (below) provide an overview of the cost profile of a range of sectors.

Figure 3 presents summary cost profiles for four broad sectors of the economy - manufacturing, digital services, broader business services, and research and development (R&D) services. These profiles have been developed using KPMG’s Competitive Alternatives 2012 report, which uses case study business operations for 19 different sub-sectors<sup>29</sup>. More detailed sub-sectoral profiles are provided in Appendix 1.

The profiles illustrate the relative importance of location sensitive and location insensitive costs (i.e. goods and services produced on international markets where the price is determined by global supply and demand conditions e.g. commodity raw materials, industrial equipment, etc.).

Figure 3: Summary Cost Profiles for Manufacturing, Digital Services, Services and R&D Operations



Relative to manufacturing, location insensitive costs form a smaller component of total costs for digital services (12.5%), broader services (16.3%) and R&D (13.3%) operations. Over half of the total costs in manufacturing (54.1%) comprise location insensitive costs. There are, however, significant differences within manufacturing; 37.1% of total costs in the medical devices sector are location insensitive compared to 66.6% in the chemicals sector (see Appendix 1).

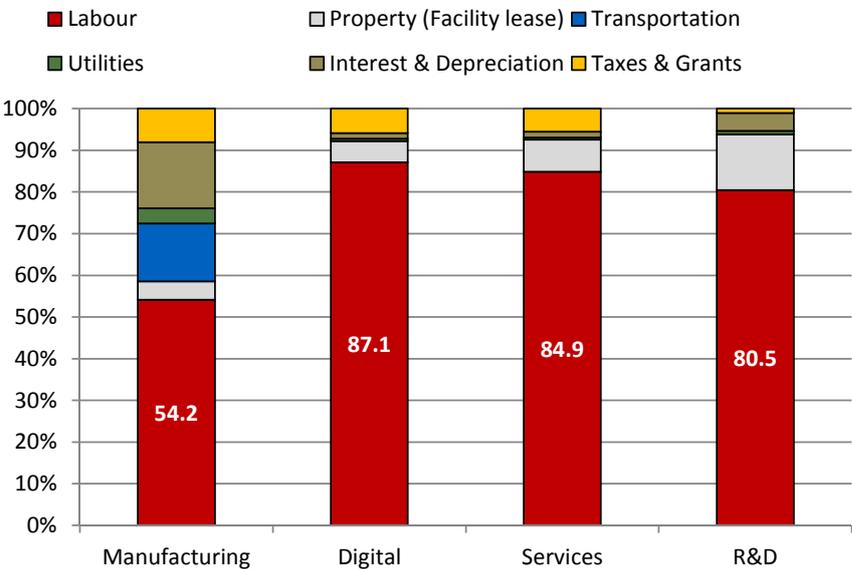
Source: KPMG, Competitive Alternatives 2012, Forfás Calculations

<sup>29</sup> Ireland is not included in the study. The benchmarked countries used to calculate the cost profiles are Australia, Canada, France, Germany, Italy, Japan, Netherlands, the UK and the US. As the profiles are based on a single case study firm in each sector, the profiles should be regarded as indicative rather than representative of the cost structure across sectors.

While not discounting the importance of location insensitive costs, it is nonetheless notable that Irish-owned companies are generally much more integrated into the domestic economy and therefore are more sensitive to locally influenced, location sensitive costs. Differences in sectoral specialisation will also influence spend in the local economy. Forfás data on development agency assisted exporters<sup>30</sup> shows that:

- In overall terms foreign-owned industry spent €24.51 billion on raw materials in 2011, €2.6 billion of which (or 10.8 per cent) relates to material sourced in Ireland (by either indigenous suppliers or other foreign-owned multinationals in the country). In contrast, Irish-owned firms spent €12.14 billion on raw materials. In this case, however, 66.8 per cent of these materials were sourced locally.
- A similar story emerges in terms of services inputs - in 2011 foreign owned firms purchased over €58.6 billion worth of services, 8 per cent of which was sourced in Ireland. While the value of services purchased by Irish-owned firms is much lower (€4.3 billion), almost 78.5 per cent of these were sourced in Ireland.
- In 2011, the total payroll bill of foreign-owned firms amounted to almost €8.27 billion with manufacturing accounting for €4.9 billion (58.9 per cent) and services contributing the remaining balanced (41.1 per cent). Irish-owned companies spent €5.25 billion in 2011 on payroll costs - €3.37 billion (64.2 per cent) of which was accounted for by manufacturing firms.

Figure 4: Summary Cost Profiles for Manufacturing, Digital, Services and R&D Operations, Excluding Location Inensitive Costs



In general, location insensitive costs include inputs for which the price is set in international markets, such as materials and equipment. As location insensitive costs do not influence decisions on where to invest, these cost elements have been excluded from Figure 2 and from the more detailed sectoral cost profiles in Appendix 1<sup>31</sup>.

Source: KPMG, Competitive Alternatives 2012, Forfás Calculations

<sup>30</sup> Forfás, Annual Business Survey of Economic Impact 2011, July 2013

<sup>31</sup> The assumption that location insensitive costs do not influence decisions on where to invest may not hold in all cases. For example, peripheral locations may face additional transportation costs on commodity products. Domestic policies such as taxes and tariffs may also impose additional costs on 'location insensitive costs'.

In summary, while a high share of total manufacturing costs are determined internationally, the cost base of services companies is highly dependent on the local cost environment. The cost of labour is the most significant driver of business costs for most firms – particularly for services firms. Across manufacturing, a range of other inputs also play an important role – in particular, transport, utilities and property costs.

## What Drives Costs?

During a boom such as Ireland experienced in the early and mid-2000s, it is to be expected that prices and costs will increase. Wealthy countries are generally expensive countries. Recent analysis, however, suggests that price rises in Ireland were not necessarily a result of price convergence between Irish and European price levels, arising from faster growth rates here<sup>32</sup> – Irish price levels were above the euro area average in 1999, and so movements in price levels between 1999 and 2008 served to widen the existing gap<sup>33</sup>. This mirrors analysis by the European Commission which has found that even allowing for Ireland’s relatively high level of GDP per capita, the price level in Ireland prior to the current crisis had been relatively high in comparison with other euro area economies. Notwithstanding the price adjustments which have occurred as a result of the recession, the Irish price level remains elevated compared with many of our competitors (see Figure 47)<sup>34</sup>.

In the past (i.e. during the boom years of the Celtic Tiger), a number of factors contributed to the rise in costs including:

- Economic overheating caused by pro-cyclical fiscal policy (fast growth in public spending and tax cuts) while euro area interest rates were low;
- Rapid credit growth and the unsustainable boom in the construction industry;
- The circular impact of rapid house price inflation on wage growth; and
- Regulatory and other restrictions to competition as outlined in various Competition Authority reports.

With the onset of recession, many of these cost drivers dissipated. However, as referenced in the previous chapter, a range of costs are now increasing.

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<sup>32</sup> Higher inflation due to this ‘convergence effect’ is not, in itself, a major concern, reflecting a natural rise in the cost of domestic services justified by higher incomes and living standards. In an economy catching up with its richer neighbours, labour productivity tends to rise faster in sectors producing internationally tradable goods (particularly in capital intensive manufacturing industry) than in those involved in the more labour intensive and generally non-traded service sector. Increases in labour productivity growth in traded manufacturing industries are usually followed by wage growth throughout the economy. Thus, a combination of wage growth across both traded and non-traded sectors, but lower labour productivity gains in the services sector, leads to more rapid increases in the cost of services. In this way, services inflation is often higher in those regions of a monetary union enjoying the most rapid growth in productivity and incomes. This is known as the ‘Balassa-Samuelson effect’.

<sup>33</sup> Forfás, Consumer Costs and Inflation, February 2013

<sup>34</sup> Directorate-General for Economic and Financial Affairs, The Economic Adjustment Programme for Ireland, European Economy, Occasional Papers 76, February 2011, page 14.

# Chapter 3 - Labour Costs

Figure 5: Growth in Labour Costs, 2001-2013

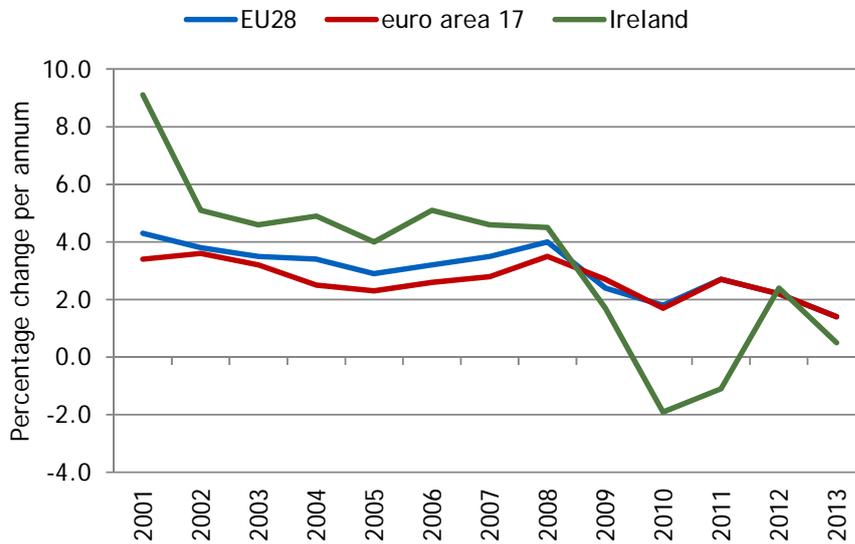
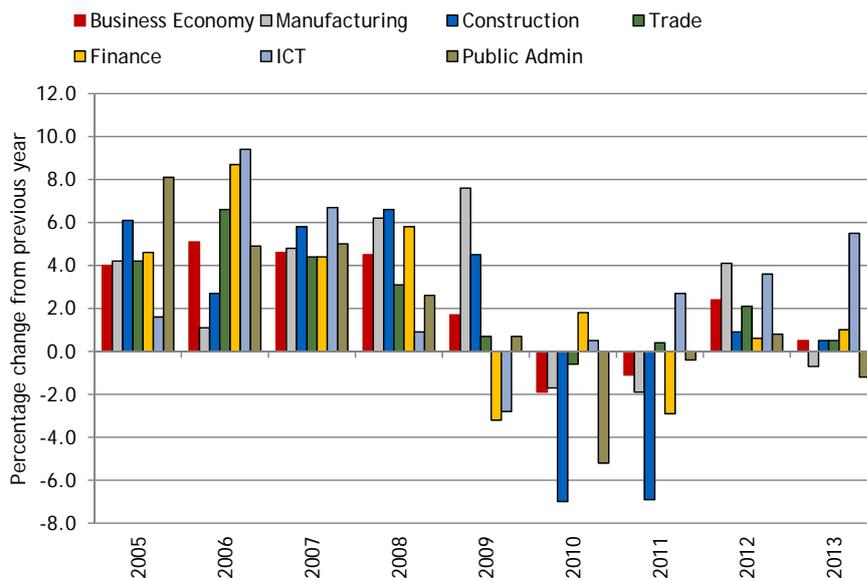


Figure 5 compares trends in labour costs in Ireland with the euro area-17 and EU-28. From a high of 9.1% growth in 2001, Irish labour costs fell in both 2010 (-1.9%) and 2011 (-1.1%). This represents a gain in competitiveness as labour costs rose in the EU and euro area. In 2012, labour costs rose by 2.4% in Ireland - slightly above the EU and euro area averages (2.2%). In 2013, while wage growth in Ireland was positive (0.5%), the rate of growth slowed and was less than the both the euro area and EU (1.4%).

Source: Eurostat

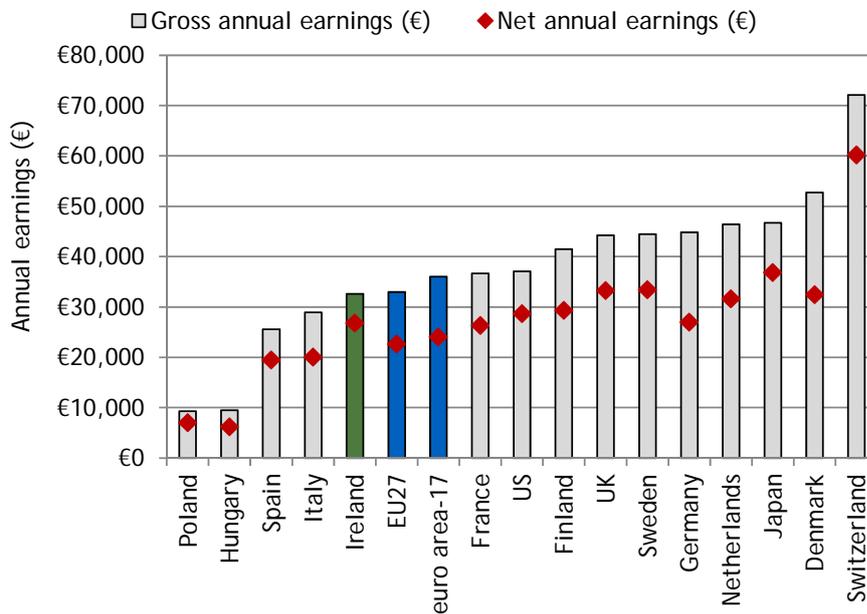
Figure 6: Average Growth Rate in Labour Costs in Ireland by Sector, 2005-2013



In 2010 and 2011, average growth rates in labour costs fell across most sectors in Ireland. In 2012, growth in labour costs resumed, particularly in the manufacturing (+4.1%) and trade sectors (+2.1%). In 2013, the sectoral data demonstrates a large degree of variation between sectors - for example while labour costs in ICT increased by 5.5%, labour costs fell in manufacturing (-0.7%), and public administration (-1.2%).

Source: Eurostat

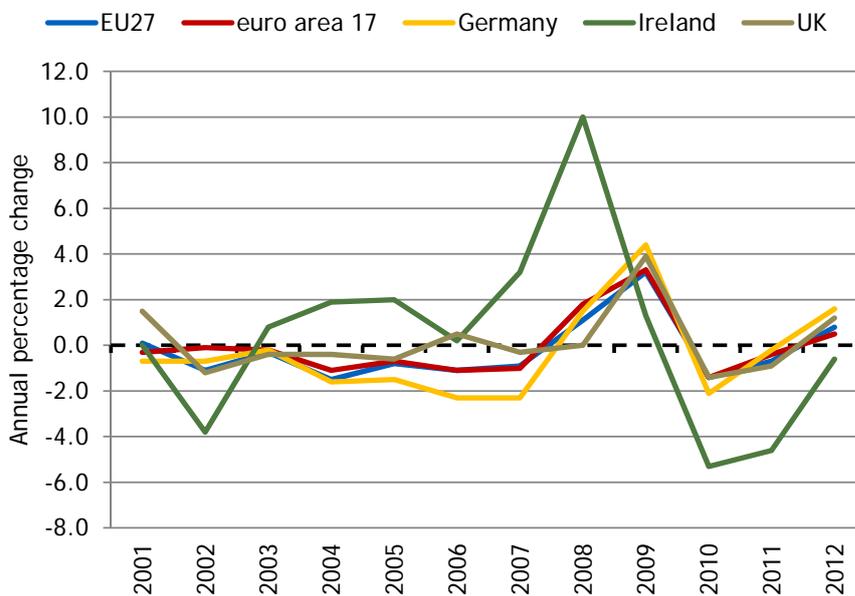
Figure 7: Average Annual Gross and Net Earnings, Single individual without children, 100% of average earnings, 2012<sup>31</sup>



Gross wages include wages, taxes on income and employer and employee social security contributions. Ireland has the 8<sup>th</sup> highest gross wage level in the euro area-16 and the 6<sup>th</sup> highest net wage level. While gross earnings are 9% below the euro area average, net earnings are 11.5% above the euro area average, partly a result of the relatively small gap between before and after-tax wages in Ireland.

Source: Eurostat

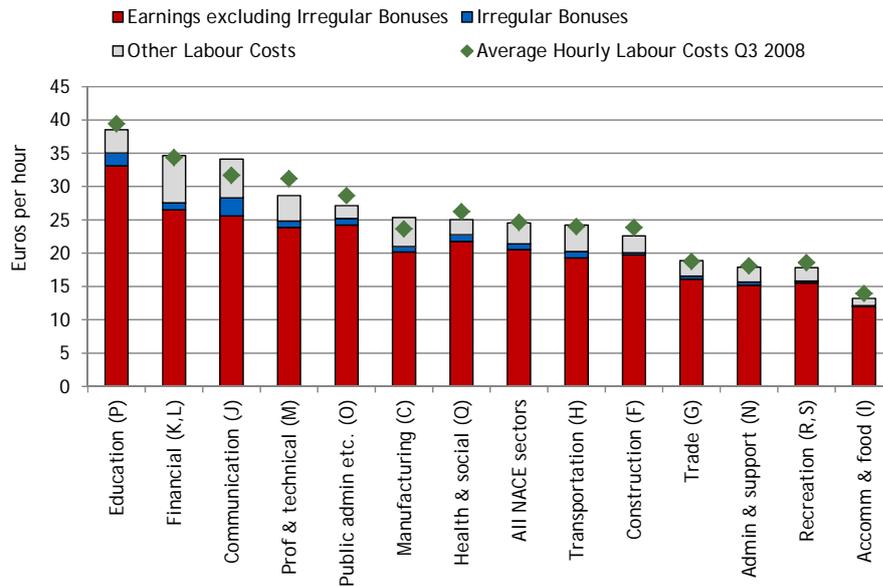
Figure 8: Annual Change in Real Unit Labour Cost<sup>32</sup>, 2001 - 2012



Between 2002 and 2008, higher annual increases in Irish ULC's were generally recorded compared with EU and euro area averages. Conversely, real Irish ULC's fell by 5.3% in 2010 and 4.6% in 2011, with a more modest reduction of 0.6% recorded in 2012. Data from the Central Bank of Ireland shows that Irish ULCs increased by 1.4% in 2013, and are projected to increase by 0.3% and 0.2% in 2014 and 2015 respectively<sup>33</sup>.

