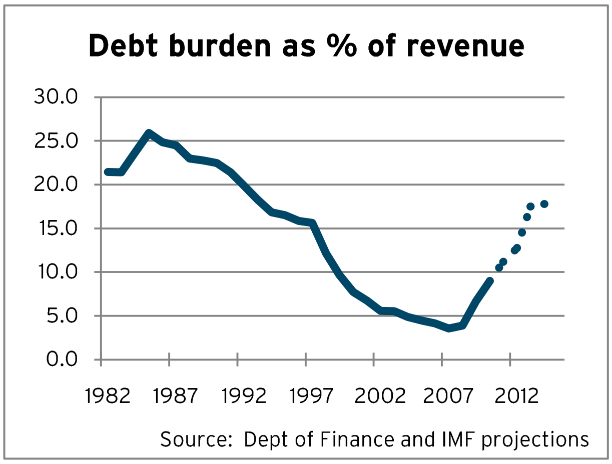
Ireland as a place to do business

March 2011

EU/IMF loan deal will not stifle recovery

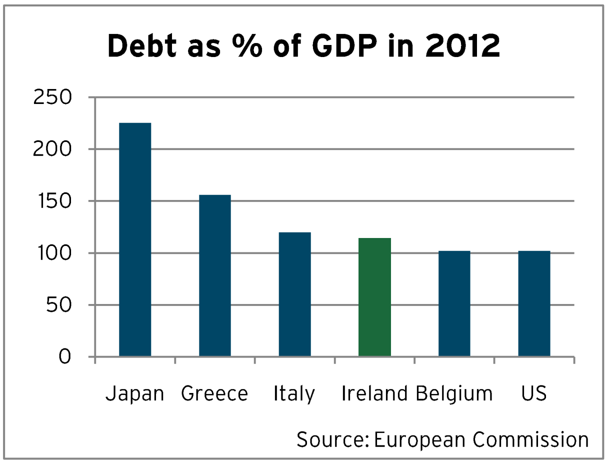
The EU/IMF loan deal agreed in late November does not fundamentally change the task of the new Government in terms of fiscal adjustment, nor the trajectory for the macroeconomy. In fact, the structural reforms that form part of the loan agreement will enhance the productive capacity of the economy.



The new Fine Gael-Labour Government is fully committed to bringing the budget deficit to 3% of GDP by 2015, in line with the EU/IMF loan deal. The programme for government contains a number of actions that will help improve the environment for business. Most importantly, the two parties have a sizeable majority and a proven track record of working together; this will help bring political stability to Ireland.

Although the debt burden will be high, Ireland has coped with worse. Using the IMF's projections, which factor in the full €35 billion banking recapitalisation provisions under the loan agreement, the debt burden will remain lower than during the 1980s. The cost of debt repayment as share of revenue will peak at close to 18% in 2014. In 1986, the debt burden was 25% of government revenue and never dipped below 20% during that decade. Crucially, Ireland will have completed two-thirds of the total fiscal adjustment by the end of 2011.

As we detail in this document, there are reasons to believe that even in the context of challenging fiscal retrenchment, Ireland will be able to post a relatively robust export-led recovery. This in turn will ease the debt burden.



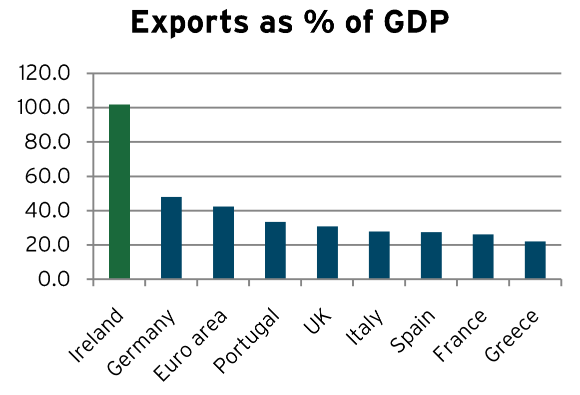
The fiscal multipliers for Ireland are low by international comparison due to the exceptional openness of the Irish economy. Much of the reduction in household consumption is therefore offset by a reduction in imports and a higher contribution to growth from net exports.

Although Ireland's debt burden has increased dramatically, it is not exceptionally out of line internationally. US gross debt is projected to exceed 100% of GDP by 2012 and reach 110% by 2015. Belgium has lived with a high debt burden for decades; Italy's debt will reach 120% of GDP; Japan's is in excess of 200%.

Ireland is on track for an export-led recovery

While tax increases and budget cutbacks mean that economic growth will be significantly lower than would otherwise have been the case, the austerity measures don't mean that growth cannot be achieved.

Because Ireland is an exceptionally open economy, an export-led recovery is possible, even in the context of relatively subdued domestic demand. Exports account for over 100% of GDP – in Germany that share is close to 50% while for the euro area exports account for just over 40% of GDP on average.



