



REFORM
AND
RENEWAL

**A GROWTH
STRATEGY FOR IRELAND**

IBEC Budget Submission 2012

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1. Executive summary

Despite renewed turmoil in the international debt and equity markets in recent months, the Irish economy remains on track to grow this year for the first time since 2007. The recovery is fragile, however, and the weakness of the domestic economy remains a concern. The unemployment crisis is stark and much still needs to be done to close the budget deficit. In order to address these major challenges we need a radically new approach to economic policy. In addition to a plan for austerity, we need a vision and a strategy to grow the economy.

Budget 2012 must make difficult choices to close the budget deficit but must also put in place the building blocks needed to grow enterprise and employment. In order to make this happen innovative economic policies are required and Budget 2012 must provide the platform for these. This Government has not yet outlined its own strategy for economic growth and must now urgently do so.

IBEC has identified the following six priority areas as the essential ingredients of a comprehensive strategy for recovery and growth:

1. **Deliver more radical economic reform:** the reform priorities set out in the Memorandum of Understanding (MOU) with the EU/IMF must be seen as the minimum requirement rather than a limit to the economic reform agenda. New thinking is needed in order to deliver economic recovery. The new Government must put its own stamp on economic policy and this requires ambitious reform to make Ireland competitive again; get people back into jobs; and reform public services.

2. **Introduce measures to support the domestic economy:** the revitalisation of exports over the past two years has lifted Ireland out of recession and is central to future economic prosperity. In isolation, however, export recovery will not be enough to substantially reduce unemployment. In order to do this, we must achieve a normalisation of activity and spending and saving patterns in the domestic economy. A comprehensive communication strategy is needed to give consumers the confidence to spend again. The property sector is in a state of paralysis and transactions must be unlocked by delivering a credit flow for mortgages and using a reformed NAMA model to bring properties to the market at realistic prices. Rule changes in relation to pension savings are needed in order to allow people draw down a proportion of their AVC pension funds and spend it in the economy. Reform of how the social welfare budget is administered is needed in order to maximise the economic impact in the domestic economy. Measures are also needed to target the rise in the informal economy, particularly in the home improvements sector where a refundable tax credit model has been shown to work well internationally.

3. **Stick to a detailed fiscal plan:** Government should stick to the original €3.6 bn budget adjustment set out in the MOU. Economic growth may well be lower than forecast in the plan for 2012 but it is far too early to be definitive on this. Government has to stick to its deficit reduction targets but doing more now will merely unnerve consumers and will undermine growth prospects, and indeed the credibility of the entire new three-year plan. There is more to be gained from giving consumers confidence in the economic outlook by sticking to the €3.6 bn adjustment than by trying to impress bond markets which we are not currently borrowing from. Ireland has shown to the markets that it can deliver austerity. We now need to prove our credentials on economic growth prospects. The split of the €3.6 bn adjustment should be €2.7 bn in spending reductions and €900 mn in tax increases.

4. **Improve Ireland's attractiveness for mobile investment:** there is currently a complacency in Government that the defence of the 12.5% corporation tax rate is sufficient for Ireland to remain attractive for mobile investment. While Government is to be lauded for its robust support of the corporation tax regime, which remains essential in maintaining and attracting investment, more needs to be done to ensure that Ireland stays ahead of other countries competing for mobile investment. By standing still on our offering for investors, we are rapidly falling behind much of the competition. We urgently need to enhance our taxation regime for intellectual property and we also need to become more effective in attracting the specialist mobile talent needed to build global business units and market headquarters here in Ireland.

5. **Enhance the environment for indigenous enterprise:** the indigenous enterprise sector suffered greatly as a result of the crowding out and competitiveness pressures of the Celtic Tiger years. Government must now reduce costs such as energy and local rates for business and prioritise smarter regulatory processes.

More action is also needed to get the pillar banks lending to sustainable businesses again – without sufficient credit and the full range of financing products such as credit insurance, the indigenous enterprise sector will not be able to exploit new market opportunities.

6. Deliver a stronger incentive to work: a radical shake-up is needed of the social welfare system in order to deliver a stronger incentive to work. Ireland is an outlier in EU terms by not having an effective model of conditionality in unemployment assistance payments. A much more robust system of enforcement is needed in order to ensure that people seek work, attend interviews and training and take up job offers. A rapid roll-out of more intervention-intensive labour supports is also needed.

2. A strategy for economic growth

2.1 Introduction

The Irish economy will grow in 2011 for the first year since 2007 but it will take a number of years to return to the pre-crisis levels of employment and income. We are on a road to recovery but significant challenges remain. Government must urgently set out its stall in relation to its vision and strategy for economic recovery. To date little has been delivered in terms of new or innovative economic policy. Given the scale of the challenges which the country still faces, a radical departure is needed in a whole range of economic policy issues. Conventional policy responses will not succeed in addressing the stark unemployment and public debt problems. In Budget 2012 Government must demonstrate its capacity to deliver the radical reforms needed to regain economic sovereignty and prosperity and to help get people back to work. Crucially, it needs to achieve a balance between necessary austerity and a growth strategy for the economy.

2.2. Economic outlook

Since the second quarter of this year there have been signs that the global economic recovery is losing momentum. The market turmoil of the summer months has added to the risk that growth will slow in the second half of 2011 and into 2012. Given the Irish economy's reliance on exports, there is clearly a downside risk to our economic outlook. However, it remains far too early to significantly revise down the short-term growth forecasts.