Source: Eurostat, Unit Labour Costs Annual Data

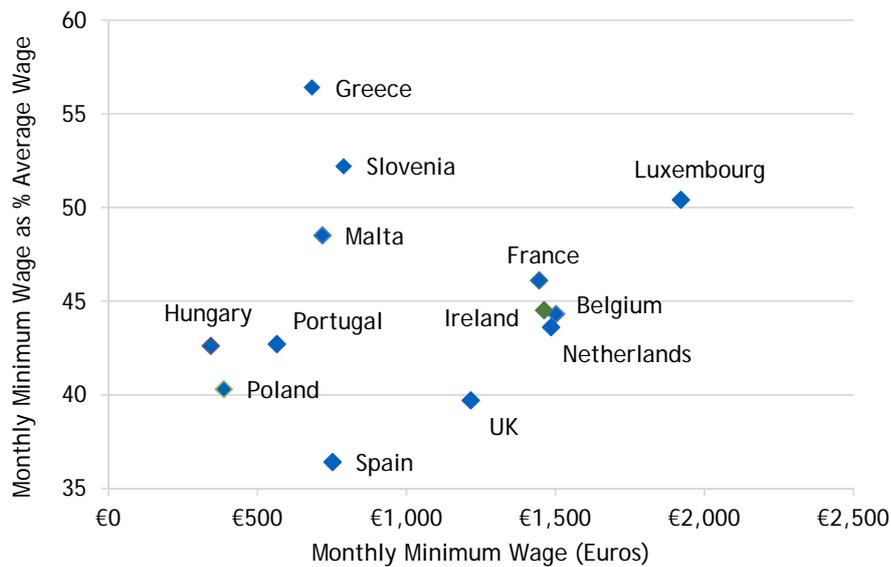
Figure 9: Average Hourly Labour Costs in Ireland by Sector, Q3 2008 - Q3 2013



CSO data shows that since Q3 2008, average hourly labour costs (-0.37%) and average hourly earnings (+0.9%) have remained relatively static, despite the challenges posed by recession. The data suggests that firms preferred to control labour costs through reductions in employment and hours, rather than through reductions in hourly rates.

Source: CSO, EHECS Earnings, Hours and Employment Costs Survey

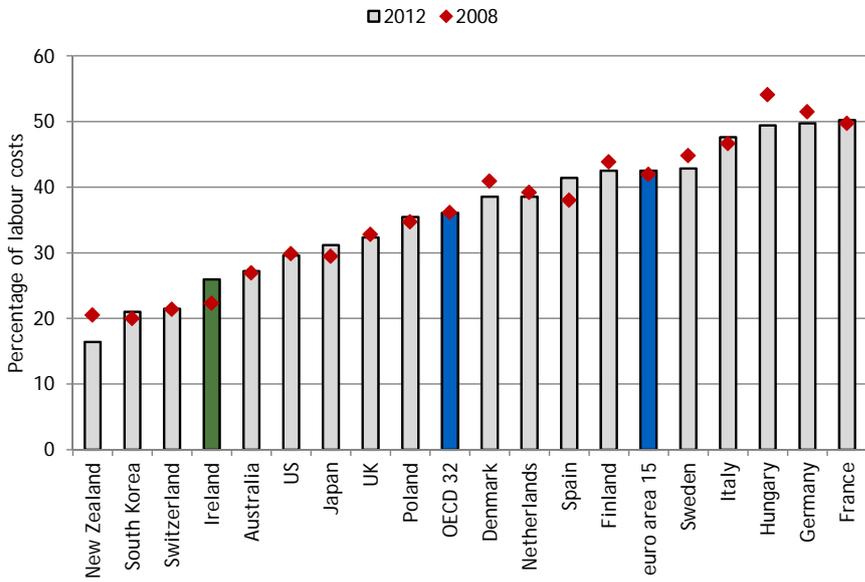
Figure 10: Monthly Minimum Wage (2014) and Minimum Wage as a % of Average Wage (2013)<sup>34</sup>



In 2013 the minimum wage level varied between 36.4% in Spain and 56.4 per cent in Greece of average gross monthly earnings. When expressed as a percentage of average wages, Ireland has the 6<sup>th</sup> highest minimum wage (out of 21 countries). Of the 21 countries for which data was available, Ireland had the 5<sup>th</sup> highest minimum wage in PPS terms and 4<sup>th</sup> highest in euro terms.

Source: Eurostat, Minimum Wages

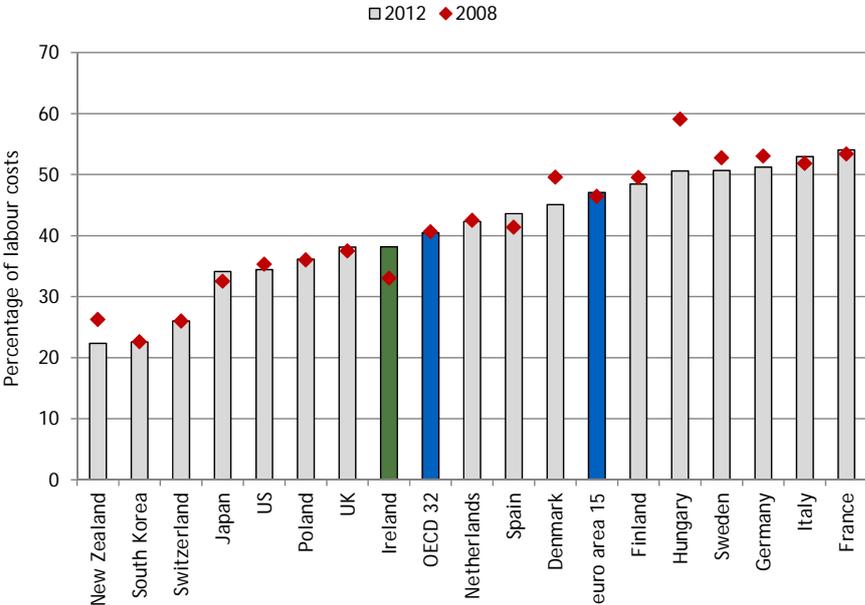
Figure 11: Average income tax plus employees' and employers' social security contributions: Single individual without children, 100% of average earnings, 2012



For a single person with no children on 100% of the average wage, the combined total of income tax plus social security contributions (the gap between what the employer pays and what the employee receives) is the 6<sup>th</sup> lowest in the OECD. At 25.9% it remains well below the OECD average of 36.1%, despite the recent upward trend<sup>35</sup>.

Source: OECD, Taxing Wages, 2012

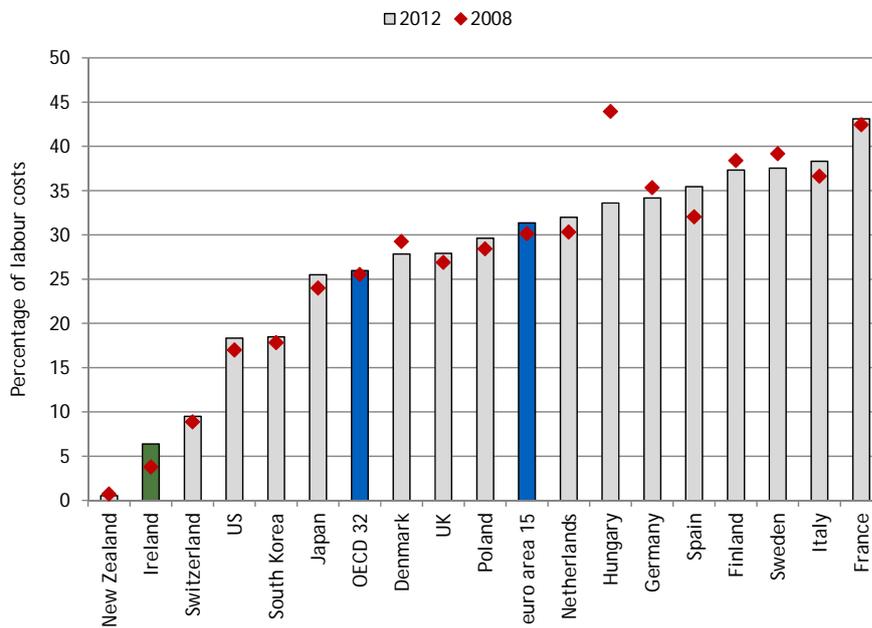
Figure 12: Average income tax plus employees' and employers' social security contributions: Single individual without children, 167% of average earnings, 2012



The combined total of income tax and social security contributions is the 12<sup>th</sup> lowest in the OECD for single individuals with no children earning 167% of average earnings, down from 9<sup>th</sup> lowest in 2008. For this higher income cohort, the total income tax on labour plus social security contributions in Ireland (38.2%) is much closer to the OECD average (40.5%).

Source: OECD, Taxing Wages, 2012

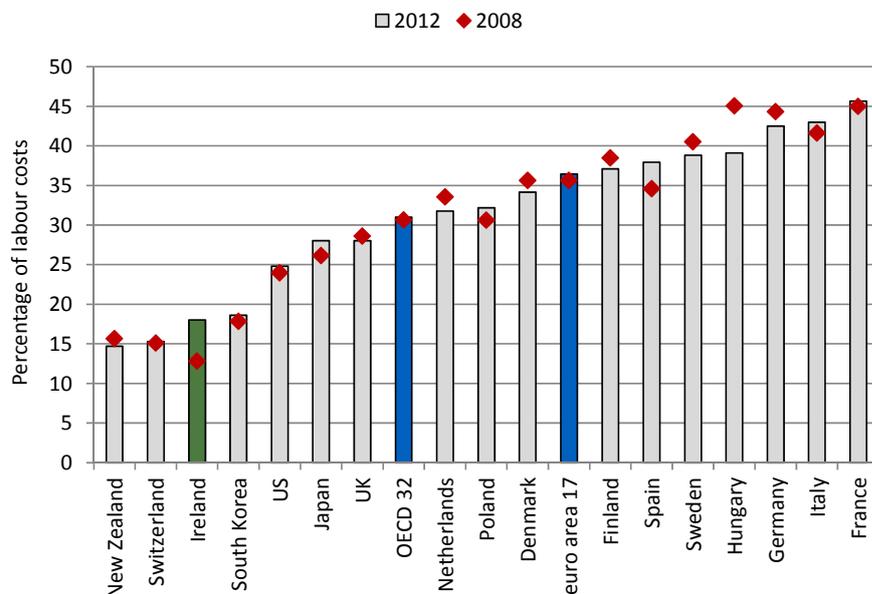
Figure 13: Average income tax plus employees' and employers' social security contributions: Married Couple with two children, 100% of average earnings, 2012



For married couples with two children, the total average rate of income tax plus social security contributions is much less pronounced at 6.4%. At this income level, Ireland had the second lowest average rate in the OECD for this family cohort. This ranking remained unchanged relative to 2008, although the rate has increased from 3.8%.

Source: OECD, Taxing Wages, 2012

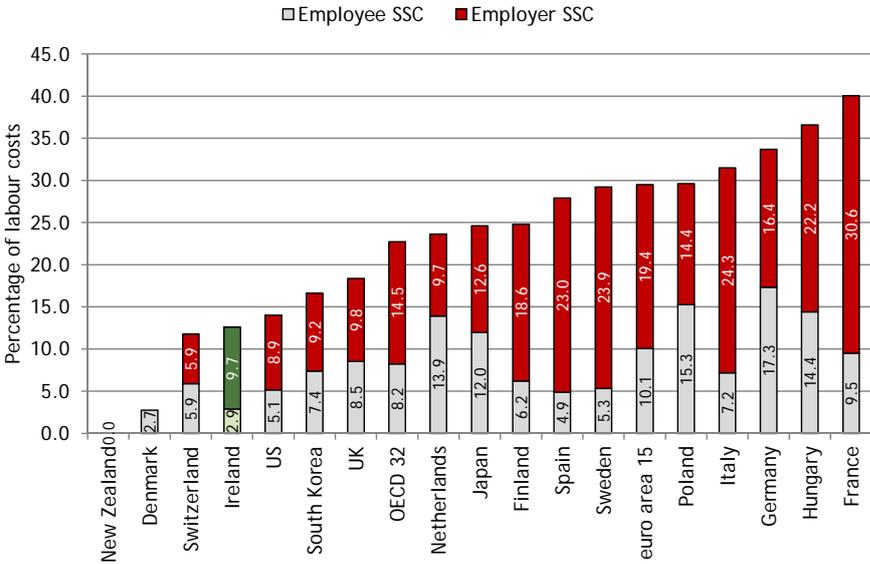
Figure 14: Average income tax plus employees' and employers' social security contributions: Married Couple with two children, 100-67% of average earnings, 2012



18% of total labour costs for a married couple with two children earning 167% of average earnings (i.e. the first earning 100% and the second earning 67% of average earnings) went towards income tax and social security contributions, up from 12.8% in 2008. This is below the OECD average of 31%. As a result, gap between the cost to the employer and net take home pay is now the 5<sup>th</sup> lowest in the OECD 32 (down from 2<sup>nd</sup> lowest in 2008).

Source: OECD, Taxing Wages, 2012

Figure 15: Employer and Employee Social Security Contributions, 2012

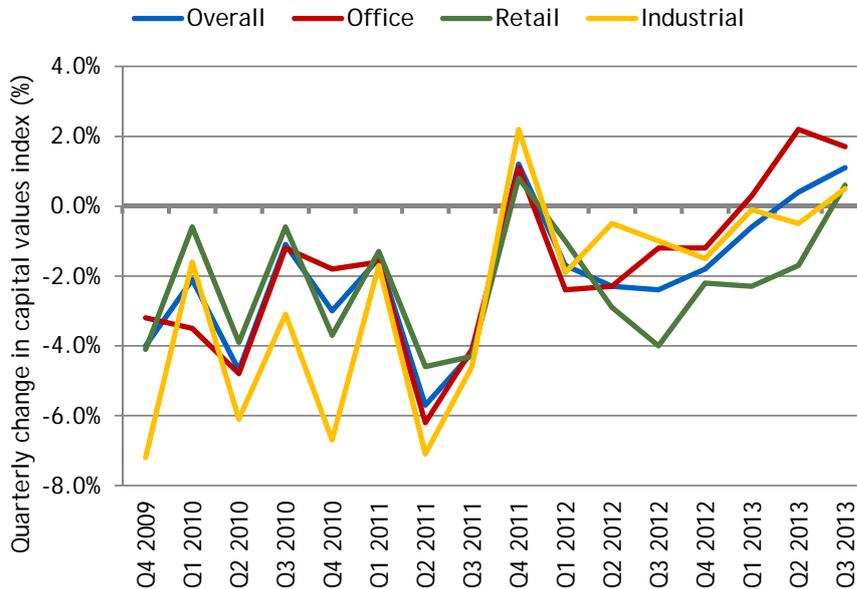


Ireland has the 8<sup>th</sup> lowest rate of total social contributions in the OECD-32. Employer’s social security contribution is the 10<sup>th</sup> lowest, while employee contributions are the 6<sup>th</sup> lowest. In many countries, however there is either a cap on employer social security costs or a reduced rate above a certain income threshold. In Ireland, a flat rate is charged on the full salary: as salaries increase, Ireland’s competitive position is quickly eroded.

Source: OECD, Taxing Wages 2012

## Chapter 4 - Property Costs

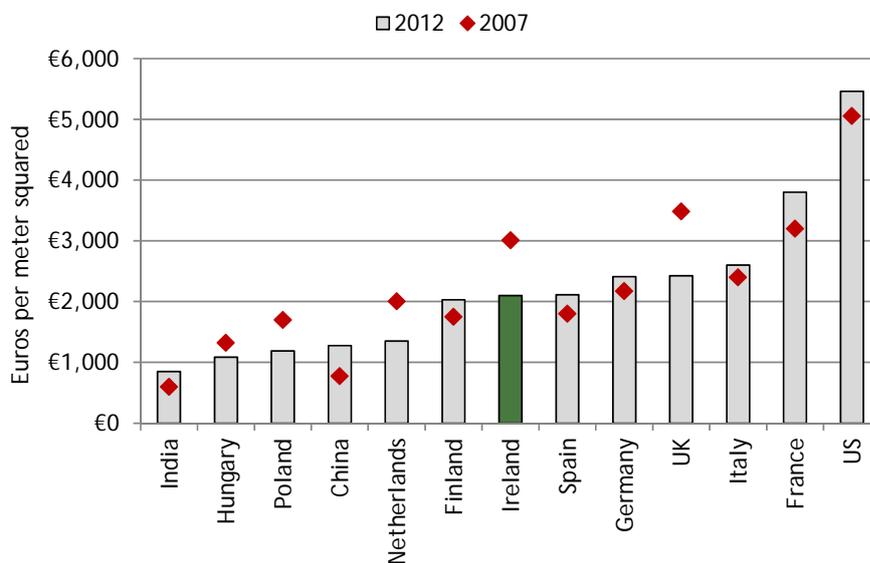
Figure 16: Quarterly Change in Capital Values in Ireland, 2009 - Q3 2013



This indicator illustrates the change in capital values in Ireland for a range of commercial property classes over the last number of years. Overall values increased for the second quarter in a row in Q3 2013 suggesting a stabilisation in the property market after a period of sustained losses.