Source: European Commission

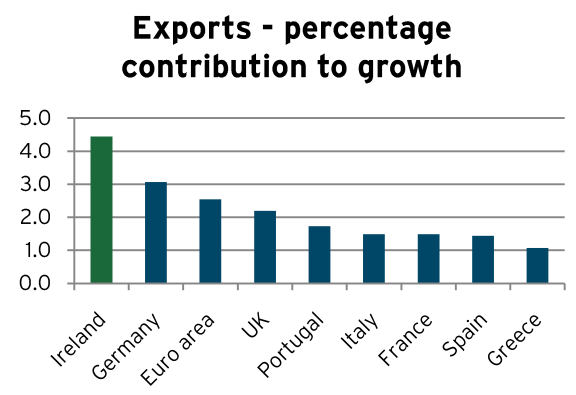
Even taking account of imports Ireland comes out very favourably. Net exports make up 23% of GDP – for Germany the corresponding proportion is 5%. In many other countries – Greece, Spain, Portugal, UK, France – imports outweigh exports and the net impact on GDP is negative.

Ireland's export base is fairly diverse. As a result exports fell less during the global crisis than in many other countries, but Ireland has also been able to post a robust recovery. The volume of exports exceeded the previous peak in Q2 2010 and grew by over 8% during the year.

Ireland's services exports account for nearly 50% of the total, the highest proportion in the developed economies. Financial, ICT and business services form the core of this. In terms of goods exports, modern high technology sectors such as pharmaceuticals, medical devices and ICT are important, but Ireland has strengths in a number of traditional sectors such as food and drink as well.

This diversified export base means that Ireland is not exposed to any one sector – as the fortunes of industries wax and wane and activities shift around the globe, Ireland has been able to adapt. Even as lower value add activities have moved to cheaper locations, they have been replaced by new activities, both in companies already located in Ireland and new companies in new sectors.

The ICT industry is the perfect example. Research from the Economic and Social Research Institute shows that although activities and companies located in Ireland churned as a result of global shifts, a highly educated and skilled workforce has been able to adjust to changing circumstances. The extraordinary flexibility of the economy has allowed Ireland to embrace the process of creative destruction.

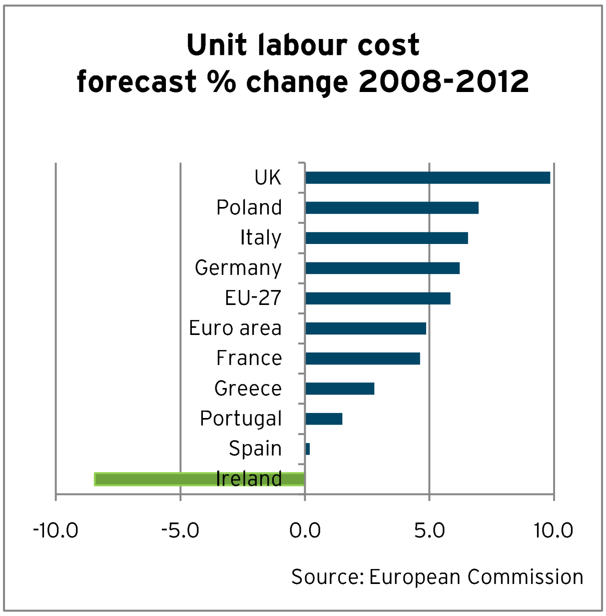


Source: European Commission

Because of the highly open nature of the Irish economy, exports make a substantially higher contribution to GDP than in most other countries. In 2011, exports will add about 4 percentage points to GDP. Even in Germany, with its booming manufacturing, exports will only add 3 percentage points to growth, while for the euro area as a whole the contribution will be about 2.5 percentage points.

The strong contribution from exports will substantially help counteract the negative impact of fiscal austerity; we project that the Irish economy will grow by close to 2% in 2011.

Productivity and falling costs will underpin growth



The European Commission forecasts that Irish unit labour costs will fall by over 8% in the period 2008-2012. Relative to the EU average, this is an improvement of 14%.

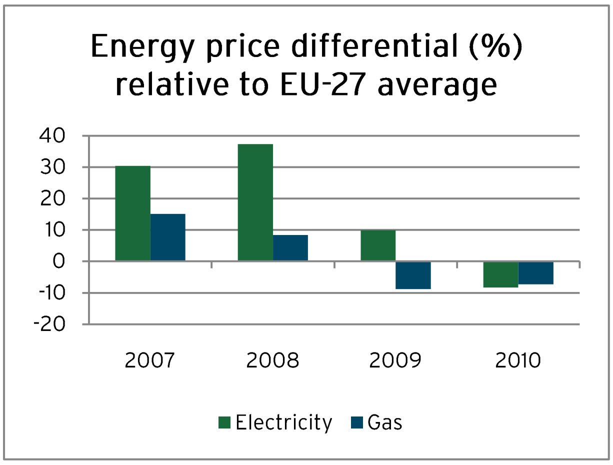
IBEC research shows that at least 25% of firms reduced nominal pay rates over the course of the recession and that the vast majority of firms implemented wage freezes in both 2009 and 2010. Average pay fell by 2.5% in 2010 on top of the fall of 1.6% in 2009.