Firstly, while global growth is likely to slow, it is currently impossible to accurately determine how sharp the slowdown will be and much will depend on the response by policy makers. Secondly, given the strong resilience to cyclical downturns of a number of our large export sectors such as pharmaceuticals, medical devices, traded services and the food and drinks sector, it is unclear to what degree a global slowdown will impact on Ireland's export performance. Finally, unlike the global economy, the Irish economy has not experienced any upturn since 2008. Consumer and investor confidence remains fragile. The impact of the most recent global market turmoil on spending and investment plans in Ireland is therefore likely to be much less negative than it would have been in more normal economic circumstances.

In summary, we believe that the significant competitiveness adjustment achieved in Irish business since 2007 will continue to support a strong export performance, despite the more challenging global economic context. GDP growth in 2011 is likely to exceed the current Government forecast but given the slowdown in the eurozone, there are risks to the outlook for Ireland's export performance. Crucially, the nominal size of GDP – adjusting output growth for inflation – is likely to reach the targets set out in the agreement with the EU/IMF. Domestic demand, however, will remain very fragile unless ambitious policy reform addresses this issue.

2.3 An economic growth strategy

The focus of policy makers since the start of the recession has been predominantly on the need to correct the public finances and to work through a solution to the banking crisis. There has been little attention, therefore, on policy measures needed to grow the economy. The IMF has recently acknowledged that economic growth strategies will be needed in addition to austerity measures in order to solve the sovereign debt crisis. It is essential that the new Government retains a strong level of ambition for the Irish economy and sets out a detailed plan to support growth as soon as possible.

This submission identifies six policy areas which Government must address in order to deliver sustainable and balanced economic recovery:

1. A detailed fiscal plan which focuses on a return to a balanced budget mainly through expenditure reductions, supplemented with some broadening of the tax base
2. Ambitious economic reform aimed at improving the efficiency and competitiveness of all sectors of the economy
3. Innovative approaches to support domestic demand in the economy
4. Measures to ensure that Ireland remains one of the world's most attractive locations for FDI
5. A targeted policy strategy, with a particular focus on financing businesses, aimed at growing the indigenous enterprise sector, including manufacturing, tourism and traded services
6. A plan of labour market and social welfare reform to get people back to work

2.4 Delivering economic reform

The Memorandum of Understanding (MOU) with the EU/IMF sets out a number of targets in relation to structural reform in the economy. These largely relate to some labour market reforms, competition issues and review of semi-state utilities. It is essential that all of the targets in the MOU are reached and that review groups and reports are not accepted as a substitute for policy change. The commitments made to the EU/IMF must be seen as the bare minimum needed in the area of economic reform and should not limit Government's ambition in delivering much needed change.

There is ample evidence to demonstrate that Ireland ranks strongly in an international context in relation to economic openness and flexibility. In particular, our labour market flexibility is a key strength in attracting FDI. We clearly don't have the same type of structural reform challenges faced by many other EU countries. Equally, however, there are a number of policy areas which must be addressed if we are to become one of the most competitive economies in the world. We must set the bar for the reform agenda much higher than the minimum requirement of the MOU.

Areas in which more ambitious plans for economic reform are required include the cost of doing business; labour market; social welfare; and public sector efficiency. These issues are addressed in the following sections of this submission.

2.5 Measures to stimulate the domestic economy¹

In order to achieve balanced economic recovery and to significantly reduce the unemployment rate, it is essential that the improvement in export activity is matched by a recovery in domestic demand. It is clear that the savings ratio in Ireland has increased substantially since the start of the recession and although some of this can be explained by debt repayment, many householders have also increased their precautionary savings. Data provided by the main financial institutions and compiled by IBEC, show that on average deposit account balances have increased since the start of the recession. Increases were mainly recorded in the younger age cohorts (18-24 and 25-34) and older age cohorts (55-64 and 65+), while balances in the middle age cohorts declined or remained flat. The data confirm the view that the most financially pressurised households are in the 35-44 and 45-54 age groups as these are most likely to have the highest debt levels. The younger age groups are in many cases likely to be saving to buy a house.

A return to more normal spending and savings patterns would provide a significant boost to the domestic economy and while an improvement in consumer sentiment is the prerequisite for this to occur, there are a number of policies which Government could pursue in order to stimulate domestic demand.

IBEC has identified the following six specific policy areas which Government should address:

1. **Economic communication:** uncertainty about the economic outlook greatly reduces consumer confidence and spending. This uncertainty is exacerbated by inaccurate and misleading claims made by a range of commentators on the Irish economy. Government needs to have a clearer strategy and operational process for targeting communication on the economy directly at the concerns of consumers. In particular it needs to be more effective in countering the often very damaging inaccuracies of some domestic and international economic commentators. As a matter of urgency it needs to address issues such as Ireland's debt sustainability. A more effective economic communication strategy should involve greater input by independent third parties such as the new Fiscal Council or the EU/IMF. Effective communication around a new four-year plan for the public finances will also have a significant impact on consumer confidence. It is crucial that this plan clearly sets out the detailed household budget impacts of all planned fiscal policy measures.
2. **Budget policy and measures:** the scale and the detail of the budget measures will have a significant impact on consumer spending over the coming years. It is essential that all measures are stress tested against their impact on both employment and domestic demand. Section 3 of this submission addresses this issue in detail.
3. **Pensions:** despite the turbulent market conditions of recent years, Irish pension funds are currently worth about €70 bn. This is a substantial wealth stock which is largely invested outside of the state. Although many individuals have not provided adequately for their retirement, there are some who have put substantial contributions into AVCs during the boom years. Many of these individuals are now in more difficult financial circumstances and may wish to draw down a portion of their AVCs to either pay down debt or fund their living expenses. Government should therefore allow a period of three years during which up to 25% of the value of AVCs could be drawn down without penalty and at the standard rate of tax. Short-term changes to pension rules should also be made to allow drawdowns for major life events such as home purchase or coping with unemployment.
4. **Social welfare retail and services payment card:** Government should introduce a payment card or voucher model for some social welfare payments. It should pilot this approach for child benefit payments and could subsequently extend it to other schemes such as the back to school allowance.