Source: Jones Lang LaSalle, Irish Property Index

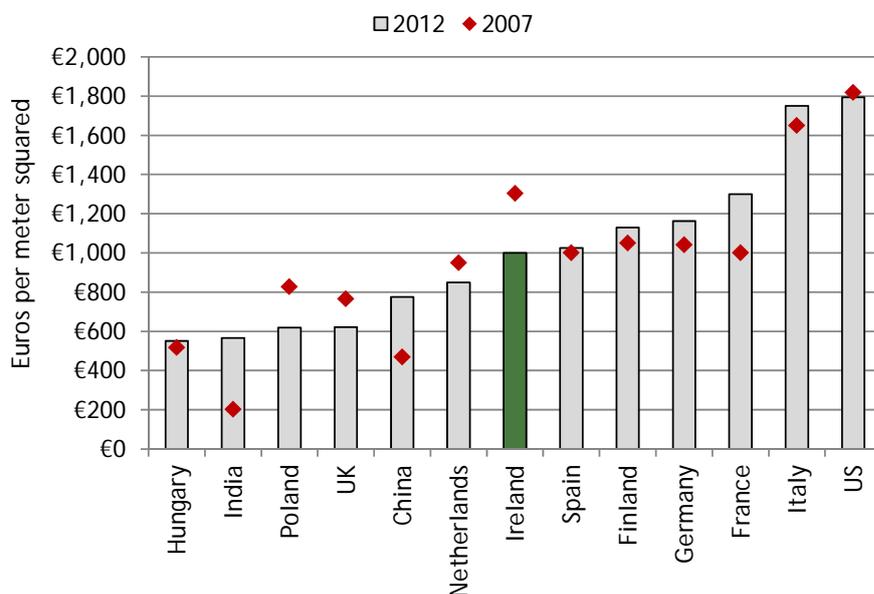
Figure 17: Cost of Constructing a Prime Office Unit<sup>36</sup>, €/m<sup>2</sup>, 2012



Construction costs data takes account of building, labour and material costs. The cost of constructing a prime office unit in Ireland has fallen by 30% since costs peaked in 2007. Amongst the locations surveyed Ireland was the 7<sup>th</sup> most expensive location (out of 13) to construct a prime office unit in 2012, compared to 6<sup>th</sup> most expensive in 2011.

Source: Gardiner and Theobald, International Construction Cost Survey

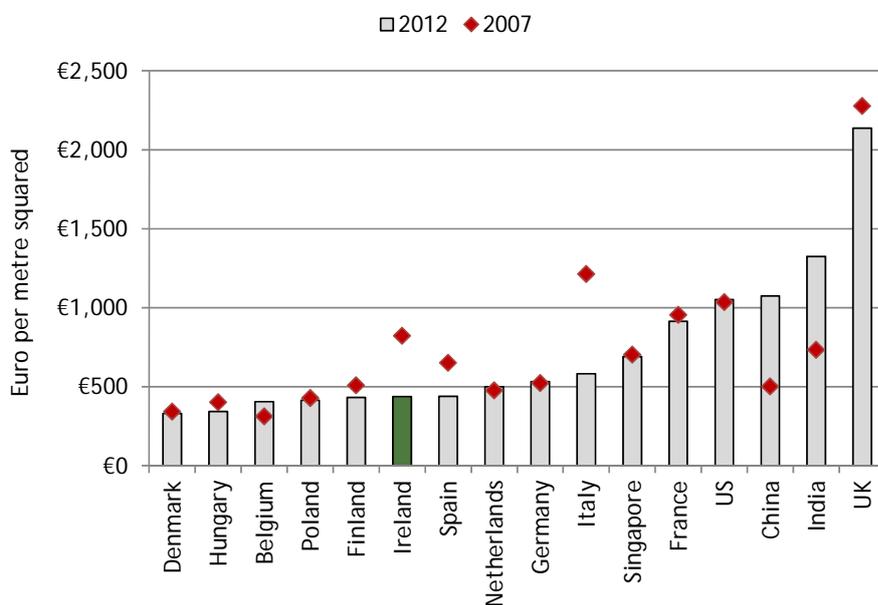
Figure 18: Cost of Constructing an Industrial Unit<sup>37</sup>, €/m<sup>2</sup>, 2012



The cost of constructing a prime industrial unit in Ireland has also fallen significantly over recent years. Costs in 2011 and 2012 had fallen back to levels last seen in 2005. Relative to the cost peak recorded in 2007, costs have fallen by over 23%. Ireland is the 7<sup>th</sup> most expensive location within the group of 13 countries for constructing prime industrial units.

Source: Gardiner and Theobald, International Construction Cost Survey

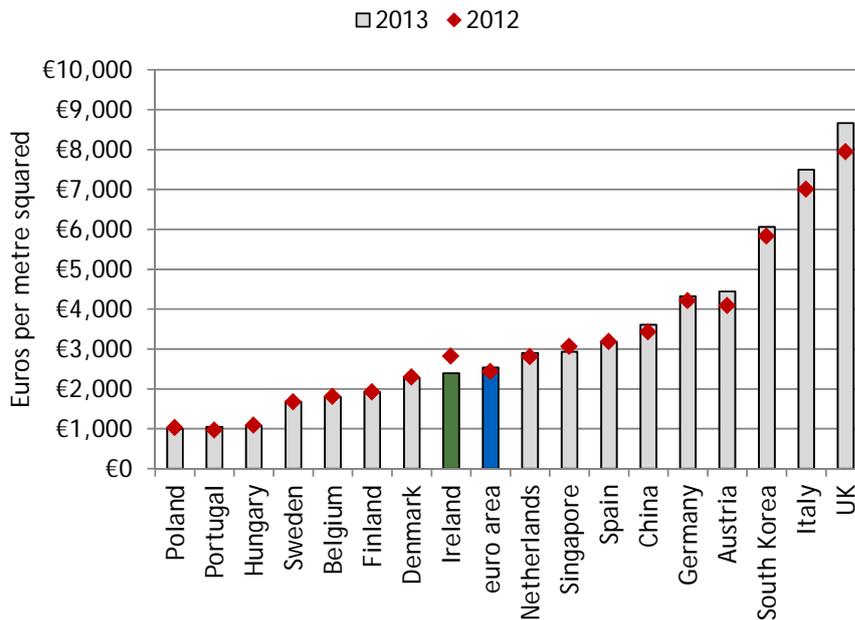
Figure 19: Cost of Renting a Prime Office Unit, €/m<sup>2</sup>, 2012



Office rents in Dublin on new leases fell by 47% between 2007 and 2012. A significant proportion (46%) of the decline in rental costs was realised by 2010, indicating that prices have stabilised in more recent years. Ireland was the 11<sup>th</sup> most expensive location (out of 16) benchmarked in 2012 for office rental costs, a significant improvement from 2007 when Dublin was the 5<sup>th</sup> most expensive location. In terms of industrial rents, there is a shortage of well located, high quality premises resulting in rents edging upwards in Q3 2013.

Source: Cushman and Wakefield, Office Space Across the World, 2007 - 2013

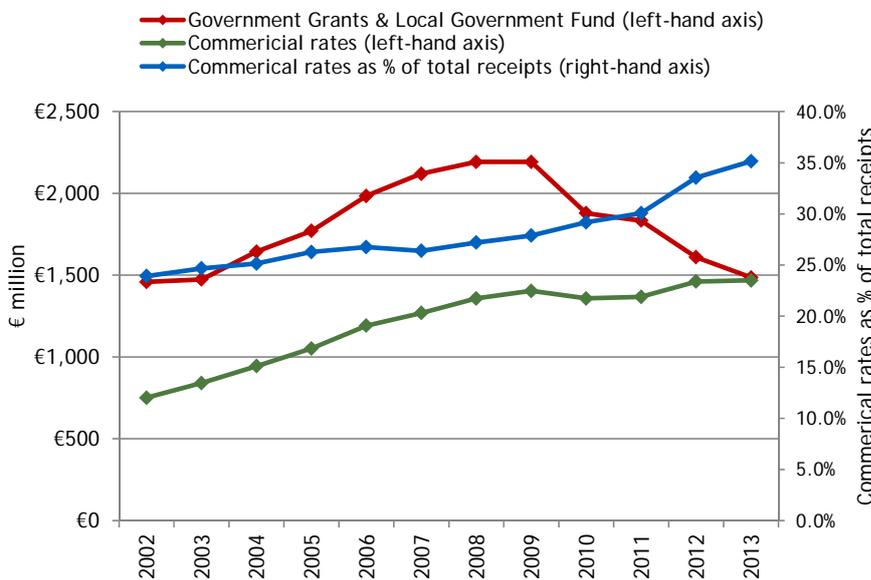
Figure 20: Cost of Renting a Prime Retail Unit, €/m<sup>2</sup>, 2013



Prime high street rents have come under downward pressure over recent years - Ireland is ranked the 12<sup>th</sup> most expensive out of 19 benchmarked countries, an improvement of 1 place from 2012 - but the most noticeable trend in the high end market is the lack of activity<sup>38</sup>. The issue of upward only rent reviews continues to pose problems for existing retailers.

Source: Cushman and Wakefield, Main Streets Across the World, 2012 - 2014

Figure 21: Commercial Rates, Receipts from Central Government and Rates as a Percentage of Total Revenue, 2002-2013

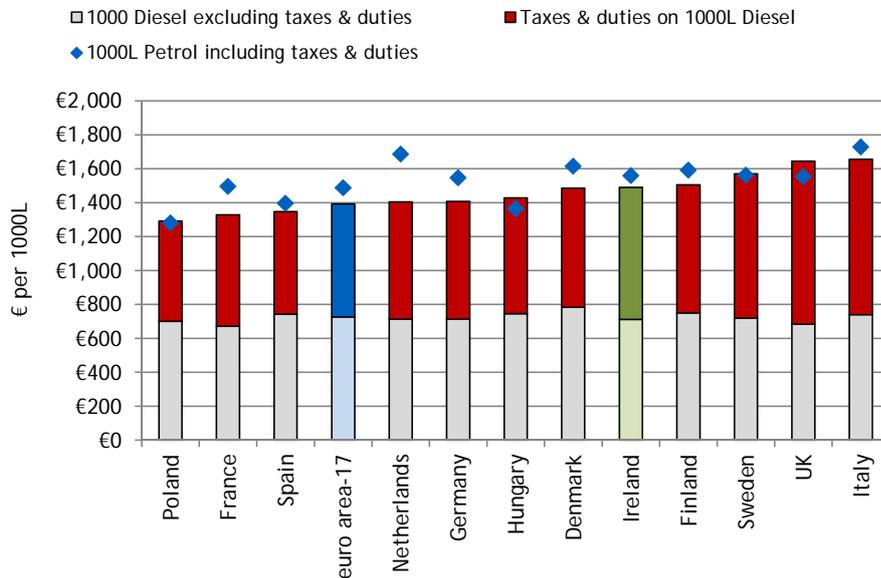


Total commercial rates collected by local authorities increased by 96% over the period 2002 to 2013. The bulk of this growth occurred between 2002 and 2009. As a proportion of total Local Authority revenue, commercial rates grew from 24% in 2002 to 35% in 2013. Meanwhile, the proportion of revenue received from Government (through grants/subsidies and the Local Government Fund) fell from 46% to 36% during the same period.

Source: Department of Environment, Community and Local Government

## Chapter 5 - Transport Costs

Figure 22: Average Diesel and Petrol Costs per Litre, 2013



Some sectors are more sensitive to fluctuations in fuel costs than others (e.g. the haulage industry). The cost of 1,000 litres of diesel in Ireland (€1,489) was 7% above the euro area-17 price (€1,392) in December 2013. Ireland is the 3<sup>rd</sup> most expensive country in the euro area for diesel. The average price of 1,000 litres of petrol in Ireland was €1,559, 4.8% above the euro area average (€1,487) - and the 5<sup>th</sup> most expensive in the euro area.

Source: European Commission, Energy Statistics & Market Observatory

Figure 23: Average Diesel and Petrol Costs per Litre, Ireland, 2007-2013

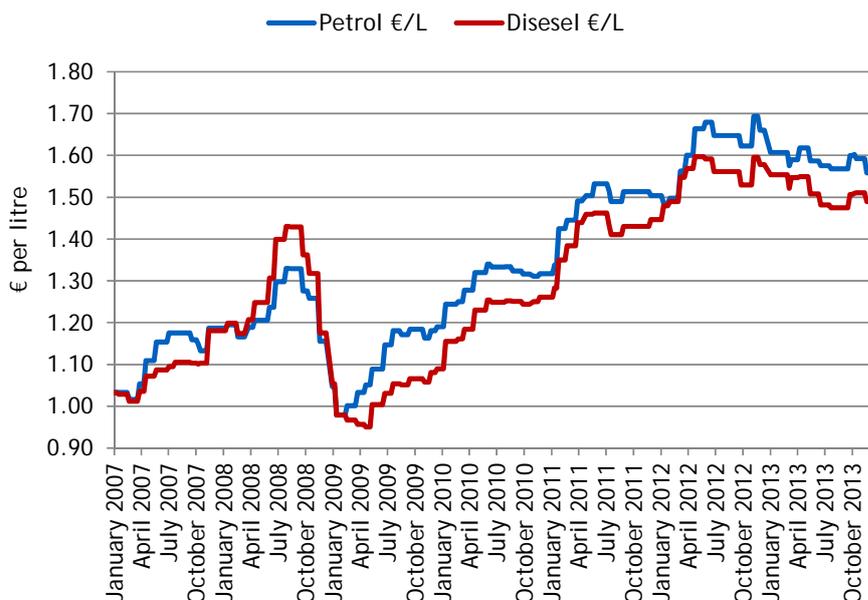
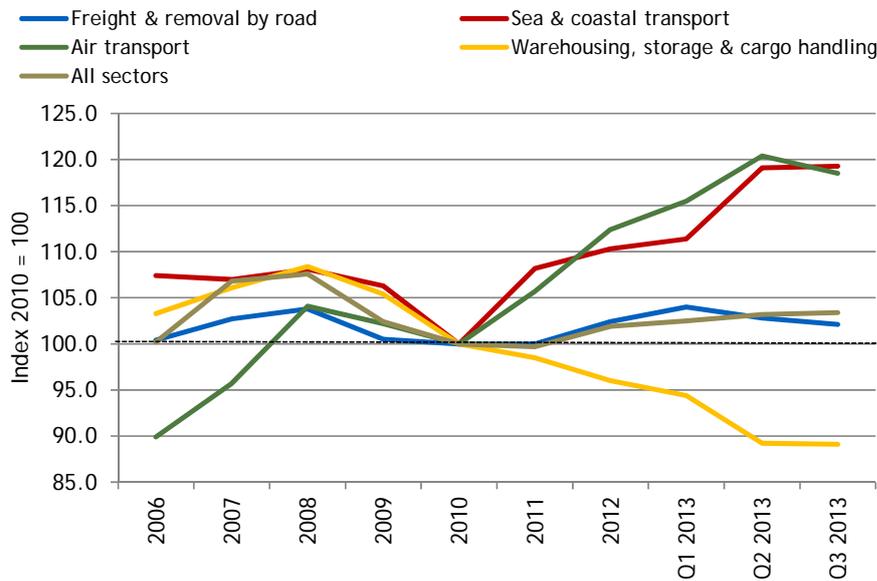


Figure 23 illustrates historic trends for both diesel and unleaded petrol prices in Ireland (including taxes and duties). As of December 2013, European Commission data indicates that Government taxes account for 58% of petrol prices and over 50% of diesel prices, which is on par with the euro area averages.

Source: European Commission, Energy Statistics & Market Observatory

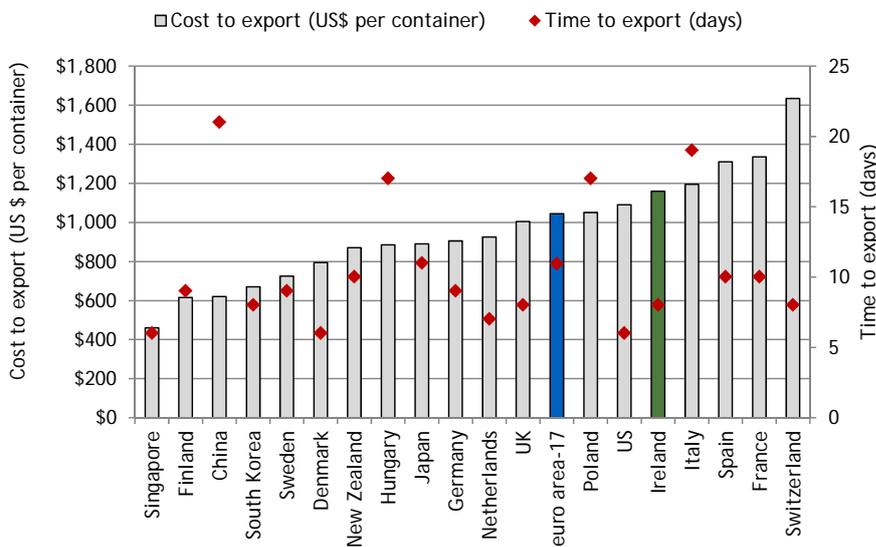
Figure 24: Trends in Transport Related Prices in Ireland, 2006 - Q3 2013



The CSO's experimental services producer price index tracks the evolution in prices for a range of services. This chart focuses on prices for a range of transport and storage services. Since 2010 the cost of air transport, and sea and coastal transport has increased significantly.

