



**National Competitiveness Council Submission to
the Department of Finance on the Forthcoming
National Development Plan (2007-2013)**

October 2006

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Introduction

The NCC defines national competitiveness as all those factors that impact on the ability of firms in Ireland to compete in international markets. While prices of business inputs are central to competitiveness, this definition recognises that over the longer run, competitiveness is about all those factors that contribute to better business performance, such as good physical infrastructure, high levels of education, training and research, and a regulatory and tax environment that encourages enterprise, competition, and innovation.

In the coming years, the Irish economy will need to adapt to new emerging patterns of globalisation by winning market share in higher value added markets in manufacturing and services, while supporting our current enterprise base by controlling cost inflation and building enterprise capabilities. The extent to which Ireland is successful in these areas will largely determine our economic performance to 2013 and beyond.

The forthcoming National Development Plan (NDP) 2007-2013 provides an ideal opportunity to put in place the necessary framework conditions required to sustain and develop Ireland's international competitiveness. While the pursuit of public policy objectives, broadly speaking, requires a combination of market regulation and public expenditure, this submission focuses on outlining policy priorities within the context of a national spending plan. A forthcoming report, Ireland's Competitiveness Challenge, will provide a more comprehensive treatment of the NCC's recommendations to address the wider challenges facing the Irish economy.

This submission highlights a small number of key priorities that are critical to national competitiveness, and have not been given adequate attention in the debate to date. For example, while the NCC strongly supports the funding of Transport 21, the NCC believe that sufficient commitment for this programme is already in place, rendering further restatement unnecessary. Additionally, while not included in this submission as priorities, the NCC would like to acknowledge the key role the NDP should play in addressing quality of life issues in Ireland such as social disadvantage, healthcare, cultural, leisure and recreational amenities, and the environment.

The remainder of this submission is divided into seven sections, each covering a priority the NCC would like to emphasise before the details of the NDP have been finalised. The NCC's priorities are summarised on the following page.

National Competitiveness Council's NDP (2007 - 2013) Priorities

- 1. Appropriate Investment Levels:** The NCC supports sustained investment in infrastructure under the new NDP. The 2006 Annual Competitiveness Report (ACR) indicates that Ireland's public capital stock (infrastructure level) remains well below the OECD average and that the perceived quality of our infrastructure is low relative to leading countries. Efforts are required to enhance the capacity of the construction industry to deliver without contributing to further price inflation. The NCC also recommends prioritising higher return projects and the use of user charges to provide clear market signals. Changes in the tax system should support the delivery of the NDP by re-orientating construction capacity away from non-productive assets (e.g. second homes).
- 2. Improved Planning and Implementation Procedures:** The NCC believes that while advancements have been made on planning and implementation procedures, further improvements need to be made. The NCC recommends that proposed projects should be output as well as input focused, and be evaluated ex-ante both individually and as part of a network. Under the next NDP a greater proportion of projects should be delivered through PPPs. Additionally, evaluations related to projects should be published to improve transparency.
- 3. Balanced Regional Development:** The NCC believes that the NDP should be designed to make a reality of the National Spatial Strategy, with a special fund for gateway development in particular. Sufficient focus should also be given to Dublin and collaboration on north-south projects of mutual interest.
- 4. Research and Development:** The NCC strongly supports the recent Strategy for Science, Technology, and Innovation 2006-2013. The NCC remains concerned about Ireland's weak performance in private firm level R&D. Further incentives to encourage R&D in private firms should be supported and initiatives to encourage commercialisation and greater industry involvement in state funded R&D. Finally, as Ireland seeks to capitalise on opportunities in internationally traded services over the next decade, innovation in services will become increasingly important.
- 5. Education:** While further investment and reform is required at all levels of the education system from primary to life long learning, the NCC would like to highlight the particular importance of additional investment in pre-primary facilities. The NCC recommends a substantial transformation of the pre-school system over the course of the next NDP. The NDP should provide the funds necessary for training pre-school teachers and infrastructural improvements to existing primary schools to provide facilities for pre-school classes.
- 6. Energy Infrastructure:** Government investment should be available to facilitate the development of the energy market. The NCC recommends that the East-West electricity interconnector and new infrastructure in gas and oil storage should be included in the NDP. Additionally, the NDP should also place a greater emphasis on developing a public transport system less dependent on non-renewable imported energy, developing sources of renewable energy such as wind, tidal and bio-fuels, and supporting research and development in energy related fields.
- 7. Telecommunications and Waste Infrastructure:** The NCC believe that the next NDP should continue to fund telecommunications infrastructure to address competitiveness concerns until the regulatory environment is further developed. With respect to waste infrastructure, if the next NDP relies significantly on private sector investment, regulatory reform will be required to improve incentives to the invest.