Child benefit currently costs the Exchequer €2.2 bn and is paid to almost 600,000 families. It is a poorly designed and blunt measure with unclear policy objectives and does not target resources at those most in need of assistance. Although detailed data are not available, it is likely that a high proportion of payments are put into savings accounts by middle and upper income families. EU nationals working in

¹ IBEC has prepared a separate and more detailed submission on this topic. This section presents a summary of that paper.

Ireland are also eligible to claim benefits for children resident elsewhere in the EU and this money is largely repatriated. It is therefore likely that a sizeable percentage of the total payment of €2.2 bn is not spent on goods and services in the State.

Government should reform the scheme by offering a voucher payment (using a retail and services payment card) to recipients. Vouchers are now widely accepted in the retail sector as payment for goods and services. In order to encourage take-up of the payment card the value of cash benefits should be reduced by 25%.

The benefits of such reform would include:

- A substantial increase in spending in the domestic economy as a greater proportion of benefits would be spent rather than saved and less money would be repatriated
- A substantial net saving for the Exchequer as not all recipients would take up the payment card option
- There will also be an upside for consumers as they will benefit from additional incentives which some retail sectors will be able to offer to customers using the payment card
- No additional administrative costs for the Exchequer
- The payment card could be used to purchase a range of goods and services in the State, including pre-school childcare services
- The necessary technology is already in place in thousands of retail outlets right across the State and there would be little or no restrictions to consumer choice

5. **Property transactions:** the property market has effectively frozen over the past few years, as prospective buyers expect prices to fall further and potential vendors are either unwilling or unable to sell at current prices. The number of mortgages for first-time buyers and mover purchasers has dropped from about 80,000 p.a. at the peak to about 10,000 p.a. at present. A normalisation of the market would likely see the number of mortgages issued increase to about 40,000 or so. Each property transaction results in spending of about €20,000 in ancillary items such as professional services, furnishings and home improvements. A normalisation of transactions in the market would therefore generate about €600 mn p.a. for the domestic economy. While it is not in the economic interest of the country for house prices to increase, there would be a substantial economic and employment benefit of a return to more normal transaction volumes in the residential property sector. There is considerable merit in Government introducing a suite of policy measures which would encourage prospective home buyers to bring forward their purchasing decisions.

In order to provide a two year 'window of opportunity' for home purchases Government should:

- Exempt homes purchased before end December 2012 from any new property taxes for a period of six years and those purchased during 2013 for three years
- Pre-announce an increase in the flat rate of residential stamp duty on purchases after December 2012 to 2% and to 3% after December 2013
- Allow up to 10% of the value of pension funds to be drawn down tax free for the purpose of buying a property
- Restructure NAMA's operational model by introducing a competitive framework using private sector bidders to dispose of properties more rapidly. Increased activity is needed in order for the market to find a floor and to encourage purchasing decisions
- A national house price database should be rolled out immediately in order to improve market transparency and reduce buyer uncertainty
- Ensure that a properly quantified supply of mortgage credit is committed to by the State controlled financial institutions

6. **Home improvements:** home improvement works have significant economic impacts in the retail and construction sector. Higher unemployment for construction workers and recent tax increases have seen increased activity in the sector move into the informal economy. This had led to a substantial loss of revenue for the Exchequer. An increase in formal activity in this sector would reduce social welfare costs and increase taxation revenue for the Exchequer. The home improvements sector is currently valued at about €2.2 bn – about the same as the new home building sector. A 30% increase in activity in the sector would generate about 4,000 jobs and would directly yield some €100 mn to the Exchequer – with further substantial indirect or multiplier benefits.

A targeted suite of policy measures could be used to incentivise older age cohorts with high savings levels and younger age groups who are unable to move house due to negative equity to invest in formal economy home improvement works. Government should:

- Introduce a home improvement tax credit (similar to that recently used in Canada) for a period of three years. Such a scheme could involve a refundable tax credit of 20% of approved home improvement between the value of €3,000 and €20,000, carried out by tax compliant contractors. The cost of the scheme would be funded by a reduction in informal economy activity.
- Review planning regulations in line with best practice internationally to ensure that home improvement works and house extensions are fully facilitated

3. Fiscal policy priorities

3.1 Introduction

IBEC has supported the scale of fiscal adjustment that was necessary for the previous administration to undertake, though not always agreeing with the specific measures implemented. It is clear that without decisive action, Ireland's deficit would have risen to entirely unsustainable levels of around 25% GDP. However, the balance to date has been too heavily weighted on the side of taxation rather than reducing expenditure. Given the reviews of both current and capital budgets that this Government has undertaken, it is crucial the fiscal plan for the next four years place emphasis on reducing waste and achieving efficiencies in public expenditures. Tax increases should be kept to a minimum, as this method of attempting to close the deficit will cause the greatest damage to the economy.

3.2 Scale of adjustment required

It is clear that the overriding objective of the Government's fiscal policy must be to meet the targets agreed under the EU/IMF loan agreement. This is a precondition for receiving the funding but also necessary to maintaining Ireland's hard-earned credibility in international markets.

Since the EU/IMF loans were initially agreed, a number of factors have changed. The economic outlook for Ireland is more uncertain, given the global slowdown that became evident over the summer months. However, as we detail in the previous section, it is too early to tell yet how the deceleration in global growth will affect Ireland.