In 2011, almost 70% of firms will freeze basic wage rates. Just under one in ten expect to reduce basic pay rates by an average of 9%.

During 2010 IBEC conducted a series of firm-level case studies to drill down into the detail of the productivity gains that Irish businesses have made over the past two years, showing that the firms examined had been highly successful in reducing their unit costs since the start of the recession.

Major restructuring programmes and a stronger focus on productivity delivered average annual unit cost reductions of 7%. The costs over which firms have the most control – overheads and labour – fell by much more than this. Marginal costs have reduced dramatically and the cost of hiring new staff has fallen by up to 25%. One firm in the sample noted that although gross wages in Ireland remained on a par with those in the group's plant in Germany, the unit labour costs in Ireland were 50% lower.

The firms generally regarded the Irish workforce as being highly flexible and good at change. It is this ability to adapt which has enabled Irish businesses to overcome the greatest of challenges during the past three years and to ensure their sustainability through strong productivity growth.

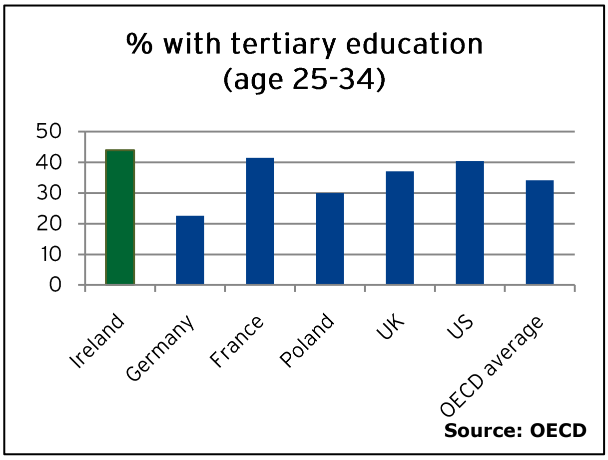


Irish energy costs have come down substantially. During 2008, the cost of electricity for large energy users was 37% more in Ireland than in the EU-27. By 2009 this gap had narrowed to 10% and by the first half of 2010 (latest data available) Irish electricity prices were 8% below the EU-27 average. The price of natural gas has moved from 15% above the EU-27 average in 2007 to 7% below by the first half of 2010.

Other business costs have also adjusted and Ireland's cost base is now more attractive than before the recession. The cost of renting and constructing commercial property in Ireland has fallen significantly. A ban on upward-only rent reviews for all new rental contracts came into effect in February 2010; this will make the commercial rental market more flexible in the future. Data from the Central Statistics Office indicates that the cost of business-to-business services has fallen by 8% from the Q1 2008 peak.

Ireland's strengths as a business location

The labour force is among the best educated in the world; the share of population aged 25-34 with a third level qualification is higher than in the US and the UK, and the OECD average. The Government is committed to further developing and improving third-level education.



The 2010 IMD World Competitiveness Yearbook ranked Ireland 1st for corporate taxes, 4th for the availability of skilled labour, 4th for openness to new ideas, 6th for labour productivity and 7th for the flexibility and adaptability of people.

The 2010 IBM Global Location Trends report ranked Ireland first in the world for FDI job creation, when taking account of population size. The World Bank's 2011 Doing Business report ranked Ireland 9th in the world in terms of ease of doing business; paying taxes and starting a business are areas where Ireland ranks particularly well.

Throughout the last decade, Ireland invested substantially in infrastructure and achieved major improvements, particularly in the quality of road, rail, air and sea transportation. The completion of the inter-urban motorway network has reduced travel times between the major cities by up to 50%.

The Irish Government is fully committed to maintaining its competitive 12.5% corporation tax rate and continues to enhance its tax offering for FDI through expanding the tax treaty networks and supports for intellectual property and R&D. The corporation tax system is simple and transparent, and income taxes remain competitive.

Ireland has clusters with capacity to drive growth

Thanks to clusters and networks of multinational companies, Ireland has achieved critical mass in a number of high-tech sectors. Eight of the top ten global medical technology companies have a manufacturing base in Ireland and employment in the sector on a per capita basis is the highest in Europe. Eight of the top ten pharmaceutical companies have operations in Ireland.

ICT is another strong sector; many major software and hardware companies have significant operations in Ireland and the cluster of internet-based companies is growing because Ireland is the location of choice.

In 2006-2008, 45% of all enterprises in Ireland and 86% of large industrial enterprises were engaged in innovative activities. This substantial investment is paying off and the business functions located in Ireland are shifting to higher value added activities and are in many cases becoming increasingly R&D-driven.

Apart from a strong multinational sector, there are also a number of vibrant indigenous companies operating in Ireland. Half of the medical technology companies are Irish and there is a vibrant software sector exporting mainly to the UK and the US. Ireland has a natural competitive advantage in the food and drinks sector – in fact, Ireland is the largest exporter of beef in Europe and fourth largest in the world.

Indigenous manufacturers are becoming increasingly sophisticated and thanks to competitive adjustment achieved to date, Ireland is pricing itself back into international markets

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