1. Appropriate Investment Levels

Since the late 1990s, much progress has been made in closing the infrastructure gap in Ireland. However, the evidence on Ireland's infrastructural deficit strongly makes the case for continued investment. The 2006 Annual Competitiveness Report indicates that Ireland's public capital stock (infrastructure level) remains well below the OECD average and that the perceived quality of our infrastructure is low relative to leading countries. The NCC strongly welcomes the Government's commitment to sustained investment in infrastructure.

Given current capacity constraints in the construction industry, there is a risk that without additional policy interventions, significant increases in public investment may cause price and wage inflation in the construction sector and in the wider economy.¹ There is also a concern that by bidding up wage levels and other costs, the current construction boom may 'crowd out' many internationally trading firms, particularly in manufacturing. The policy challenge is to choose and deliver appropriate levels of investment that balance our need for infrastructural improvements with the potential impact on value for money and private sector crowding out.

The NCC makes a number of recommendations. The NCC suggests that as market conditions in construction change over the seven years of the investment plan, investment levels should be sensitive to capacity changes. Efforts are also required to expand the capacity and productivity of the construction sector - for example, the development of larger scale projects may attract more international bidders with additional capacity and capabilities.

The NCC also recommends the phasing of investment over the course of the NDP by prioritising higher return projects. As much of the current construction boom is being driven by demand for investments in non-productive construction assets (e.g. second homes), continued efforts should be made to reorient the taxation system towards investments in productive assets. Finally, user charges can provide funding as well as provide policymakers with clear market signals for infrastructural demand that can greatly improve the future allocation of resources.

2. Improved Planning and Implementation Procedures

The capability of the public sector to deliver large infrastructural projects has improved considerably over the last number of years. However, the NCC believes that further improvement is both possible and necessary during the next NDP. Given the huge financial resources that a new national development plan will require, it is crucial that the process through which spending is allocated and managed is robust: even a marginal improvement in the allocation of public capital spending will yield sizeable economic benefits. There are

¹ Between 2000 and 2005, construction activity in nominal terms has increased by 79 percent. Construction sector wages have risen faster than in industry as average weekly earnings for construction workers have increased by 45 percent since 2000 as opposed to 33 percent for industrial workers. Source: CSO Construction and Housing in Ireland, July 2006.

four areas in the current system of planning and implementation where the NCC believes that opportunities for improvement exist.

Firstly, it is important to ensure that projects that offer the highest economic and social returns are prioritised both within individual Government departments and across Government departments. This process requires the development of structures and skills to assess the true economic and social benefits and costs of projects. While calculating the return of each project on an individual basis is necessary, calculating the returns of projects in an integrated fashion is also very important. For example, as new transport infrastructure is proposed, it should be designed and evaluated in the context of how it would contribute to the transport network.

Secondly, the previous NDP had a tendency to focus on financial inputs rather than actual outputs. The NCC recommends that the next NDP should be more output focused on the delivery of key national objectives. In this context, a set of output metrics should be published so that progress towards the specified targets can be evaluated.

Thirdly, public private partnerships (PPPs) offer further opportunities to improve implementation mechanisms by making the best use of the capabilities of the private sector. Under the next NDP, a greater proportion of projects should be delivered through PPPs.