The most significant development has been the sharp improvement on the conditions on Ireland's loans, placing the country's public finances on a much more favourable footing than previously. The reduction in the interest rate will amount to savings of about €1.5 bn annually once all the loans have been drawn down, though the savings will initially be somewhat smaller. Other things being equal, the reduction in interest payment costs means that Ireland should reach its deficit reduction target earlier than previously planned.

Improved market confidence, manifested in falling bond yields, came as a result of more favourable funding terms and assurances of continued funding, thereby changing markets' assessment of Ireland's debt sustainability, not additional promises on Ireland's part about further austerity. Though countries such as Italy and France are now embarking on austerity measures, in relative terms Ireland has already done much more and will continue to be much more aggressive. Italy's projected €45 bn adjustment over 2012 and 2013 amounts to about 2.8% of GDP. France's plans are for a €15 bn adjustment over 2011 and 2012, just 0.7% of GDP. In contrast, Ireland is committed to an adjustment amounting to 4.3% of GDP over 2012 and 2013.

IBEC therefore does not believe that an adjustment greater than €3.6 bn in 2012 is required. Despite the global slowdown, the Irish economy is on track to grow by about 3% in nominal terms in 2012. We do not believe that accelerated austerity at this point would benefit the Irish economy.

Should growth disappoint, the reduced interest cost should enable Ireland to nonetheless meet its deficit targets of 8.6% of GDP in 2012 and 7.5% in 2013. In the April 2011 Stability Update, Government is committed to reviewing progress on deficit reduction in advance of Budget 2013, with view to reaching 3% of GDP by end-2015. If necessary, any recalibration of the plan should happen at that point, rather than in the current highly uncertain climate.

Recommendations:

- Adhere to the current plan and not exceed a €3.6 bn fiscal adjustment in 2012
- If necessary, any recalibration of the plan should happen in advance of Budget 2013
- For 2013 and 2014 the fiscal adjustment should be predominantly on the expenditure side as the comprehensive expenditure review process gains traction. The expenditure tax split in this period should be four to one

3.3 Priorities for Budget 2012

Throughout the fiscal crisis, IBEC has consistently argued that the balance of adjustment should be on the side of cutting expenditure. Extensive research literature examining episodes of previous fiscal consolidation across a number of countries and time periods shows that cutting expenditure, particularly current spending, is less damaging to economic growth than raising taxation. This is a view that we continue to hold and we believe that the split between expenditure cuts and tax increases in coming years should be about three to one.

This ratio between expenditure and tax would mean that the Government should implement about €900 mn in revenue-raising measures in Budget 2012. Where taxes are increased, the focus should be on broadening the tax base through user charges and property taxation, as this would be the least damaging approach for economic growth. In particular, as we detail in the following section, Government needs to be much more ambitious in relation to revenue raised from a property tax. Income taxes should not be increased further.

On the expenditure side, the reviews of current and capital budgets will give size and shape to Government's spending and cutting decisions for the coming years. IBEC has made separate submissions on these issues², but we wish to take this opportunity to highlight some key principles.

The focus of Budget 2012 should be to reduce current spending and Government should target expenditure cuts of the order of €2.7 bn. Administrative efficiencies under the Croke Park agreement must deliver quantifiable cost savings and if necessary, Government should go beyond the agreement to drive further efficiencies.

IBEC believes that the budgets for physical and human capital should be protected to the greatest extent possible. Infrastructure spending has already been reduced from €9 bn at the peak in 2007 to a projected €4.5 bn in 2010. Government should retain ambition for the economy and not repeat the mistakes of the 1980s, when severe cutbacks in infrastructure investment led to bottlenecks that proved very expensive to remove in later years. While resources are scarce, Government should strive to maximise funding from external sources, for instance through public-private partnerships or finance from the European Investment Bank.

Recommendations:

- Keep a split between expenditure reductions and tax increases of three to one, implementing a maximum of €900 mn in revenue-raising measures in Budget 2012
- Not increase income taxes any further. Revenue-raising measures should focus on a property tax and user charges
- Target expenditure cuts of about €2.7 bn, with focus on current expenditure
- Ensure that Croke Park delivers quantifiable cost savings, and, if necessary, go beyond the agreement to drive further efficiencies. Croke Park should not be the upper limit of savings achieved from public sector reform
- Protect investment in physical and human capital to the greatest extent possible and maximise funding from external sources

² See for instance the IBEC submission on the review of the public capital programme 2012-2016, July 2011.

3.4 Reform of the budgetary process

IBEC welcomes the Department of Finance April 2011 discussion paper on reforming Ireland's budgetary framework, which contains a detailed analysis of the issues at hand. We also welcome the establishment in July of the Fiscal Council as an independent voice on the Government's budgetary policy, fiscal stance and economic forecasts and look forward to the fiscal responsibility bill due to be submitted to the Oireachtas by the end of the year.

Now is the time to put in place mechanisms that will prevent the fiscal crisis from repeating itself in the future. We are, however, concerned that the measures proposed to date would not be sufficient to ensure that public finances remain on a sound footing. The root of the current crisis is in the unbalanced structure of tax revenues that built up over the boom years (over-reliance on transaction-based property revenue and a hollowing out of the income tax base) and unsustainable current expenditure growth.

We are in particular concerned that neither the fiscal responsibility bill nor the fiscal council in their present configurations would have sufficient reach to prevent those types of imbalances from recurring. While the fiscal responsibility bill will, by its very nature, focus on macro-level targets, we believe that the role of the fiscal council could usefully be expanded to include scrutiny of detailed Budget measures proposed by Government. In short, we believe the role of the Irish fiscal council should closely resemble that of its Swedish counterpart.