Source: CSO, Services Producer Price Index

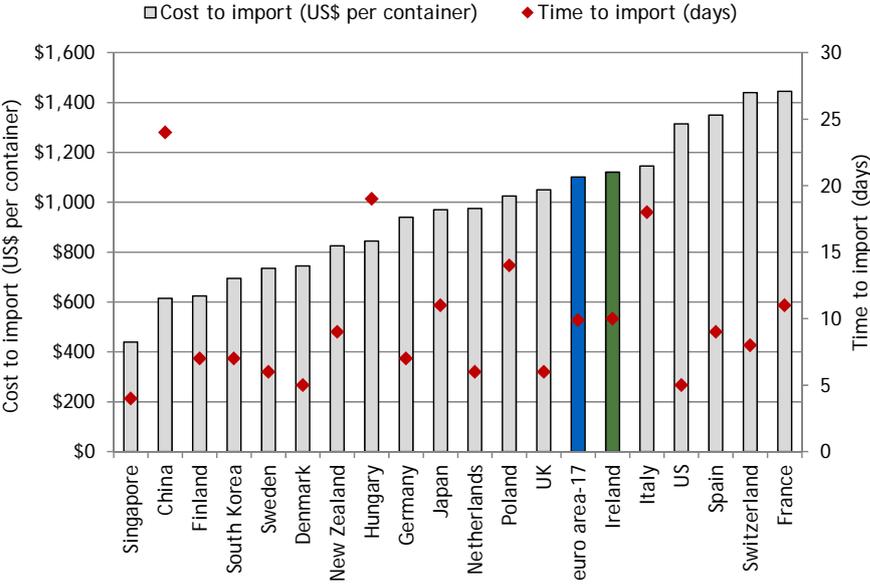
Figure 25: Administrative Costs and Time to Export, 2012



Compliance with the procedures to export a 20-foot container costs more in Ireland (€1,160) than in the euro area (€1,044)<sup>39</sup>. This metric relates to the typical fees associated with completing the procedures to export and does not include customs tariffs and duties or costs related to ocean transport. It takes 8 days to complete the required procedures to export in Ireland, compared to the euro area average of 11 days.

Source: World Bank, Doing Business 2013

Figure 26: Administrative Costs and Time to Import, 2012

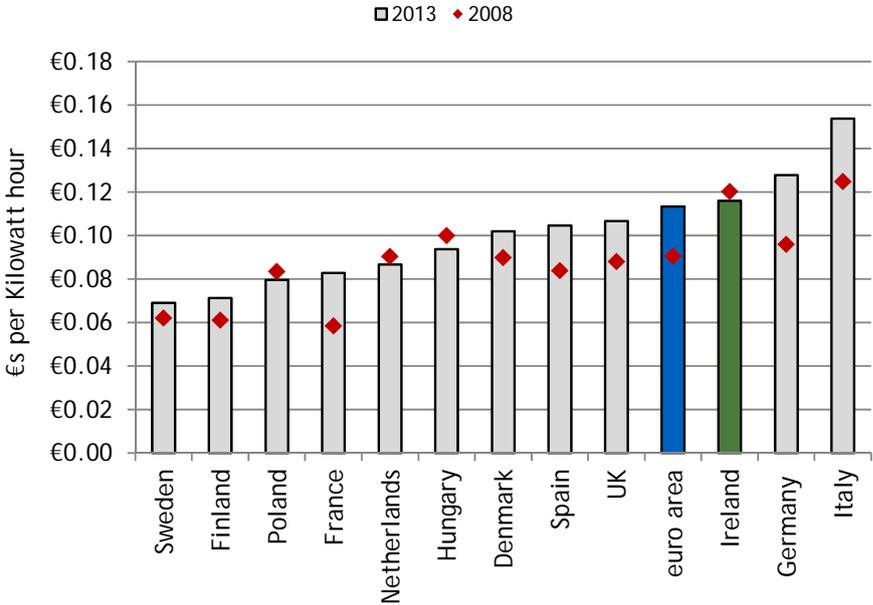


It is slightly more expensive to comply with the required procedures to import a 20-foot container into Ireland (€1,121) than the euro area-17 average (€1,101). Ireland is the 9<sup>th</sup> most expensive euro area location. At 10 days, the time taken to complete the procedure is on par with the euro area average.

Source: World Bank, Doing Business 2012

# Chapter 6 - Utility Costs

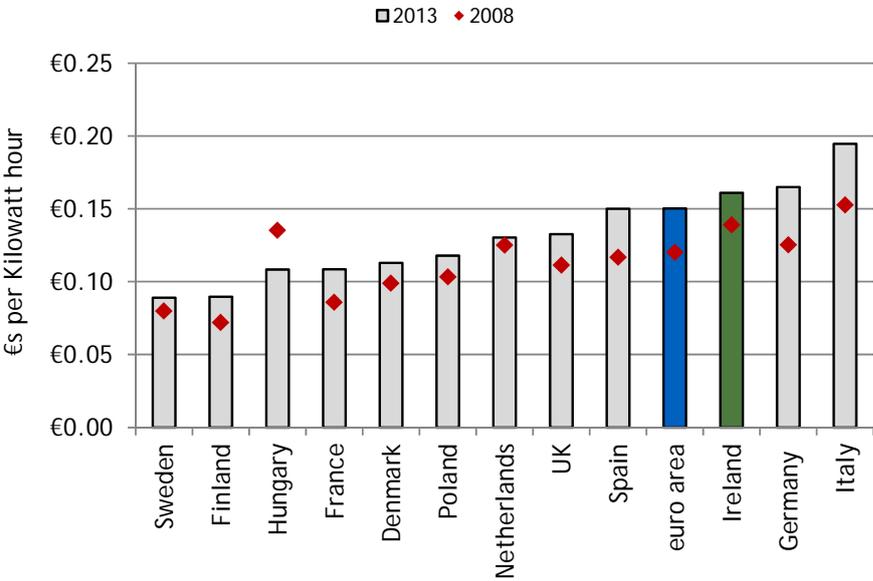
Figure 27: Industrial Electricity Prices for Large Energy Users (excluding VAT), 2013<sup>40</sup>



Despite falling by 3.5% between the start of 2008 and the start of 2013, electricity costs for large industrial users in Ireland remain slightly (2%) above the euro area 17 average. Ireland is the 6<sup>th</sup> most expensive location within the euro area behind Cyprus, Malta, Italy, Germany and Slovakia. Energy prices in Ireland were at their lowest in the first half of 2010.

Source: Eurostat - Environment and Energy

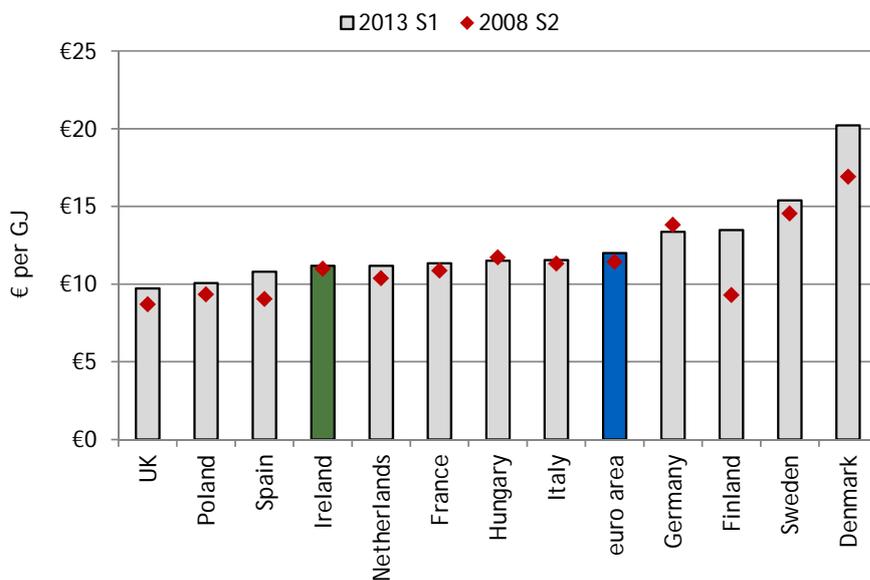
Figure 28: Industrial Electricity Prices for SMEs (excluding VAT), 2013<sup>41</sup>



Electricity for SMEs in Ireland rose by almost 16% between the start of 2008 and the start of 2013 - this mirrors trends in most EU countries which have experienced price increases. Electricity costs for SMEs in Ireland are the 5<sup>th</sup> most expensive in the euro area after Cyprus, Malta, Italy and Germany, and are 7% higher than the euro area average.

Source: Eurostat - Environment and Energy

Figure 29: Industrial Gas Prices (excluding VAT), 2013<sup>42</sup>



After a decrease in prices between 2008 and 2009 the cost of industrial gas has since then increased significantly across the euro area. In 2012 Ireland was joint 10<sup>th</sup> most expensive location for industrial gas (along with the Netherlands) out of 15 euro area countries. More broadly, the availability of low cost gas in the US continues to undermine relative European competitiveness - IEA data shows that natural gas in the US trades at one-third of import prices in Europe and one-fifth of prices in Japan<sup>43</sup>.

Source: Eurostat - Environment and Energy

Figure 30: Water Costs, 2012/2013<sup>44</sup>

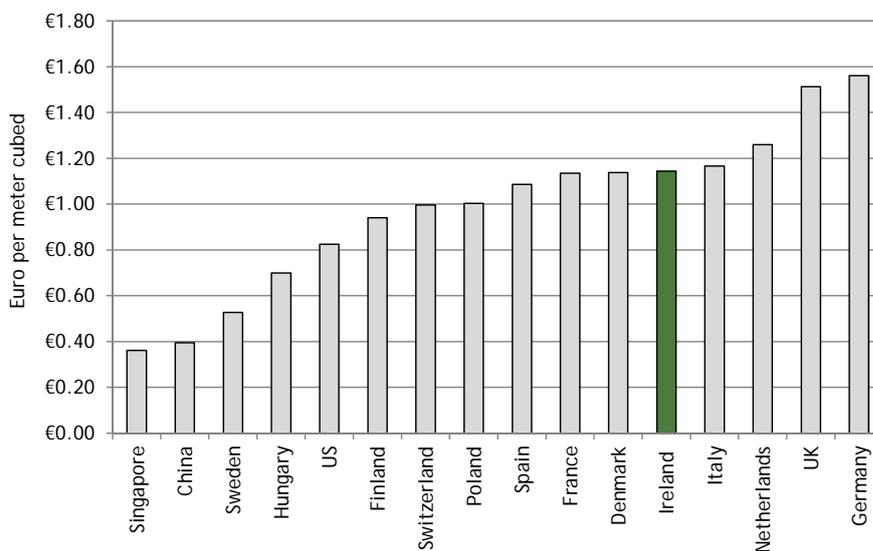


Figure 30 examines water costs for industrial users (but does not include the cost of waste water services). Given the complexities and inconsistencies in how water costs data is collected internationally, caution should be used when drawing inferences from this data. The average cost of water per meter cubed in Ireland is €1.15, making Ireland one of the more expensive locations among the group of 16 countries benchmarked.

Source: EIU World Investment Service, Local Government Management Agency

Figure 31: Business Water Service Costs in Ireland by Local Authority, 2013

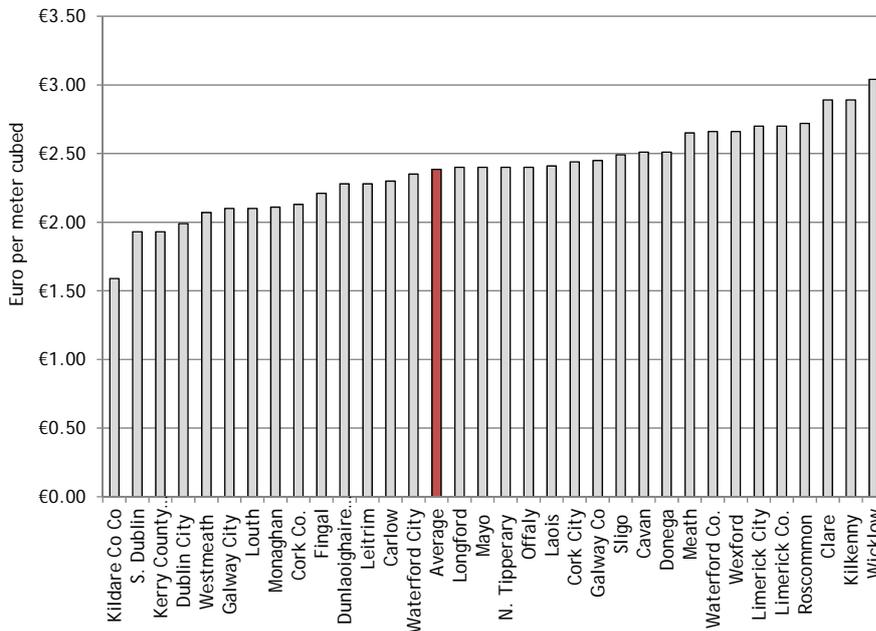
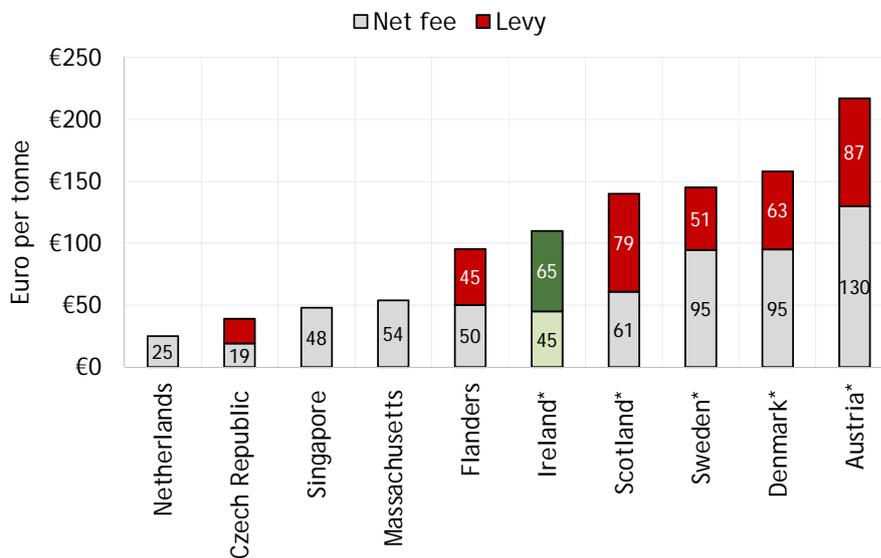


Figure 31 shows the combined (water and waste water) charge per cubic meter of water across Irish Local Authorities. The average cost of water for business in Ireland is €2.38 per metre cubed - an increase of 39% since 2007. Wicklow is the most expensive location for water services at €3.04 compared to just €1.59 in neighbouring Kildare.

Source: IBEC, Addressing the Challenge of Local Authority Costs, 2013, Local Government Management Agency

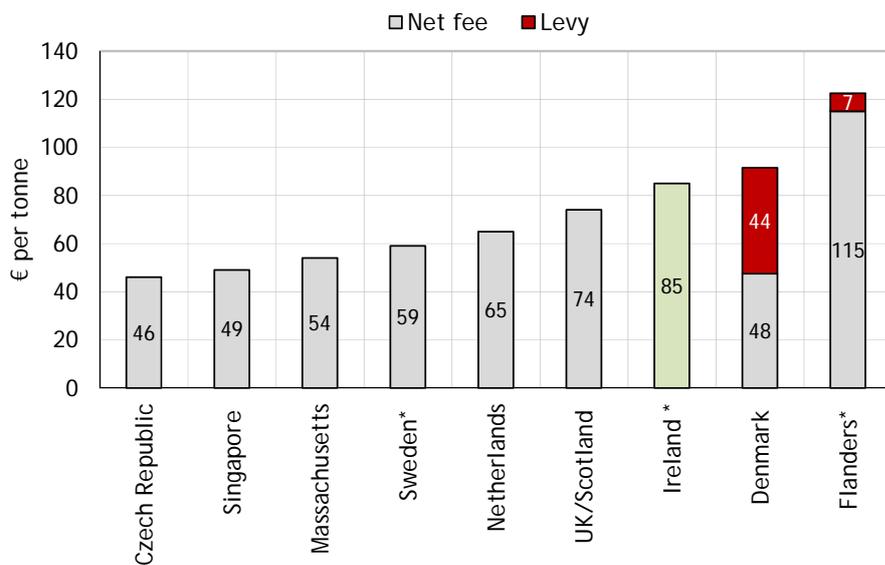
Figure 32: Landfill Gate Fees (incl. levy) for Non-hazardous Waste (€ per tonne), 2012<sup>45</sup>



Since 2010, Irish landfill gate fees have fallen sharply. In 2012, the average market rate for non-hazardous landfill was €35-45 per tonne (excluding the levy) compared to €112 in 2010. The landfill levy in Ireland has increased significantly in recent years, from €30 in 2010 to €65 in July 2012. Of the 10 benchmarked countries, Ireland had the 5<sup>th</sup> highest landfill costs (including levies) in 2012.