Finally, greater transparency is required. Where good analysis is already conducted, it is not always clear how the analysis translates into actual allocations for infrastructure investment. These evaluations and appraisals by individual government departments and their agencies should, to the greatest extent possible, have a common methodology across departments, and they should be published so that it is possible to assess their standard on an on-going basis.

3. Balanced Regional Development

Ireland has experienced an unprecedented phase of growth and development in recent years, which has brought significant opportunities and challenges in relation to how we plan our spatial policy. With the population of Ireland projected to increase to over five million by 2021, the next NDP represents a significant opportunity to shape our spatial environment, particularly in relation to the National Spatial Strategy (NSS), the Greater Dublin Area (GDA) and North-South links.²

The NCC believes that this NDP is a unique opportunity to make a reality of the NSS as the platform for regional and infrastructural development in Ireland. Ireland has yet to make real progress in developing the NSS gateway centres to their full potential. The successful development of the NSS gateways, in particular, is crucial to providing each region with

² "Regional Population Projections 2006-2021", Central Statistics Office, May 2005. M1F2 is taken as the most likely population projection.

locations of scale that will possess the population, skills, business services, infrastructure, recreational and cultural facilities, and enterprise base necessary to promote the competitiveness of the indigenous sector and to attract FDI. Delivery of a wide range of infrastructures, both hard and soft, to the nine gateway locations in a coordinated and structured way is vital to the success of the NSS. In this context, the development of a special NDP fund that is specifically focused on gateway development should be considered. Funding could then be allocated on a competitive and transparent basis to infrastructural projects that would create a step-change in the potential of that centre. It is crucial that a focus on infrastructural links between the gateways (particularly the Atlantic Corridor) be considered. The NCC also recommends that regional airports and tourism facilities are supported under the NDP as key drivers of the regional economy. Given the number of local and national bodies involved in the development of gateways, greater coordination is also required.

The success of Dublin will remain critical to the performance of the entire economy. The principle guiding regional development should be about maximising the inherent growth potential of each of region, not re-directing economic growth away from Dublin. Already, the GDA has played a significant role in Ireland's recent development.³ In a globalising economy, Dublin competes primarily against other internationally competitive regions for trade and investment, not against other regions of Ireland. According to the European Cities Monitor 2005, Dublin was positioned in 21st position regarding the important 'access to markets' indicator, performing poorly on external and internal transport facilities.⁴ These indicators, coupled with Dublin's importance, provide a strong rationale for continued infrastructural development in the capital.

Finally, the development of this NDP also provides the opportunity to collaborate on the planning, financing, and implementation of north-south projects in areas of mutual interest. An all island economy would improve competitiveness by providing greater economies of scale, improving networks and labour market mobility, reducing informational asymmetries and help develop border areas. Opportunities include hard infrastructures such as roads, electricity, waste, and ports, but also in terms of softer infrastructures in areas such as research and development, education, and health.

4. Research and Development

Sustained investment in research and development (R&D) is an essential foundation to maintain the competitiveness of the enterprise base and to develop a basis for creating knowledge driven competitive advantage across all sectors of the economy. The NCC strongly supports the recent Strategy for Science, Technology, and Innovation 2006-2013 (SSTI).⁵ The SSTI represents a step-change in national support for R&D and innovation with €8.75bn in proposed investment over the period. The NCC believe that it should be fully supported under the next NDP.

³ The Greater Dublin Area comprises Dublin and Mid East region.

⁴ Cushman & Wakefield Healey & Baker, European Cities Monitor 2005

⁵ <http://www.entemp.ie/publications/science/2006/sciencestrategy.pdf>

The NCC remains concerned about Ireland's weak performance in firm level R&D, which reflects a long-standing structural weakness in indigenous industry and a weak R&D tradition in Irish based high-tech MNCs. In Ireland, private sector R&D expenditure currently stands at 0.93 percent of GNP, while private sector expenditure in the EU-25 and the OECD are at 1.17 percent and 1.51 percent of GDP respectively.⁶

Further incentives to encourage R&D in private firms should be supported. Fourth level funding programmes also need to be carefully designed to encourage commercialisation and greater industry involvement, as experience in other countries suggests that the state's investment in research will earn the highest return for the state if closely aligned to the needs of the enterprise base.⁷ The further development of industry led networks that assist in the development of strategic research agendas could help achieve this. They have also been found to be an effective mechanism for sharing knowledge and driving innovation.