IBEC welcomes the plans for establishing a medium-term expenditure framework; we believe such a system can play a crucial role in the future in preventing unsustainable spending growth. Greater flexibility in use of resources can lead to greater efficiencies and we support a multiannual budgeting where overruns in one year are compensated from next year's budget but which also allows for some carryover of allocations from one year to another. In particular, we welcome requirements to deliver minimum administrative savings of 2-3% per year across all areas of the public sector.

We also welcome the suggestion to conduct comprehensive spending reviews on a regular basis. We would like to note that the review of current expenditure should be closely linked with the review of the capital budget. This will not only help deliver maximum value for money, but also identify synergies and interdependencies across the two spending areas (for instance in science, technology and innovation spending the need for current and capital investment can be closely linked.) Demand-led schemes should also be subject to scrutiny and care should be taken to keep any increases in monetary allowances in line with economic fundamentals.

IBEC also welcomes recent efforts to strengthen programme evaluation capabilities across the public service, essential for evidence-based policy making. Programmes must at their inception be designed with evaluation in mind and appropriate data collection mechanisms must be put in place. Greater use of administrative data sources will also ease policy evaluation and where necessary, data protection legislation should be amended to enable use of administrative data for evaluation purposes. Public resources will remain scarce for the foreseeable future and Government must ensure that it derives maximum value for taxpayers from any public spending initiatives.

Performance budgeting can have a role to play in ensuring consistent performance standards across the public service, but should not be used as a key determinant in resource allocation. This would be counter-productive in that poorly performing departments or units could see their resource allocation reduced, further exacerbating the situation while efficient departments would be rewarded by receiving extra resources they would not require to perform their function. Instead, performance measurement could be used to recognise good performers and "naming and shaming" underachievers and also as a platform for knowledge sharing on best practice. However, to fully utilise the potential of performance budgeting, Ireland must move from measuring outputs or activity to measuring outcomes and impacts. Outcome statements also must clearly indicate whether the goals for a given year were met.

Recommendations

- Ensure that the Fiscal Council has the powers and mandate to scrutinise the Budget in detail, much like its Swedish counterpart
- Ensure that the medium-term fiscal framework is effective in controlling current expenditure. The scope of demand-led programmes should be kept to a minimum
- Implement the requirement for 2-3% annual administrative savings across the public service
- Conduct comprehensive spending reviews every 2-3 years, ensuring that reviews of current and capital budgets are carried out in tandem
- Strengthen policy and programme evaluation capabilities across the public service
- Move to measuring outcomes and impacts rather than outputs or activity in implementing performance budgeting

4. Taxation

4.1 Introduction

Given the current difficulties in the public finances there is a real danger that changes to taxation policy will be exclusively focused on the need to raise additional revenue. This would be a grave policy error. Taxation policy has a key role to play in supporting enterprise and employment and in promoting efficient use of scarce resources. It is therefore essential that taxation policy reform is seen by Government as a central plank of its growth strategy for the economy. Notwithstanding the fiscal policy constraints resulting from the EU/IMF loan arrangements, Government must be prepared to invest in economic growth policies and in some cases it will have to take the case to the troika in support of growth enhancing tax policy changes. In some cases such policy changes will have short-term fiscal costs but these must be viewed in the context of the medium-term economic gain.

4.2 Ireland's attractiveness as an investment location

Recent business taxation policy has been largely focused on the defence of Ireland's 12.5% corporation tax rate. The transparent corporation tax rate remains a central part of Ireland's enterprise policy and it essential that it is retained. However, defence of the rate alone will not ensure that Ireland remains an attractive location for investment. Our competitor countries, both within the EU and elsewhere, are rapidly improving their enterprise tax offerings and Ireland is now losing ground on many of these jurisdictions.

Certainty in tax policy

In addition to providing indigenous and foreign investors with a competitive taxation offering, Government must also provide certainty to investors. A number of recent policy changes have undermined this certainty and confidence and this has been damaging to our growth prospects. In particular, the retrospective nature of the levy placed on private sector pensions has alarmed many investors as it constitutes a tax on assets rather than on future income. Changes to previously awarded tax supports for certain property-based investments also run the risk of damaging Ireland's reputation as an investment location. While it may be politically popular to row back on these commitments, such a policy reversal could damage future investment decisions and could also threaten activity in sectors such as international education and tourism. Property-based tax incentives were largely poor tax policy and it was right to close such schemes to future investors but certainty on investment is a crucial feature of any tax system and must be protected above all else.

Improving Ireland's IP taxation offering

The creation, ownership and management of intellectual property (IP) is one of the key value drivers of many businesses, not just in the technology and healthcare industries, but also sectors such as retail and consumer goods. It is also a very mobile part of those businesses, and therefore one for which countries aggressively compete. From an Irish perspective the benefits are primarily the 'pull effect' of locating senior management roles and related activities such as research and development in Ireland, and most importantly helping to either deepen existing roots or lay down new roots.

When one looks at Ireland's tax regime in this respect, the most relevant pieces of legislation are those covering the tax credit for research and development (R&D regime), and the amortisation regime for acquired intangible assets (IA regime). Currently, Ireland's IA regime takes the form of an amortisation regime, i.e. the capital cost of acquiring certain intangibles can be amortised for tax purposes over a defined period and up to a limit of 80% of related income. There are a lot of conditions to be satisfied, and the mechanics, which are complex, can require financial results for a business to be artificially separated in order to separate the IP activity/income from the rest of the business. When the amortisation period has expired, the full IP income is taxed at a rate of 12.5%. In certain cases, while the cash tax rate using the IA regime is relatively low, when deferred tax is taken into account, the book tax figure can be significantly higher. It is also important to recognise that the benefit is only available over the amortisation period and is not a permanent factor which influences IP location decisions.