Source: RPS Consulting, Forfás Calculations, 2012

Figure 33: Non Hazardous Thermal Treatment Gate Fees (incl. Levy) in € per tonne, 2011/2012<sup>46</sup>



Ireland had the 3<sup>rd</sup> highest non-hazardous thermal treatment gate fees (including levies) in 2012. Gate fees differ in some countries for the biological treatment of food and green waste. In Ireland in 2012, gate fees for the biological treatment of food waste were €76 per tonne compared to €15.60 per tonne in Flanders and €50 per tonne in the Netherlands. Irish gate fees for green waste were €31 per tonne in 2012.

Source: RPS Consulting, Forfás Calculations, 2012

Figure 34: Business DSL and Cable Basket (>10 Mbps), €s per Month ex VAT, September, 2013

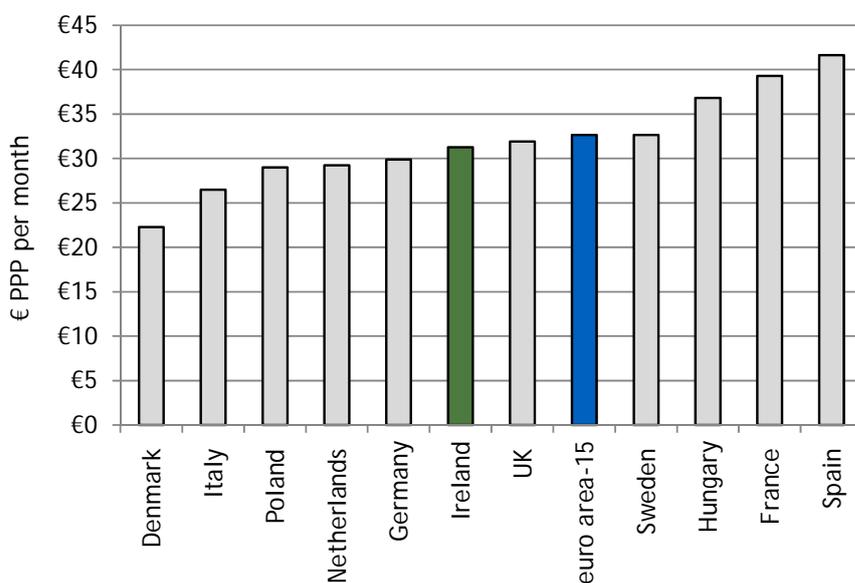


Figure 34 shows the lowest monthly business pricing for DSL and cable in the >10 Mbps speed category. Ireland is the 5<sup>th</sup> most expensive country amongst the euro area-14; costs in Ireland are 13% above the euro area-14 average<sup>47</sup>.

Source: ComReg Quarterly Key Data Report, Q3 2013, Teligen, Forfás Calculations

Figure 35: Post-Pay Business Mobile Broadband, €s per month ex VAT, August 2013

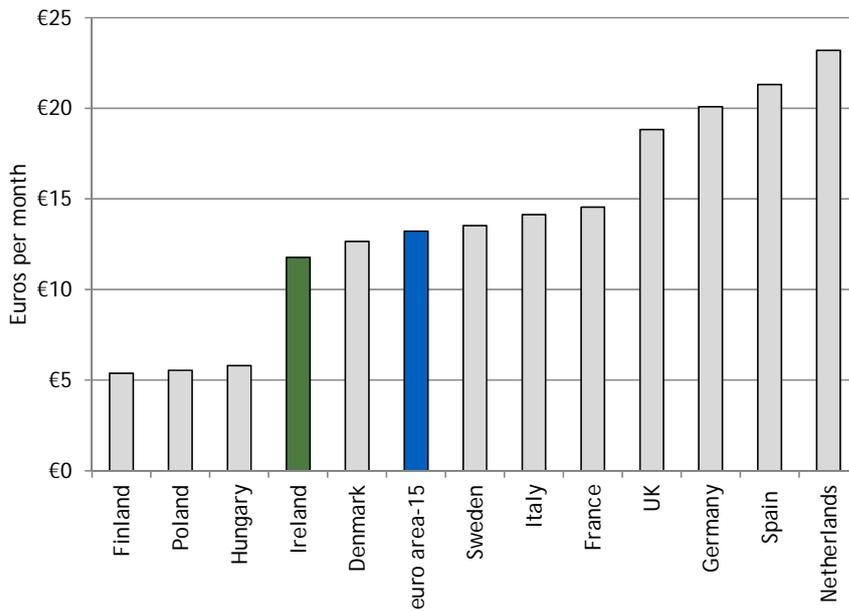
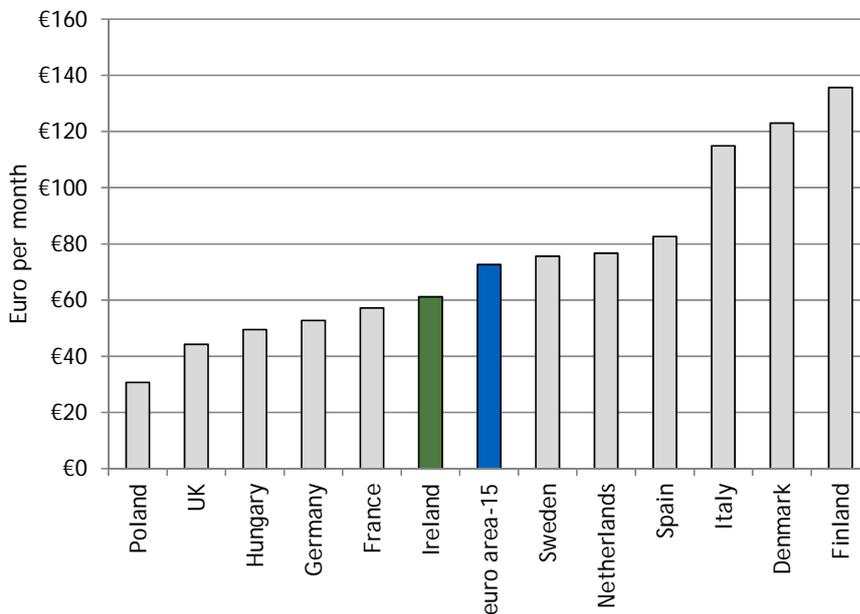


Figure 35 compares the price of a post-paid business mobile broadband basket across a range of countries. Ireland appears cost competitive on this metric. It is the 9<sup>th</sup> most expensive benchmarked location amongst the 15 euro area countries benchmarked<sup>48</sup>. Prices in Ireland are 11% cheaper than the euro area-15 average.

Source: ComReg Quarterly Key Data Report, Q3 2013, Teligen, Forfás Calculations

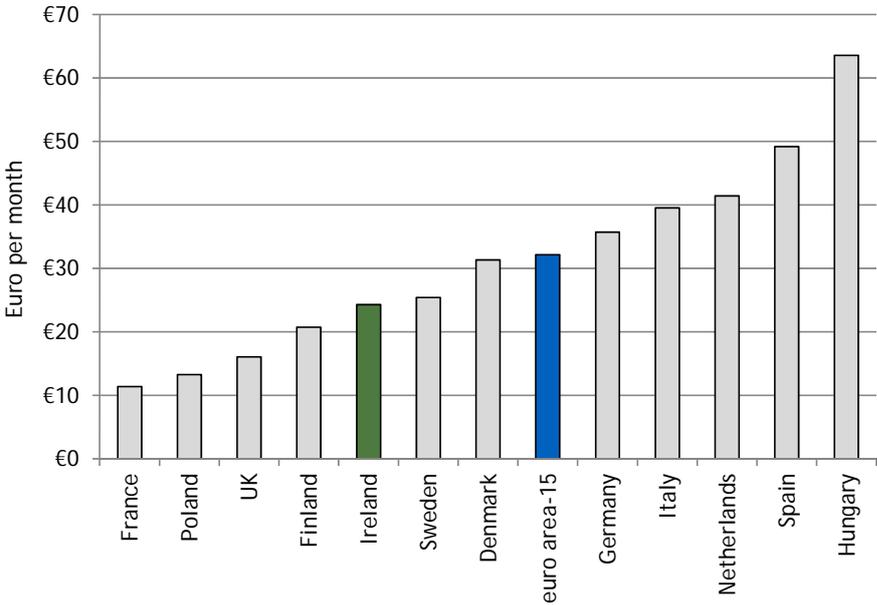
Figure 36: PSTN Business Basket of Calls (260 calls), €s per Month ex VAT, August 2013



In August 2013, the cost of a business basket of calls in Ireland was 16% cheaper than the euro area-15 average<sup>49</sup>. Ireland was ranked as the 9<sup>th</sup> most expensive euro area location.

Source: ComReg Quarterly Key Data Report, Q3 2013, Teligen, Forfás Calculations

Figure 37: Monthly Mobile Telephone Costs, High Usage Post Paid Basket, €s per month (300 calls<sup>50</sup>), 2013

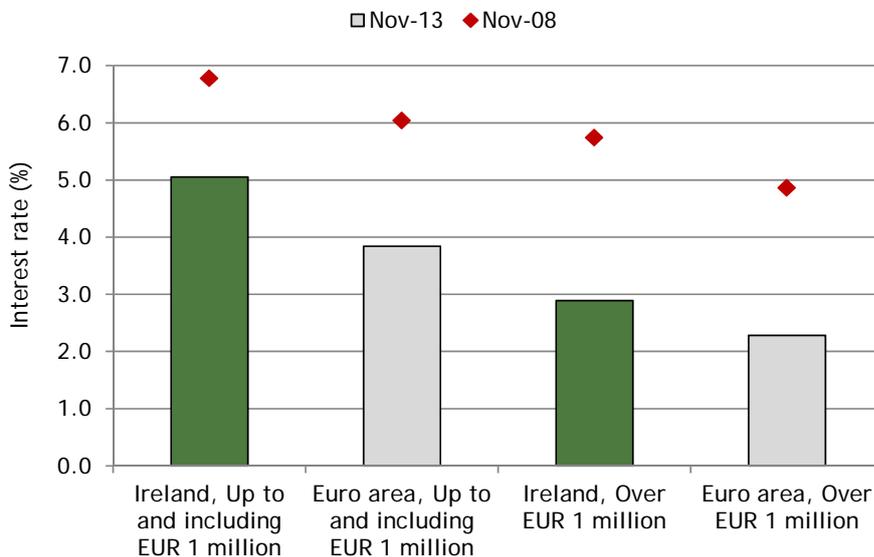


The monthly cost of a high usage mobile basket (300 calls) in Ireland was the 11<sup>th</sup> most expensive amongst the 15 euro area countries benchmarked and is 24% below the euro area average. Mobile voice traffic accounted for 68.8% of total voice minutes in Ireland in Q3 2013. The mobile market represents approximately 74.1% of all voice and internet subscriptions (fixed and mobile)<sup>51</sup>.

Source: ComReg Quarterly Key Data Report, Q3 2013, Teligen, Forfás Calculations

## Chapter 7 - Credit Costs

Figure 38: Interest Rates for Non-Financial Corporations (New Business) by Loan Size, November 2013<sup>52</sup>



In November 2013, Irish interest rates were higher than the euro area average for both loan categories examined. Loans of up to €1 million (which is often used as a proxy for the rate applying to SME loans) are over 31.5% more expensive in Ireland while loans of over €1 million are almost 27% more expensive.

Source: European Central Bank

Figure 39: Interest Rates for Non-Financial Corporations (New Business) by Loan Size and Rate Fixation, January 2006-November 2013

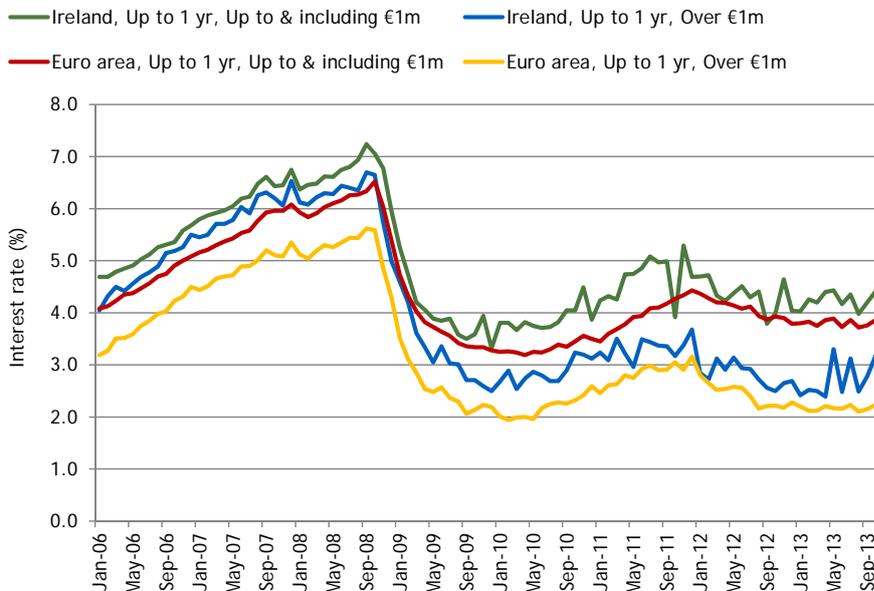
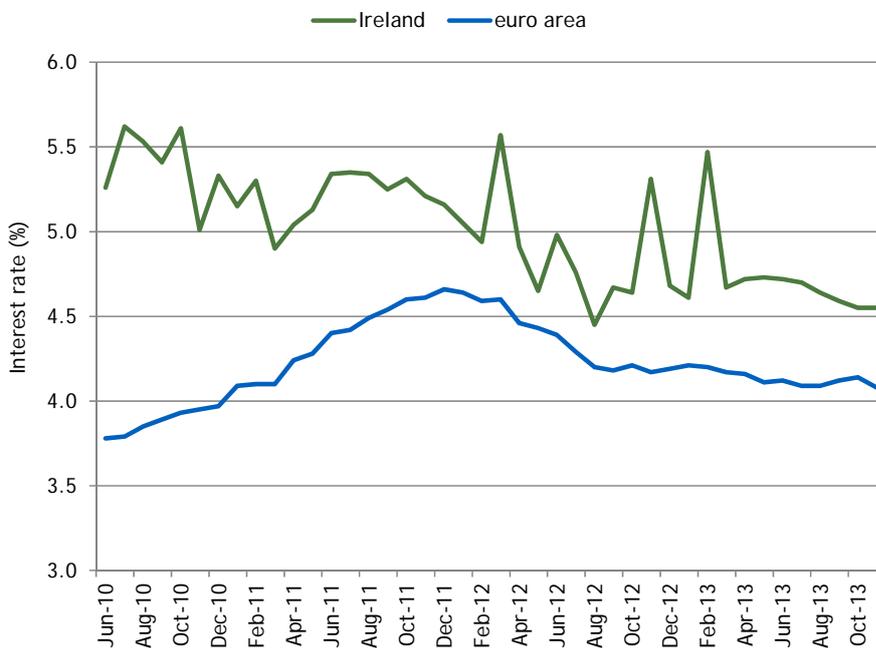


Figure 39 examines similar data as the previous chart but focuses on a longer time period. Interest rates on new loans to Non-Financial Corporations, applied by resident credit institutions, appear higher and more volatile in Ireland than across the Euro area.

Source: European Central Bank

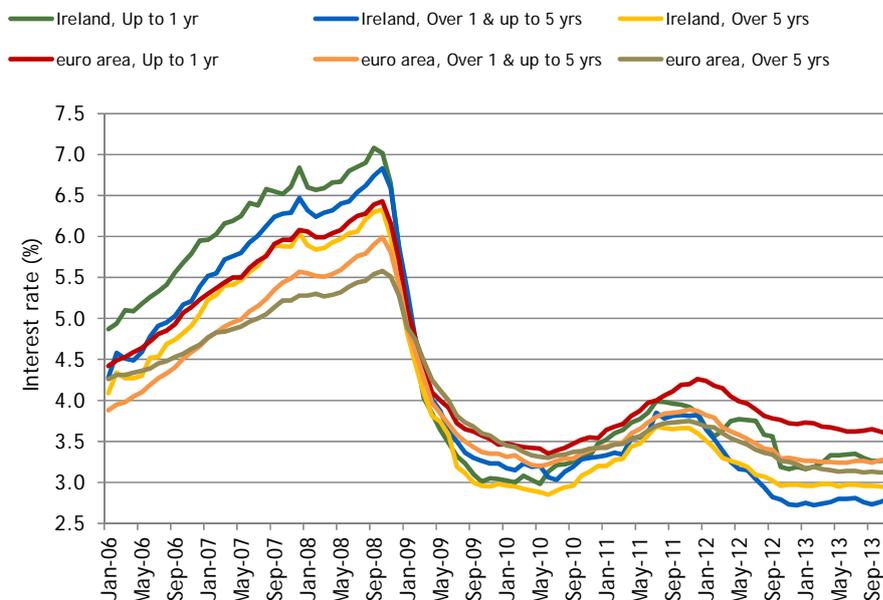
Figure 40: Revolving Loans and Overdraft Interest Rates for Non-Financial Companies, June 2010–November 2013



Interest rates for revolving loans and overdrafts in Ireland have remained elevated above that of the euro area average but the gap has narrowed over recent years. As of November 2013, however, Irish interest rates revolving loans and overdraft facilities were 11.5% above the euro area average.