Finally, as Ireland seeks to capitalise on opportunities in internationally traded services over the next decade, innovation in services will become increasingly important. In the services sector, innovation can comprise technological innovation and non-technological innovation in areas such as the development of new business models, customer-interfaces, and service-products. Additional supports for this form of innovation will have to develop accordingly.

5. Education

High performing economies and societies will increasingly rely on a culture of continuous learning and adaptation. From a competitiveness perspective, the challenge for policy makers is to modernise the education and training system to better prepare our people for the economy and society of the future. While further investment and reform is required at all levels of the education system from primary to life long learning, the NCC would like to highlight the particular importance of additional investment in pre-primary.⁸

The economic and social reasons for developing more advanced pre-primary infrastructure are convincing. Evidence from a number of OECD countries illustrates that the financial and educational returns from pre-school interventions are long lasting and significantly higher than all other education interventions. In financial terms, early interventions can make returns of up to 700 per cent - a much higher rate of return than investment at later stages. Research led by Professor James Heckman also shows that investment at an early stage is comparatively more successful at addressing educational disadvantage than later interventions at primary or secondary level. Pre-school interventions also lead to improvements in student's skills level, motivation, and the propensity to learn, which

⁶ The figures for Ireland and the OECD are for 2004. The figure for EU15 is from 2003. Source: OECD.

⁷ OECD: The Sources of Economic Growth in OECD Countries 2003.

⁸ The NCC acknowledges the need to develop all parts of the education system. For example, the need to develop a new business school focused on developing the necessary skills to maintain and develop financial services in Ireland.

improves the return to all future investments in their education.⁹ Pre-schooling is also shown to be one of the most successful interventions for tackling educational disadvantage.¹⁰ Finally, there are also likely to be significant benefits in the long term to the quality of the labour force.

Ireland's poor performance in this area is evident in the recently published ACR 2006.¹¹ Ireland is ranked 13th in the OECD for pre-primary spending and 14th among the EU15 for participation of four year olds in education. Pre-school provision is a mixture of "bottom-up" voluntary and community interventions and limited targeted state interventions. Ireland's preschool provision is under funded and inadequate for the knowledge economy we aim to create.

While pre-primary was identified as a key policy objective as early as 1999 in a Government White Paper, a 2005 NESF report also highlights that little progress has been made. The NCC supports the recommendations of the NESF report and supports in particular the provision of ring fenced funding for the development of universal pre-primary education through the NDP. Initially, funds should be targeted on areas of greatest educational disadvantage. The NDP should fund training of pre-school teachers (skills upgrading for crèche workers for example) and infrastructural improvements to existing primary schools to provide for pre-school classes. To support implementation, clear indicators should be identified and developed.

6. Energy Infrastructure

The economic importance of reliable, secure, and competitively priced energy cannot be overstated. The NCC has three main concerns: high and increasing prices, security of supply, and an over reliance on fossil fuels.¹² These concerns have come about due to a number of underlying trends in the energy market such as underinvestment in infrastructure in the past, rapid increases in demand for fuels, and the failure to attract sufficient new entrants to the Irish electricity market. A range of regulatory and market structure issues have been highlighted by numerous reports as exacerbating these concerns.¹³

Energy investment has not formed a significant part of previous national investment plans. However, the NCC recommends that the new NDP include energy as a focus area in order to facilitate the development of the market. The NCC suggests four actions from a NDP perspective.

⁹ The evidence suggests that factors operating during the early childhood years and culminating in adolescence in the form of crystallized cognitive abilities, attitudes and social skills play far more important roles than tuition or family credit constraints.

¹⁰ Pedro Carneiro and James Heckman Human Capital Policy, NBER 2003.

¹¹ http://www.forfas.ie/ncc/reports/ncc_annual_06/index.html

¹² Unpublished Forfás research ranks Ireland lowest of twelve countries in terms of its overall performance in meeting the electricity needs of industry. Ireland performed poorly in four areas; price, security of supply, access, quality, and the competitive landscape.