One of the key drivers in considering IP projects is rate of return which is typically measured by net present value (NPV) calculations. Clearly an IA regime that spreads benefits over a longer period of time will suffer in NPV terms relative to others.

Other countries have taken a different approach, introducing IP box regimes. These operate such that the IP income is simply taxed at a single low rate. The benefit here is certainty of rate, and that amortisation does not influence that rate. The most recent example is the UK which has announced proposals to introduce an IP box with a tax rate on IP income of 10%³. While the UK has always been a competitor for inward investment for many commercial reasons, it has never traditionally competed with Ireland on taxation; as such, the introduction of the IP box represents a real threat to the future ability of Ireland to attract future IP-driven projects.

In the context of other UK proposals to introduce full participation exemption on dividends, reform controlled foreign company (CFC) rules, and reduce its corporate tax rate positions the UK very strongly plans to compete with Ireland for mobile investment. At a time when the standard rate of corporate tax is continually in the news, which, despite best efforts, maintains ongoing uncertainty about its future, it is critical that Ireland continues to refine its tax arsenal in order to allow us to compete effectively internationally.

R&D offering

The R&D tax credit is provided on incremental R&D spend over that recorded in the designated base year of 2003. For a number of companies which had exceptionally high R&D investment in 2003, the scheme therefore provides no incentive for R&D activity. By allowing companies the flexibility to choose their base period from a number of years i.e. 2003 to 2005 or to use their average annual R&D spend over the 2003 to 2005 period, this problem could be easily addressed at very low cost. The strict revenue interpretation of the current subcontracting limit is also causing difficulties for many businesses who hire short-term contract or agency staff for dedicated R&D projects and the definition of outsourcing needs to be reviewed. While some changes were introduced in Finance Bill No.2 2011, a number of companies are still reporting a difficulty in relation to accounting for the R&D Tax Credit on an above the line basis. Government should relook at this issue as change would have no cost for the Exchequer but would make the scheme much more effective in attracting mobile R&D projects to Ireland.

For small companies and start-ups, the removal of the patent royalty scheme has made it much more difficult to attract and retain specialist R&D staff. Government should reintroduce a dedicated patent royalty scheme for SMEs.

Recommendations

- Commit to providing certainty to businesses and investors and avoid any retrospective changes to individual schemes
- In relation to the IP regime:
 - The existing IA regime should be improved such that the amortisation period is reduced from 15 to 10 years, and that the 80% cap be increased to 90%. This will have the effects of improving the cash tax benefits and improving NPV calculations
 - A separate innovation box regime should be introduced such that profits from ownership, development and exploitation of innovation be taxed at a single low rate of 5%. An innovation regime is broader than a patent box regime, as it has the potential to be much more active in nature and is more likely to attract higher value operations such as R&D as a consequence
- Improve the R&D tax credit offering by allowing flexibility in the base year and increasing the flexibility of the subcontracting limit. The issue of the above the line accounting treatment of the credit also needs to be re-examined

³ Other countries have introduced similar regimes with lower rates e.g. Netherlands, Spain and Belgium.

4.3 Income tax

Irish workers have experienced a substantial increase in income taxes since 2008. This has reduced the incentive to work and has made Ireland a less attractive location for mobile skilled employment. It has also seen a sharp increase in activity moving into the informal economy. In order to incentivise work it is essential that Government commits to no further increases in employee or employer labour taxes over the next three years. In particular, Government must be mindful of the competitiveness of Ireland's marginal tax rate. At 51% it is now one of the highest in the EU, and the effective tax rate of those earning above average incomes is the fifth highest in the EU 27. Any further increase in the marginal income tax burden would cost jobs and investment and would be counterproductive for the public finances.

Mobile skills

As a result of the income tax increases of recent years, employers are finding it increasingly difficult to attract mobile specialist skills to Ireland. In the ICT sector, in particular, a combination of skills shortages in the domestic labour market and the inability to attract mobile talent has resulted in thousands of unfilled vacancies. International evidence shows that targeted measures through the income tax system are effective in both attracting skills from abroad and also in addressing supply shortages in the domestic economy. As a first step, Government should reform the current Special Assignment Relief Programme (SARP), as the current scheme is not working and has seen little or no take-up. SARP should be modelled to better the similar scheme on offer in the Netherlands and would therefore require a salary threshold of €75,000. A further major weakness of the scheme is the fact that employees can only reclaim the benefit following the end of the tax year. The remittance element of the scheme should therefore be removed and the benefit should be provided to workers from the start of an assignment.

The current visa regime for the spouses of non-EEA workers based in Ireland is too restrictive as it requires a labour market needs test. In many cases, it becomes impractical for families or couples to remain in Ireland if one spouse is unable to work and it has therefore become more difficult for multinationals to attract and retain specialist skills for short to medium-term assignments.

Employee Financial Involvement (EFI) has a key role to play in terms of improving Ireland's competitiveness, fostering a more direct link between performance and reward and acting as an incentive to essential international talent. The imposition of both employee PRSI and the Universal Social Charge (USC) on employee share schemes, and particularly broad based employee share schemes, has introduced a level of complexity and administration for business that far outweighs the relatively modest revenue which might be generated. It has also curtailed the take-up levels of such schemes at a time when increasing our competitiveness and attracting key talent is a priority. It is recommended that the tax exemption available for certain employee share schemes should be extended to encompass both PRSI and the USC.

In the context of companies with an international mobile workforce the imposition of PAYE on share awards here has also given rise to significantly increased levels of withholding tax, along with additional administration and reporting requirements further increasing costs to business. There is an urgent need for a mechanism to simplify the process and avoid the application of up-front excess withholding taxes on share awards for internationally mobile employees.