Source: European Central Bank

Figure 41: Retail Interest Rates (%), Outstanding Amounts by Loan Size January 2006–November 2013



As interest rates on outstanding loans began to drop across the euro area in mid-2009, interest rates in Ireland began to converge with the euro area. In November 2013, Irish rates were lower than the euro area average across the three loan categories examined<sup>53</sup>. These three categories of loans accounted for €82.7 billion in outstanding loans in November 2013.

Source: European Central Bank

## Chapter 8 - Business Services and Other Input Costs

Figure 42: Services Producer Price Index, Q1 2006 - Q3 2013

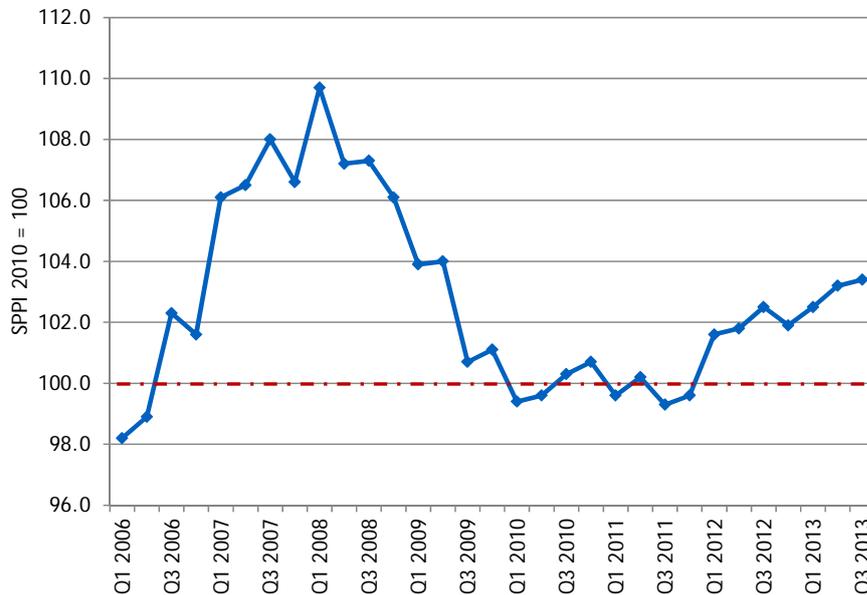


Figure 42 shows that throughout 2012 and the first three quarters of 2013, the price of a range of business services has generally been increasing. This follows a period of significant price declines over the course of the recession. In Q3 2013, prices are 3.4% above 2010 levels.

Source: CSO, Services Producer Price Index

Figure 43: Comparison of Business Service Prices and Wholesale Manufacturing Prices, 2010 - Q3 2013

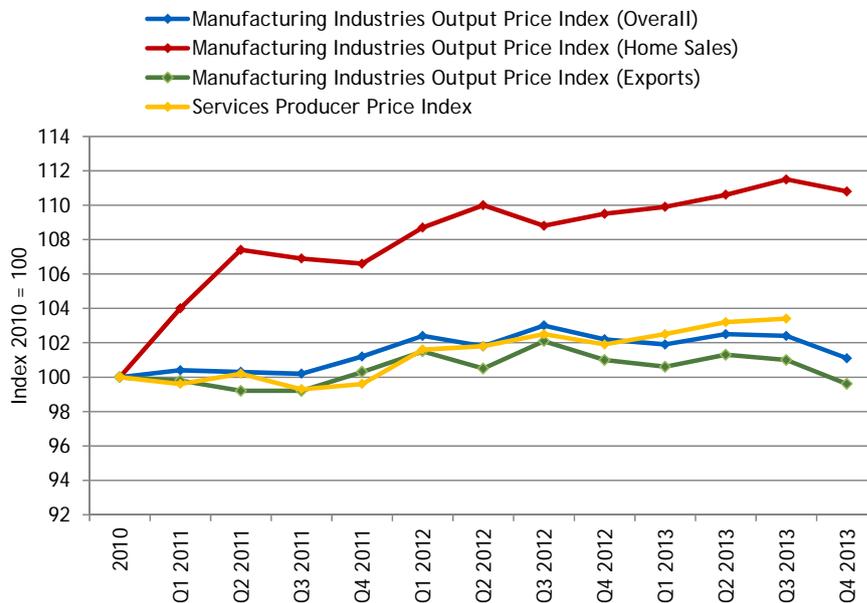
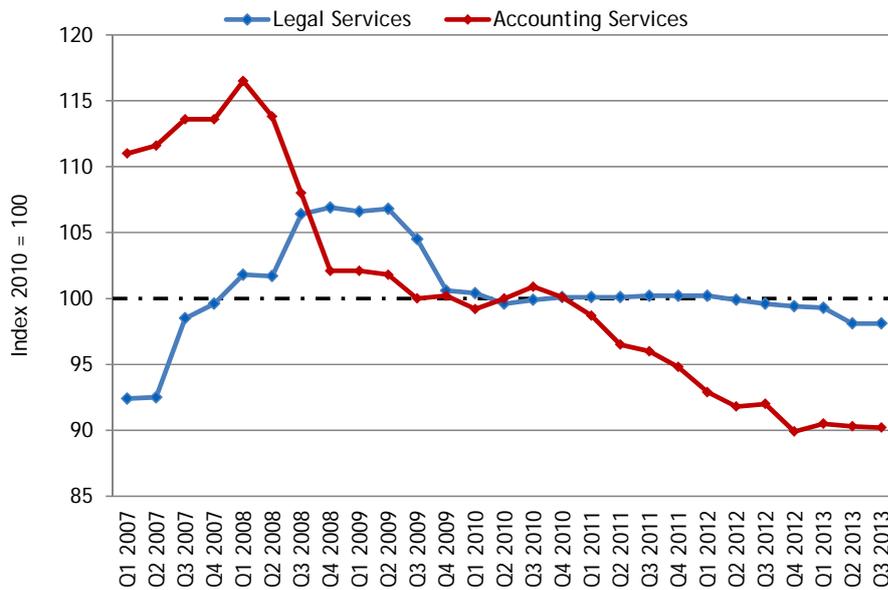


Figure 43 compares the evolution of price indices for manufacturing products and services - both of which input into the cost base for enterprise. Overall, service prices have risen by more than manufacturing prices since 2010. However, manufacturing products sold within Ireland have increased at a significantly faster pace than both services and manufacturing products traded internationally (and thus exposed to competition).

CSO, Services Producer Price Index & Wholesale Price Index

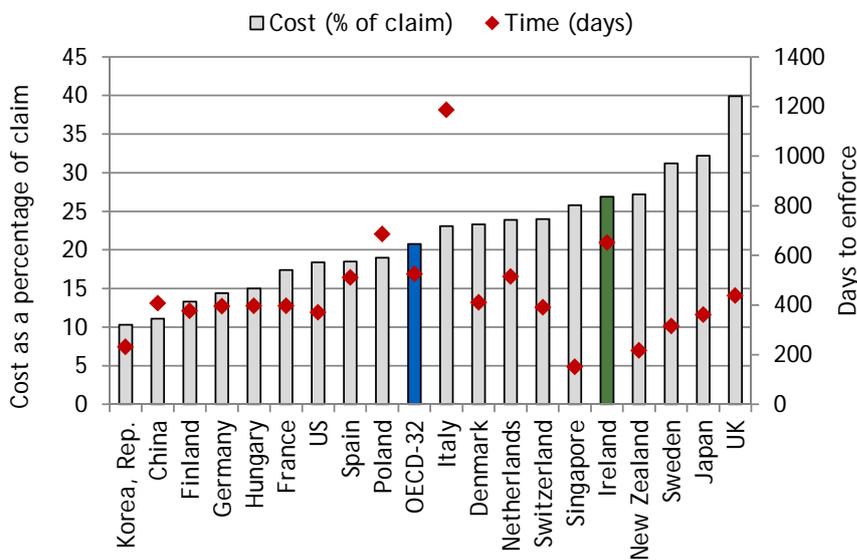
Figure 44: Accountancy and Legal Costs<sup>54</sup>, Q1 2007- Q3 2013



Source: CSO, Services Producer Price Index

This indicator examines the evolution of accountancy and legal costs in greater detail. The cost of accountancy services has been on a continual downward trajectory over recent years (prices are 10% below 2010 levels). Legal service costs (solicitor fees) have remained relatively constant throughout the recession although they did demonstrate a slight reduction in early 2013.

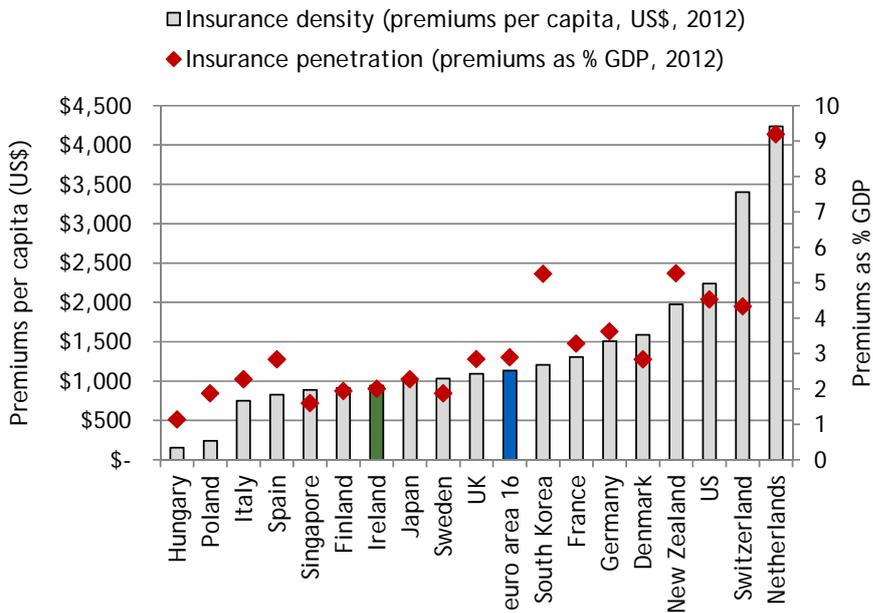
Figure 45: Legal Fees, Cost of Enforcing a Business Contract, 2013



Source: World Bank, Doing Business 2014

Ireland is an expensive location to enforce a business contract (ranked 8<sup>th</sup> most expensive in the OECD-32). The World Bank estimates that the total cost of contract enforcement in Ireland amounts to 26.9% of a claim, compared with 21% in the OECD. Attorney fees account for 70% of the reported cost of enforcing a business contract in Ireland. It also takes significantly longer in Ireland to enforce a contract than in most of the OECD - the 6<sup>th</sup> longest in the OECD.

Figure 46: Non-Life Insurance Density and Penetration, 2012

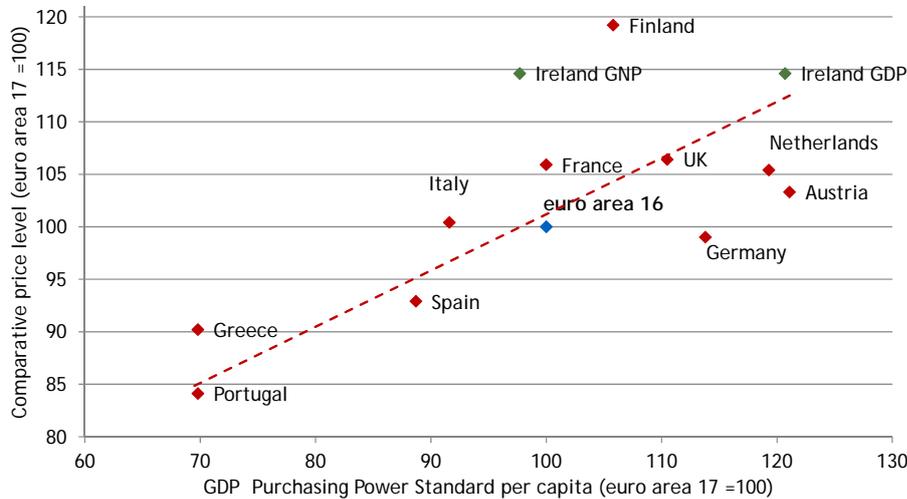


High insurance density (premiums per capita) can be a function of both high insurance costs and the requirement for high coverage levels. Non-life insurance relates to motor, property, employer’s liability, public liability, travel and other business insurance. The density of non-life insurance in Ireland (\$943) is below that of the euro area 16 (\$1,133). At 2% of GDP, insurance penetration in Ireland is relatively low (6<sup>th</sup> lowest out of 16).

Source: Swiss Re, Sigma No. 3, 2013

## Chapter 9 - Broader Cost Environment

Figure 47: Price Levels<sup>55</sup> and GDP per Capita, 2012



While consumer prices in Ireland have adjusted downward in recent years, prices remain slightly elevated relative to GDP per capita, and relative to most other euro area countries. In 2012, Ireland was the 3<sup>rd</sup> most expensive location in the euro area for consumer goods and services. Irish prices were 14.6% above the euro area average. Costs relative to national income (in GNP terms) remain particularly high when compared to the euro area average.

Source: Eurostat, Forfás calculations

Figure 48: Irish Price Levels Relative to the Euro Area, 2012

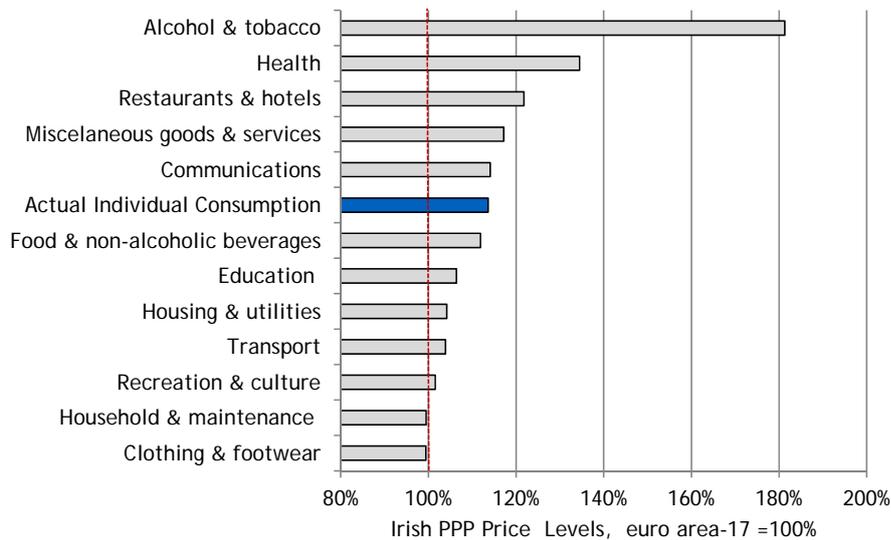
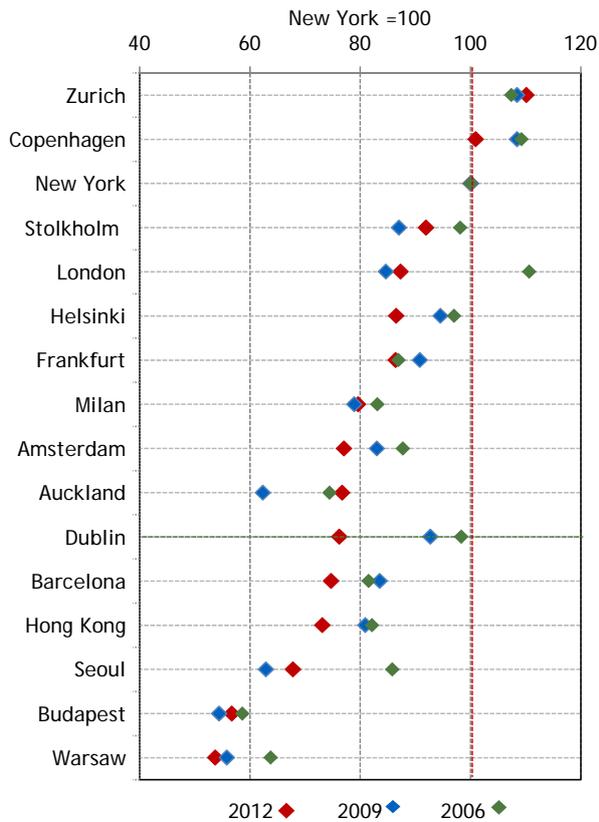


Figure 48 illustrates relative prices for a range of goods and services categories in Ireland compared with the euro area average. Irish price levels remain above the euro area average in 10 of the 12 categories (shown by the red line). Despite reductions in Irish price levels, Ireland remains within the top three most expensive euro area countries in five out of twelve categories of goods and services.