¹³ See recent reports such as OECD's Boosting Competition in Ireland (2006) and Deloitte and Touche's Review of the Electricity Sector in Ireland (2005).

Firstly, to enhance competition and improve security of supply, the NCC recommends that funding for the proposed East-West electricity interconnector be included in the NDP. Secondly, new investment in gas and oil storage infrastructure is required for the purposes of increasing security of emergency supply reserves.

Thirdly, Ireland needs to improve efficiency of energy use. In addition to providing tax incentives for fuel-efficient vehicles and energy efficient buildings, the NDP should play a role by providing the funding environment to facilitate Ireland's transition to greater energy efficiency.

Finally, greater emphasis on renewable energy such as wind, tidal and bio-fuels will help reduce our international price exposure and reduce our dependency on fossil fuels from an environmental perspective. Currently renewables only contribute 2.2% to the total primary energy requirement.¹⁴ The Irish Government is committed to targets of 15% for 2010 and 30% by 2030 for the contribution of renewable generated gross electricity consumption.¹⁵ There are three broad approaches for the NDP to help achieve this objective: the development of a more environmentally friendly public transport system, research and development in renewables energy and the support of renewable energy sources.

7. Telecommunications and Waste Infrastructure

For utilities of competitive importance, policymakers need to navigate carefully the line between regulation of private firms and public investment. Complex policy mixtures, uniquely determined on a sector specific basis, are required. The NCC wishes to raise two such utilities that currently weaken Ireland's competitive position: telecommunications and waste management infrastructure.

Telecommunications and broadband services in particular, are of major strategic importance in accelerating the contribution of ICT to economic growth in all sectors, particularly services, as well as enhancing social and cultural development.¹⁶ Although there have been a number of significant developments in the Irish broadband market in recent years, broadband take-up for households is 6.7 percent compared with an EU15 average of 14.2 percent.¹⁷ In terms of broadband business penetration, Irish small and medium enterprises lag their European counterparts.¹⁸ In light of the importance to national competitiveness of universal and high quality broadband, improvements in penetration rates are required. The NCC believe that the next NDP should continue to fund targeted telecommunications infrastructure to address competitiveness concerns until the regulatory environment is further developed to promote competition and investment.

¹⁴ Department of Communications, Marine and Natural Resources, *Green Paper on Energy*, 2006

¹⁵ The figure for 2005 was sourced from SEI's Energy Policy Statistical Support Unit.

¹⁶ Recent research found that the annual average growth rate of labour productivity in ICT-using industries was 1.7% in the EU-15 compared with 5.3% in the US between 1995 and 2002, indicating a positive relationship between ICT usage and productivity levels.

¹⁷ OECD (2005) and ECTA (2005).

¹⁸ In 2005, small enterprises achieved broadband penetration rates of 43 percent in Ireland compared with 59 percent in the EU 25. Medium sized companies achieved broadband penetration rates of 62 percent in Ireland compared with 80 percent in the EU 25.

The availability of high quality and competitively priced waste management facilities is essential to business performance, particularly for pharmaceutical firms. The Forfás Waste Management Benchmarking Study showed that Ireland has the highest landfill costs and biological treatment costs among nine countries.¹⁹ Recycling costs and hazardous waste treatment costs are also higher than most competitor countries because our lack of infrastructure ensures our reliance on export markets to dispose of these waste streams.²⁰ While significant funds were allocated for waste management facilities in the previous NDP, planning delays and weak private sector investment ensured that investment targets were not reached. If the next NDP relies significantly on private sector investment, regulatory reform will be required to improve the incentives to invest.

¹⁹ Forfas, Waste Management Benchmarking Study, 2005 Ireland was benchmarked against: Singapore, Denmark, the Netherlands, Massachusetts, Scotland, Flanders, Sweden, Austria and the Czech Republic.

²⁰ The transport costs alone add an estimated additional cost of €25 to €50 per tonne, depending on the waste material.