Recommendations

- Do not introduce any further tax increases on work for either employees or employers
- Reform the Special Assignment Relief Programme (SARP) by reducing the threshold to €75,000 and allowing the benefit to be allocated from the start of the employment rather than at the end of the tax year
- Reform the visa regime for the spouses of non-EEA workers so that they can work while in Ireland without a labour market needs test
- The tax system should continue to support employment financial involvement as it remains crucial to attracting and retaining mobile skills

4.4 Indirect taxes

Water charges and rates

It is important that local authority charges levied on Irish businesses remain internationally competitive. In this regard, we are concerned about the potential for progressive increases in water supply and waste water treatment charges after the establishment of Irish Water. It is essential that charges are not increased to business for either treated water supply or waste water.

It is also important that Government designs an effective charging model for household water usage. Suggestions that households would be allocated a generous free allowance for water run counter to good principle in design of such charging models. A free allowance would reduce the revenue which could be raised through the charge and would also significantly weaken the environmental benefits of charging for water. It is essential that the pricing structure would involve a marginal pricing element which would disincentive waste. Lower income households can be compensated in a targeted way through the social welfare system.

Proposed packaging tax

IBEC has already stated that it is opposed in principle to the proposed introduction of a new levy on packaging. We believe that it would be environmentally ineffective, and that it could actually undermine the existing successful producer responsibility regime. We also suspect that it would be counterproductive as a means of raising additional revenue for the Exchequer, particularly given the likelihood that it would encourage an increase in cross-border shopping for groceries. The cost of the levy would by necessity be reflected into product pricing and would increase retail prices to consumers which would in turn undermine Ireland's much needed competitiveness adjustment.

VAT

It remains Government policy to increase the higher rate of VAT to 22% in 2013 and 23% in 2014. Implementing such an increase in current market conditions will further delay any recovery in consumer spending and this decision should now be revisited.

Fuel excise and illegal diesel

The sale of illegal diesel is estimated to be costing the Exchequer some €150 mn p.a. Washed gas oil sold as road diesel represents a major cost to the economy, consumers, business and the environment and measures are urgently needed to stop the practice. Improvements, and in some cases additional resources, are needed in the enforcement and monitoring of the activity and the legitimate oil industry is eager to work with Government on the detailed measures required. Any cost associated with more effective enforcement would be recouped many times over as the Exchequer would recover substantial lost revenue. As a first priority, IBEC recommends that an amended duty regime is implemented to ensure parity between diesel and ultra-low sulphur gasoil purchase prices. A reclaim process must be implemented for genuine off-road fuel consumers. The option to defer duty payment should be available for all grades to industry to enable domestic fuel sellers to manage the new regime, and legislation currently covering the sale of petroleum should be extended to diesel and ultra-low sulphur gasoil.

The oil excise duty regime in Ireland is outdated, out of line with practice internationally and needs reform. The industry is significantly disadvantaged by the requirement to pay excise duty before fuel leaves bonded warehouses and prior to the sale or collection of excise from customers. This anomaly has proved increasingly difficult for the largely Irish owned fuel distributors since the onset of the credit crisis. The system should now be reformed and brought into line with best practice elsewhere in the EU.

Recommendations

- The establishment of *Irish Water* must not result in increases in local authority water charges for business
- Do not provide excessive free allowances as part of a new system of water charges for households
- Reverse current plans to increase the VAT rate in 2013 and 2014
- Reform the oil excise duty regime to bring it into line with best practice internationally and introduce new measures to target the illegal sale of diesel

4.5 Pensions policy

Pensions levy

The decision by Government to fund its Jobs Initiative through a levy of 0.6% p.a. for four years to raise €1.9 bn on pension funds will have serious unintended consequences for defined benefit pension (DB) schemes in particular, many of which are already in significant deficit and unable to meet the funding standard. For members of these schemes, of defined contribution (DC) schemes and other personal pensions, the incentive to provide for retirement has been further diminished. Notwithstanding the laudable objective of the Jobs Initiative, its funding through this measure represents an unprecedented move to expropriate private pensions savings and is being viewed negatively by Irish businesses and by international commentators and investors.

The Government has stated that it will be a matter for individual pension scheme trustees and administrators and that it is open to the pension industry to decide how and whether to pass on the levy. However, the reality will show the additional costs will be primarily borne by employers and employees and is a tax on private sector pension scheme savers. Indeed, there has been no recognition or consideration of the financial or employee relations impact the measure will have at the level of the workplace or its effect on the willingness of citizens to save for their retirement.

IBEC research has shown the introduction of the pensions levy will be a tipping point for many companies in relation to a decision to wind up their DB scheme. About one quarter of IBEC membership believes that the levy will either cause or accelerate a decision to wind up schemes. There will also be widespread reductions in benefits available to members and actuarial assessment has shown that benefits payable to those in retirement will be permanently reduced by 2.5% p.a. in order to fund the cost imposed by the levy.

This levy was a poorly thought out revenue grab which will greatly add to the very serious funding and coverage difficulties already facing pensions. In order to prevent further damage to pensions policy Budget 2012 should end the levy. As part of the Comprehensive Expenditure Review process currently underway Government should identify efficiencies and savings through reduced expenditure which could replace the revenue currently targeted by the pensions levy.

Tax relief on pensions contributions

Employers and workers are witnessing the disintegration of tax and pensions policy. IBEC has argued that the existing plans for further reductions in income tax relief by 2014 be urgently reassessed both in terms of the scale of the changes and for their impact on consumer behaviour. We welcome the stated willingness of the Minister for Finance to examine this issue in the context of the budgetary process, and any resulting scope for fiscally neutral changes to the EU/IMF agreement. IBEC research shows that further reduction in the tax relief rate for pension contributions would effectively be the death knell for many occupational pensions. Many of our members with DC schemes have already reported an increase in the number of staff seeking to leave voluntary schemes, while employers with mandatory DC schemes are under pressure to change to a voluntary approach. If the pensions coverage and adequacy falls further, the costs will simply be transferred to future tax payers. If Government wishes to retain an effective occupational pensions model in Ireland it must retain the current tax relief offering and this position should be clarified as soon as possible.