Source: Eurostat

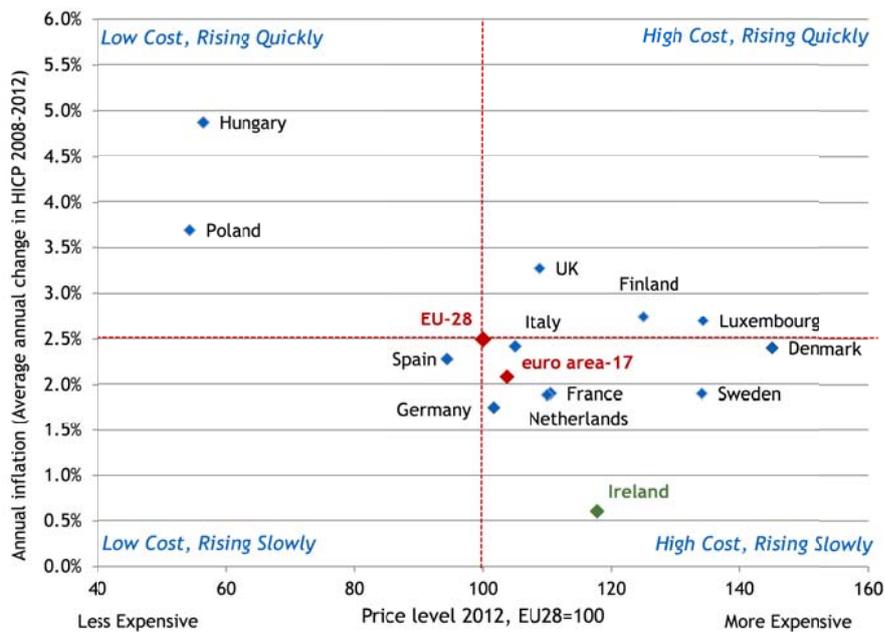
Figure 49: Consumer Price Level Comparison 2008 - 2012, (New York = 100)



Oslo, Zurich, and Tokyo are the most expensive cities in the world to live in. Dublin has become relatively less expensive over recent years as a result of the recession - in 2009 prices in Dublin were 98.3% of New York prices; in 2012 prices in Dublin were equivalent to 76% of the New York level - representing a significant reduction in the cost of living. Dublin's improved competitiveness has arisen as a result of the combined effects of exchange rate movements and the impact of the financial crisis. Also, in 2012, Dublin's price level fell below the euro area-12 for the first time<sup>56</sup>. Prices in Dublin including rents remain higher than the euro area-12 average. The relatively high cost of property rental in New York means that in all survey editions both Dublin and the euro area 12 appear relatively cheaper when rental prices are included.

Source: UBS, Prices and Earnings, Forfás calculations

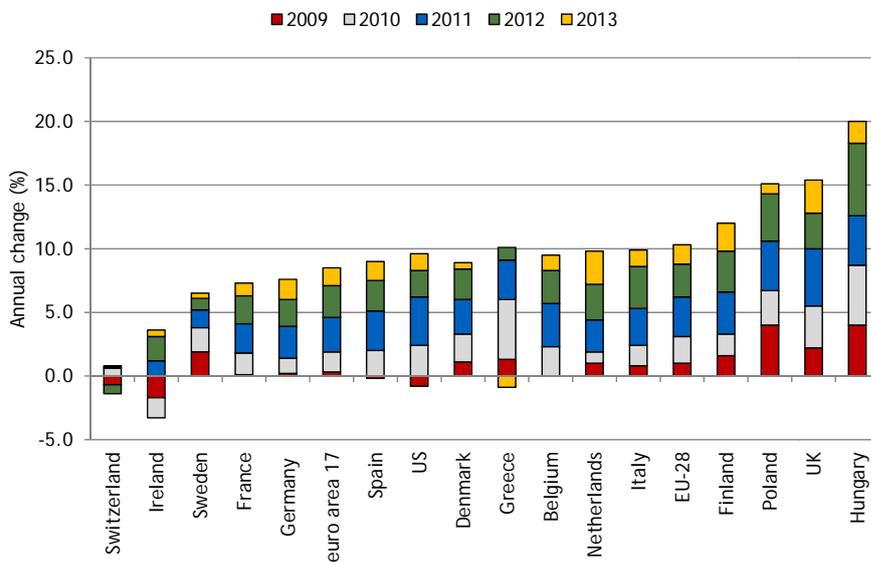
Figure 50: Consumer Price Levels (2012) and Average Annual Inflation (2008-2012)



It is important to consider both changes in prices (inflation) and price levels. As illustrated, Ireland's current price level and inflation profile can be described as high cost but rising slowly. The analysis below examines inflation in more detail.

Source: Eurostat, Forfás calculations

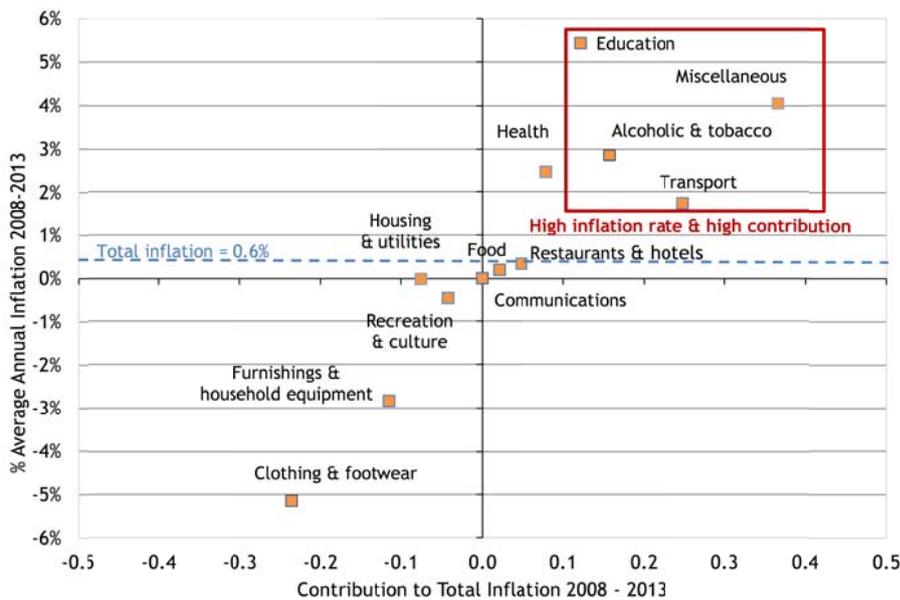
Figure 51: Harmonised Index of Consumer Prices<sup>57</sup>, Annual Percentage Change, 2009-2013



Since the onset of recession, prices in Ireland have increased at a significantly slower rate than in the euro area. Despite a return to inflation in 2011-2013 following a period of deflation, Irish rates remain below euro area averages. In 2013, Irish inflation (0.5%) was the fourth lowest in the euro area, behind only Greece (-0.9%), Cyprus (0.4%) and Portugal (0.4%). In 2013, Irish HICP inflation was also below the euro area average of 1.4%.

Source: Eurostat, Forfás calculations

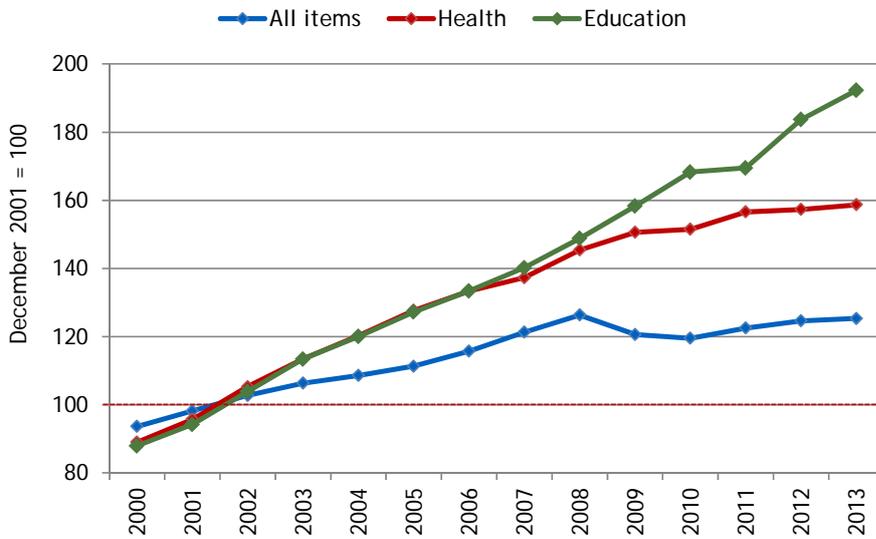
Figure 52: Average Annual CPI Inflation and Contribution to Total Inflation, 2008 -2013



Since the recession (i.e. 2008 to 2013), the principle contributors to Irish inflation have been “Miscellaneous goods and services” which is driven by health insurance, “Transport”, “Alcohol and tobacco”, “Education” and “Health”.

Source: CSO, Europe Economics and Forfás calculations

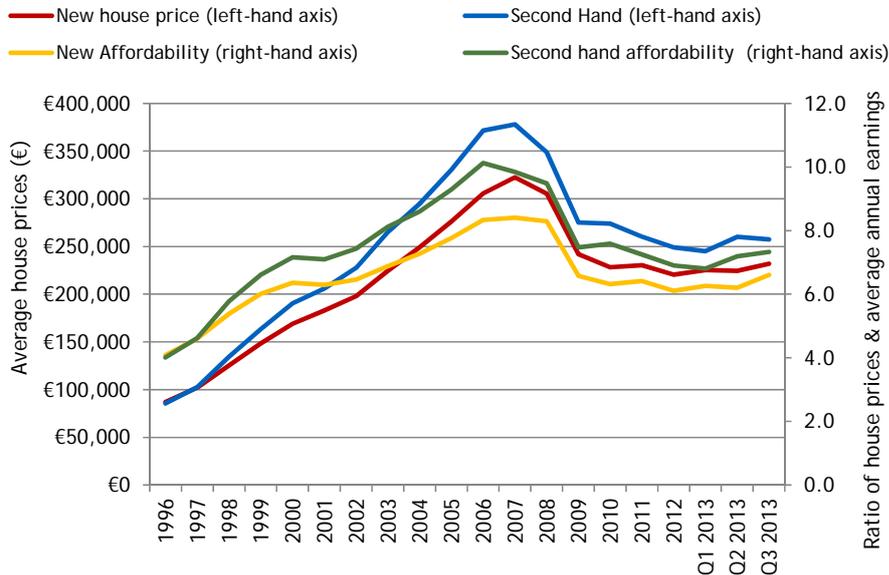
Figure 53: Health and Education, 2000-2013, (December 2001=100)



Health<sup>58</sup> and education<sup>59</sup> consumer costs have increased at a significantly faster rate than overall consumer costs since 2000. In 2013, education costs were 92% above what they were in 2001 while health costs were approximately 59% above 2001 prices. By comparison, the overall consumer price level increased by 25.3% over the same period.

Source: CSO, Consumer Price Index, Forfás calculations

Figure 54: Affordability of Irish House Prices, 1996-Q3 2013



Since the end of the construction and housing bubble, house prices have experienced a major downward adjustment - in Q3 2013, house prices (on a non-mix adjusted basis) were approximately 30% below 2007 peak levels, notwithstanding emergent upward pressures<sup>60</sup>. This has resulted in improved affordability - albeit at levels significantly elevated when compared with the mid-1990s.

Source: Department of Environment, Community and Local Government, CSO EHECS Survey

Figure 55: National Rental Index, January 2002 - October 2013 (2007= 100)



Rents nationally were 4.8% higher on average in Q3 2013 than a year previously. This was the 5<sup>th</sup> consecutive quarterly rise in rents nationally, with rents now rising outside of Dublin (by 1.8% in the year) as well as within Dublin (7.6% annually). According to Daft.ie, rents in the capital remain 20% below 2007 levels but are 12% above 2011 levels.

Source: Daft.ie, Rental Report

## Appendix 1 - NCC Members and Advisers

### National Competitiveness Council Members

Dr Don Thornhill	Chair, National Competitiveness Council
Liam Casey	Chief Executive Officer, PCH International Ltd.
Prof. Peter Clinch	Vice-President for Innovation and Corporate Partnerships, University College Dublin
Shay Cody	General Secretary, IMPACT Trade Union
Clare Dunne	Assistant Secretary, DJEI
Isolde Goggin	Chairperson, Competition Authority
John Herlihy	Vice President, International SMB Sales and Head of Google Ireland
Jane Magnier	Joint Managing Director, Abbey Tours
Danny McCoy	Chief Executive Officer, Ibec
Seán Murphy	Deputy Chief Executive, Chambers Ireland
Seán O'Driscoll	Chairman and Chief Executive Officer, Glen Dimplex Group
Louise Phelan	Vice President of Global Operations, Europe Middle East and Africa, PayPal
Heather Reynolds	Director, Eishtec
Dave Shanahan	Head of Strategic Health Initiatives Worldwide, AbbVie
Martin D. Shanahan	Chief Executive, Forfás
Paul Sweeney	Former Chief Economist, ICTU

### Council Advisers

Paul Bates	Department of Transport, Tourism, and Sport
John Callinan	Department of the Taoiseach
Michael Layde	Department of Environment, Community and Local Government
Katherine Licken	Department of Communications, Energy and Natural Resources
John McCarthy	Department of Finance
Conan McKenna	Department of Justice and Equality
David Moloney	Department of Public Expenditure and Reform
Aidan O'Driscoll	Department of Agriculture, Food and the Marine
Pat Burke	Department of Education and Skills

### Research and Administration

Adrian Devitt	Forfás
Conor Hand	Wilton Park House
Caoimhe Gavin	Wilton Place Dublin 2 Tel: 01 607 3000 Email: <a href="mailto:ncc@forfas.ie">ncc@forfas.ie</a> Web: <a href="http://www.competitiveness.ie">www.competitiveness.ie</a>

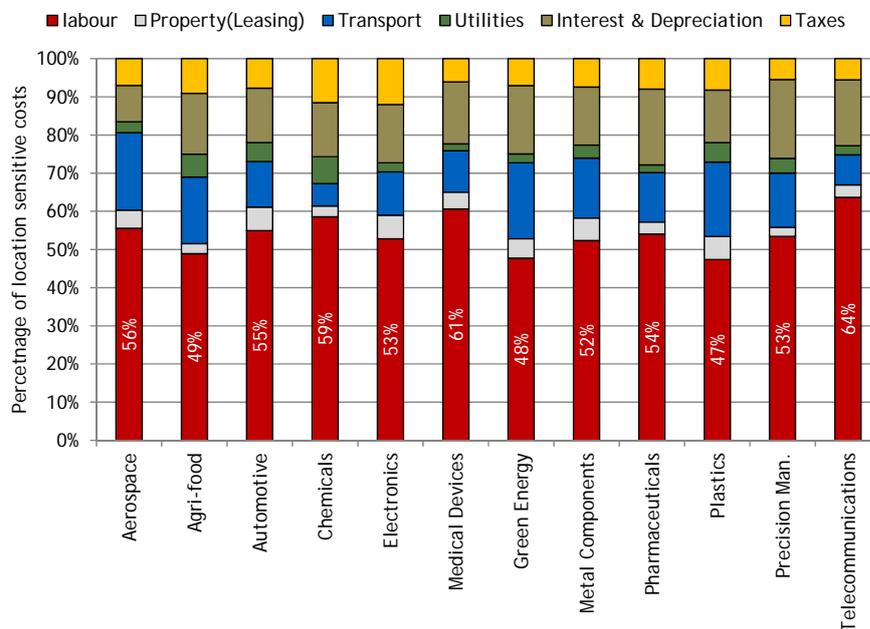
## Appendix 2 - Sectoral Cost Profiles

The following sectoral cost profiles provide an indication of the contribution of various location sensitive cost components to total costs in a number of key sectors. As the profiles are based on a single case study firm in each sector, the profiles should be regarded as indicative.

### Manufacturing Sector Cost Profiles

The contribution of labour costs to total location sensitive costs varies from 47 per cent in the case study plastics firm to 61 per cent in the case study medical devices firm and 64 per cent in the telecommunications case study.

Figure A1: Manufacturing Sectors' Cost Profiles (Location sensitive costs only)



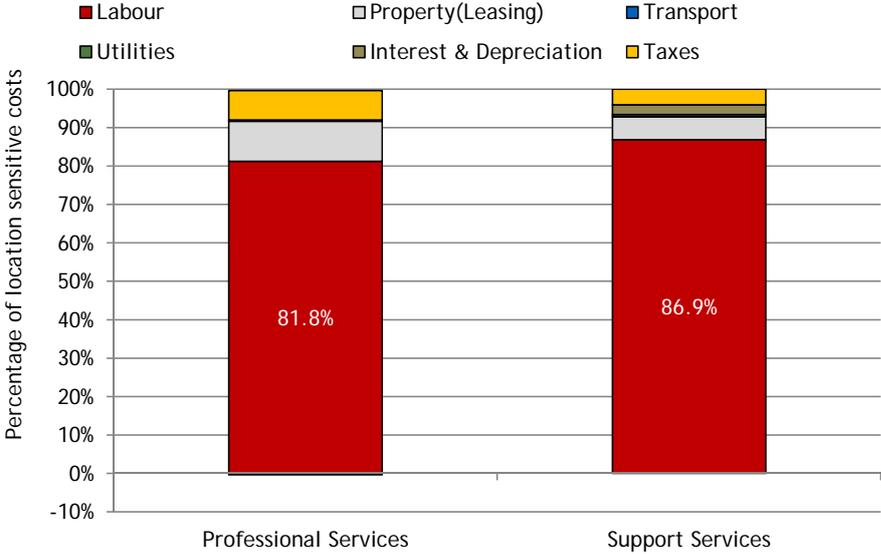
Transport costs are a major component of locally determined costs in the aerospace (20%), plastics (19%) and agri-food operations (17%) case studies. Utilities (e.g. energy, waste, etc.) are also an important cost input for the chemicals (7%) and agri-food (6%) case studies.

Source: KPMG, Competitive Alternatives 2012, Forfás Calculations

### Service Sector Cost Profiles

On average, location insensitive costs account for just 16.3 per cent of total cost for the case study services firms, making services operations highly sensitive to locally determined costs and the value they offer. In 2012, services exports accounted for 51 per cent of total Irish exports compared to 25 per cent in 2001<sup>61</sup>. Location insensitive costs have been eliminated from Figure A2.

Figure A2: Services Sectors' Cost Profiles (Location sensitive costs only)



Unsurprisingly, labour costs are the main component of costs in services sectors, accounting for almost 82 per cent of location sensitive costs for professional services and 86.9 per cent of location sensitive costs for support services (e.g. a shared services centre). Property leasing costs are particularly significant for professional services operations (10.4%).

Source: KPMG, Competitive Alternatives 2012, Forfás Calculations

Digital Sector Cost Profiles

For the first time, the 2012 KPMG cost profiles examine the digital sector in isolation. The digital sector includes both digital entertainment and software design - two key sectors in Ireland's economy. As with the services sector, location insensitive costs account for a small proportion of overall costs - 12.5 per cent in this case.

Figure A3: Digital Sectors' Cost Profiles (Location sensitive costs only)

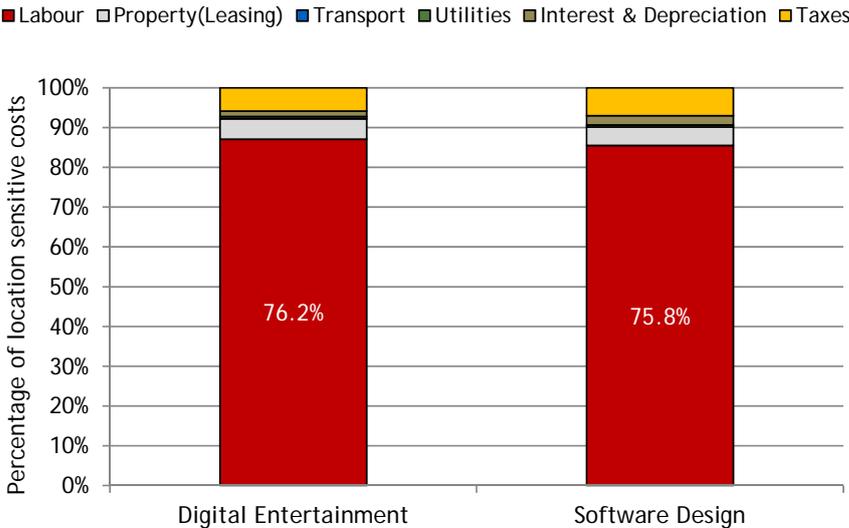


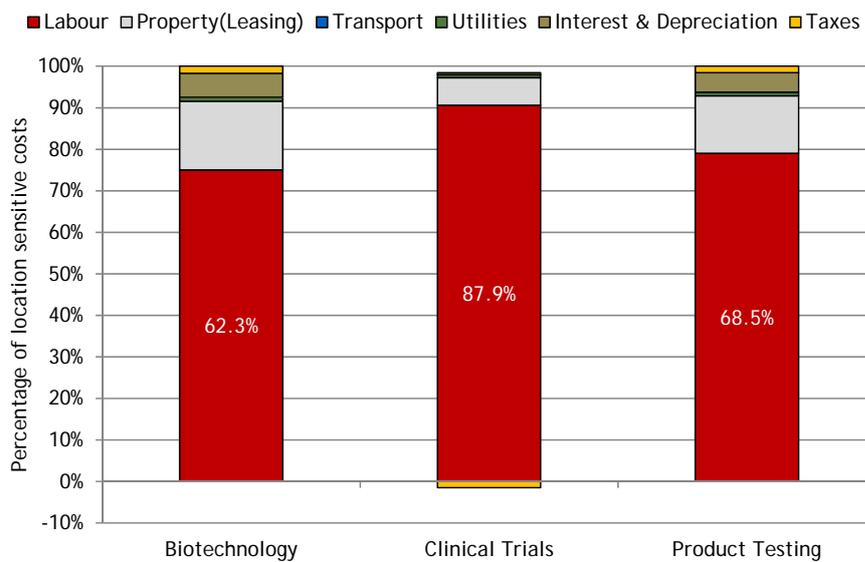
Figure A3 looks in more detail at the breakdown of location sensitive costs. Once again, labour represents the largest cost element for firms, accounting for over 75 per cent of total costs for both digital entertainment and software design. Tax and property costs are the next two most important costs for the sector.

Source: KPMG, Competitive Alternatives 2012, Forfás Calculations

## R&D Sector Cost Profiles

Labour costs comprise a large component of location sensitive costs for the case study R&D operations. They account for 93 per cent of costs within the clinical trials firm, 79 per cent within the product testing operation and 75 per cent within the biotechnology firm.

Figure A4: R&D Sectors' Cost Profiles (Location sensitive costs only)<sup>62</sup>



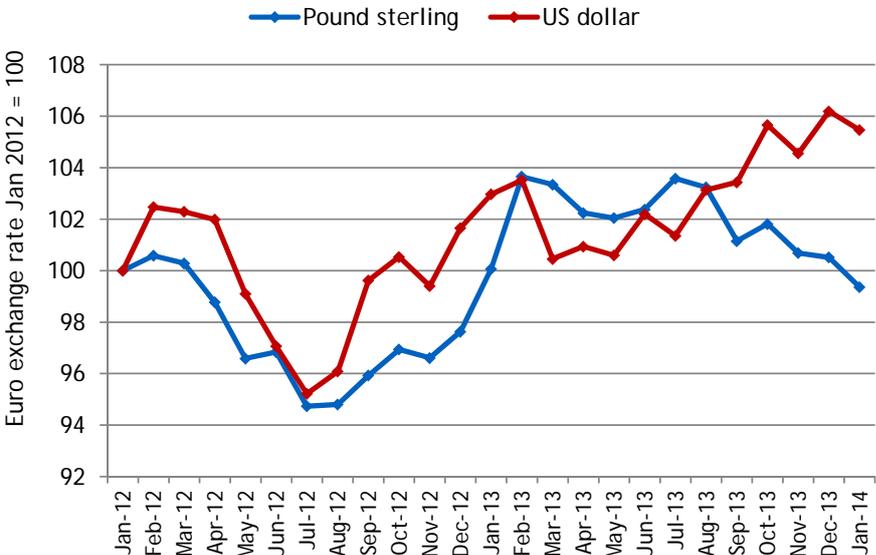
The leasing of property is a major cost element for these firms also (16.5 per cent for biotechnology, 14 per cent for product testing). Interest and depreciation charges are also significant for biotechnology and product testing facilities.

Source: KPMG, Competitive Alternatives 2012, Forfás Calculations

# Appendix 3 - Exchange Rates and Cost Competitiveness

Following the decline of the euro on global markets post 2008, it is not surprising that Ireland, as an export dependent, open economy, should show a large competitiveness gain. Indeed, non-euro area trade is far more important to Ireland than to any of the other euro area countries. As a consequence, the decline in the value of the euro on world currency markets, and especially relative to sterling and the dollar, had a larger, more positive effect on Ireland’s competitiveness than on that of any other euro area country.

Figure A5: Euro/Pound Sterling and Euro/Dollar Exchange Rate, January 2012 - January 2014

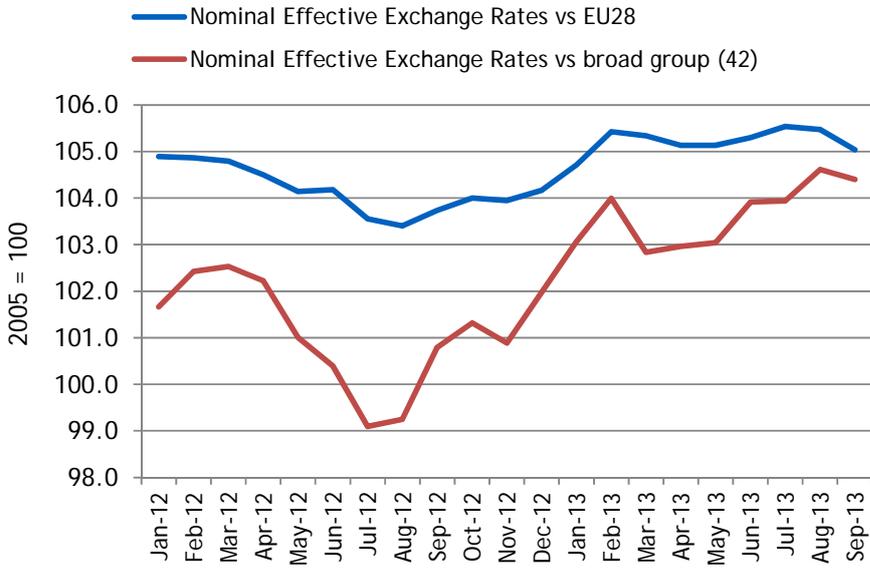


Since mid-2012, however, the euro has appreciated in value, particularly against the dollar. By comparison, euro gains vis-à-vis sterling has reversed since July 2013. Given the importance of the US as a destination for Irish exports, the increasing value of the euro adversely impacts upon Irish competitiveness.

Source: Eurostat

This exchange rate effect is also evident in data measuring Ireland’s nominal effective exchange rate (NEER). The NEER (or “trade-weighted currency index”) tracks changes in the value of a given country’s currency relative to the currencies of its principal trading partners.

Figure A6: Ireland's Nominal Effective Exchange Rate, January 2012 - September 2013



The impact of the euro's appreciation is most evident for Ireland in relation to the broader group of 42 countries captured in Figure A6. This reflects the importance of Irish trade with the US and other non-EU markets.

Source: Eurostat

## Endnotes

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<sup>31</sup> Euro area-16 excludes Cyprus.

<sup>32</sup> Unit labour costs (ULC) measure the average cost of labour per unit of output. ULCs represent a direct link between productivity and the cost of labour used in generating output. Nominal unit labour costs are defined as total wage compensation per unit of output. This is equal to the nominal wage rate per worker divided by labour productivity. Real unit labour costs are derived by dividing nominal unit labour costs by the price level and are therefore identical with the wage share in GDP.

<sup>33</sup> Central Bank of Ireland, Quarterly Bulletin Q1 2014, January 2014

<sup>34</sup> Data relating to the minimum wage as a percentage of average wages is based on the latest year available between 2011 and 2013 - the Irish data relates to 2011. All data measuring monthly minimum wage levels relates to the first half of 2014 (i.e. S1 2013) except for Greece and the US which relates to the second half of 2013. It is also worth noting that many countries have sectoral and regional minimum wages in addition to national minimum wages (e.g. Denmark).

<sup>35</sup> Where relevant, the Universal Social Charge is included in the Irish data.

<sup>36</sup> Prices quoted are the upper boundary of the cost of the constructing a prime office unit. A prime office unit refers to a city centre, self-contained building of a size and height typical of major cities in a country; building costs include for accommodation to a good finish with raised floors, carpet, suspended ceilings, air conditioning, lighting and power, but excluding partitioning.

<sup>37</sup> Prices quoted are the upper boundary of the cost of the constructing an industrial unit. An industrial unit for the purposes of this data is referred to as a large single-storey unit of steel portal frame and profiled aluminium cladding, with an eaves height of at least 6m, on an out-of-town site, finished to a basic shell with services and heating to the office space.

<sup>38</sup> Cushman and Wakefield collate data on the most expensive retail locations across a range of countries. Data for Ireland is based on rents for Grafton St. in Dublin. The chart excludes data on France (Paris - €13,255/m<sup>2</sup>) and the US (New York - €20,702/m<sup>2</sup>) for presentational purposes.

<sup>39</sup> The World Bank methodology assumes that traded product travels in a dry-cargo, 20-foot, full container, weighing 10 tons and valued at €20,000. It is further assumed that the product in question does not require refrigeration or any other special environment and does not require additional safety other than accepted international standards.

<sup>40</sup> Electricity prices for large users are based on an annual consumption of 2,000 to 20,000 MWh (Band ID). Data refer to half-yearly prices for each year (first six months of 2008 and first six months of 2013).

<sup>41</sup> Electricity prices for SMEs are based on an annual consumption of 20 and 500 MWh (Band IB). Data refer to half-yearly prices for each year (first six months of 2008 and first six months of 2013).

<sup>42</sup> Based on band I3: 10 000 GJ < Consumption < 100 000 GJ.

<sup>43</sup> International Energy Agency, World Energy Outlook 2013, November 2013

<sup>44</sup> Data for international locations is sourced from the Economist Intelligence Unit and relates to 2012. Data for Ireland is sourced from the Local Government Management Agency and relates to 2013. The Irish data reflects the average cost of the water services element of the consolidated water services charge across 31 Local Authorities for which data is available.

<sup>45</sup> A range of landfill fees are in operation for those countries marked with an asterix; the upper limit of this range is used in Figure 32. Net landfill fees in Ireland ranged from €35-45 per tonne and from €60-€130 in Sweden. The landfill levy in Flanders differs, depending on whether it's private or public landfill - the public landfill levy is used. The private landfill levy is €32 per tonne.

<sup>46</sup> In countries marked with \*, there is a range of thermal treatment fees. The upper limit is used in Figure 33.

<sup>47</sup> Euro area 14 excludes Cyprus, Finland and Malta.

<sup>48</sup> Euro area 15 excludes Cyprus and Malta.

<sup>49</sup> This metric includes a fixed charge for access as part of a bundled service. Euro area 15 excludes Cyprus and Malta.

<sup>50</sup> The basket also includes 225 SMS per month. Euro area 15 excludes Cyprus and Malta.

<sup>51</sup> ComReg, Quarterly Key Data Report Q3 2013, December 2013

<sup>52</sup> Loans under €1 million and up to one year refer to loans up to €1 million at floating rate and up to 1 year initial rate fixation. Loans over €1 million and up to one year refer to loans over €1 million at floating rate and up to 1 year initial rate fixation.

<sup>53</sup> The outstanding loans interest rate captures the interest rate for longer-term facilities which originated at a time when credit in Ireland was cheaper than in most euro area countries. This is the most likely explanation for Irish interest rates being higher than the euro area average for new business but lower for longer-term outstanding loans.

<sup>54</sup> Data on legal services is based on responses received from 18 companies (and 112 price observations), the majority of whom employ between 10 and 49 employees. The survey does not include data on prices for barrister services. Given the small sample size, caution should be used when interpreting the results.

<sup>55</sup> Comparative price levels are the ratio between Purchasing power parities (PPPs) and market exchange rate for each country. The ratio is shown in relation to the euro area-17 average. If the index of the comparative price levels shown for a country is higher/ lower than 100, the country concerned is relatively expensive/cheap as compared with the euro area average.

<sup>56</sup> Euro area-12 includes Amsterdam, Athens, Barcelona, Brussels, Dublin, Frankfurt, Helsinki, Milan, Lisbon, Luxembourg, Paris and Vienna. Cities from member states that joined the euro after 2003 are not included in Euro area average to avoid skewing the data.

<sup>57</sup> Consumer price inflation in the euro area is measured by the Harmonised Index of Consumer Prices (HICP). Certain items are excluded from the coverage of the HICP, which in essence makes the HICP a subset of the main CPI. The HICP expenditure covers just under 90 per cent of the total CPI expenditure and excludes mortgage interest, building materials, union subscriptions, motor taxation, house insurance (dwelling), and the non-service elements of motor and house insurance (contents).

<sup>58</sup> "Health" includes medical products, appliances and equipment, hospital charges and outpatient services supplied by doctors, dentists, opticians, physiotherapists and practitioners of alternative and complementary medicine.

<sup>59</sup> "Education" includes pre-primary and primary, secondary, third level fees and other education and training such as night courses and examination fees.

<sup>60</sup> The Department of the Environment, Community and Local Government (DECLG) compile average house prices per quarter, whereas the CSO produce a price index. The principal conceptual difference is that the latter is mix-adjusted. Based on data from DCELG, prices for new houses are down 28 per cent on their peak, while second hand house prices have fallen by 32 per cent. According to CSO data, the national Residential Property Price Index in December 2013 was 46.4 per cent lower than its highest level in 2007.

The CSO's Residential Property Price Index (RPPI) is designed to track the evolution in prices for the exact same set of properties month-on-month. However, in reality, the same properties are not sold month after month. Every property sold is unique (and, therefore, a 'fixed basket of properties' cannot be created). To resolve this problem, the CSO use econometric modelling techniques to strip out the different price effects of size, location, etc. every month to produce a price change of fixed notional property types. This process is known as mix-adjustment.

The interpretation of the difference between the two measures is that the quality (in terms of size, location, etc.) of the properties transacted since the crash has improved (i.e. more proportionately more 'premium' properties are being sold).

<sup>61</sup> CSO, Balance of International Payments Q3 2013, December 2013

<sup>62</sup> On average, 13.3 per cent of costs for R&D operations are determined on global markets. Of the three R&D sectors benchmarked in this report, clinical trials operations are the most sensitive to locally determined costs (88%).

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