Recommendations

- Reverse the recent levy on private sector pension funds and offset this revenue loss through additional savings through the Comprehensive Review of Expenditure
- Maintain the tax relief on personal pension contributions at the current rate and at the current allowable limits i.e. there should be no further changes to the standard fund threshold

5. Supporting indigenous enterprise

5.1 Introduction

Access to finance, cost competitiveness and better regulation will be crucial for ensuring that Ireland's recovery becomes sustainable, even in a more challenging global context. Access to funding is a particular problem for SMEs and if not rectified risks stifling the economic recovery. The cost base in Ireland still remains too high, particularly when it comes to state-influenced or controlled costs. Finally, the regulatory burden on business should be reviewed and reduced, while all new regulations should be subject to compulsory regulatory impact assessments.

5.2 Access to funding

The most recent report (August 2011) from the Credit Review Office (CRO) indicates that the pillar banks AIB and BOI are unlikely to meet their €3 bn lending target for this year. The CRO attributes the shortfall to weak demand for credit. IBEC member surveys, however, continue to indicate that credit conditions for business remain very tight. IBEC's Q2 business sentiment survey found that 22% of firms reported reduced availability of investment finance over the previous three-month period, while 23% reported reduced access to working capital.

Access to bank credit

To ensure that viable businesses have access to credit and that the pillar banks meet their lending targets, Government should put in place a measure of demand for credit, against which the banks' performance could be assessed. It is essential that the staff in the pillar banks have both adequate training and the authority to grant new loans. Finally, while new regulation has needed to be introduced and existing rules enforced more rigorously, to be effective new rules and requirements should aim for simplicity and transparency. Finally, a particular issue that smaller companies engaging in overseas contracts face is banks' unwillingness to issue contract bonds, resulting in lost business opportunities. Government should put in place measures to ensure the availability of contract bonds for real and viable commercial opportunities.

SME loan guarantee scheme

Government should move quickly to implement the loan guarantee scheme for SMEs announced in the May Jobs Initiative. The scheme should be constituted on an ongoing rather than temporary basis. A number of countries such as the US, UK, Netherlands, Canada and Sweden operate loan guarantee schemes for smaller companies which may in the absence of Government intervention be underserved by conventional finance methods. The scheme should extend credit to viable firms that could not otherwise receive financing, focusing on both firm survival and firm expansion. Support should not be conditional on employment creation. Given the constraints on the public finances, Government should investigate potential European sources of joint funding, including the European Investment Fund.

Roll-over relief for entrepreneurs

The Irish tax system currently provides no incentives for entrepreneurs selling a business to invest some of its proceeds in other enterprise activity. Such a 'roll-over' type relief was removed a number of years ago. The Innovation Taskforce report has recommended its reintroduction in order to support investment in innovation start-ups. There is a strong rationale, however, to provide such an incentive for general investment in enterprises by entrepreneurs and other high net worth individuals. As a result of ongoing credit access difficulties SMEs and start-ups are finding it increasingly difficult to source investment and the angel investor model offers considerable potential in an Irish context. If Government proceeds with plans to raise additional revenue from capital gains tax, it is essential that roll-over relief is introduced for non-property based enterprises.

Employment and investment incentive scheme

IBEC welcomes the move in the Finance Act 2011 to introduce a new employment and investment incentive scheme (EIS) to replace the existing business expansion scheme (BES). The current plan contains a number of positive features, such as the removal of qualifying trade limitations, simplification of certification requirements

and increases in the lifetime and annual investment limits. However, to fully realise the economic benefits of the scheme, it should be removed from the list restricting the use of tax reliefs by high earners and the restrictions on connected persons should be revised.

Bankruptcy regime

IBEC notes the initial changes to Ireland's bankruptcy legislation enacted in the Civil Law (Miscellaneous Provisions) Act 2011. However, meaningful reform of Ireland's personal insolvency regime must go further and indeed, under the EU/IMF MOU, Government is required to present a personal debt regime bill by the end of Q1 2012. It is essential that Ireland's outdated system is reformed in line with international best practice, enabling those who simply cannot pay their debts a fresh start so that they again can make a meaningful contribution to society. Government should take onboard a number of the recommendations contained in the December 2010 Law Reform Commission report. In particular, legislation should provide for automatic discharge from bankruptcy after three years and introduce a comprehensive out-of-court debt settlement system. A key element in the commission's proposals is to allow debtors to retain essential business assets that will enable them to earn a living.

Removal of milk quotas

Ireland's dairy sector has the potential to substantially increase output once milk quota restrictions are removed from 2015. The removal of quotas presents an unique opportunity for farming and dairy processing and it is essential that the right policy mix is in place to ensure that Ireland optimises these new market opportunities. Government needs to ensure that taxation policy supports investment at both the farm and processing level and it should review current arrangements with a view to bringing forward a range of improvements over the coming years.

Recommendations:

- Ensure that pillar banks have appropriate structures in place to meet their lending targets for 2011 and 2012
- Ensure that any new bank regulations are fit for purpose, simple and transparent
- Ensure that banks engage with business to issue contract bonds, where those are necessary to tender for projects on international markets
- Move quickly to implement a loan guarantee scheme for SMEs on an ongoing, rather than temporary, basis
- Introduce a roll-over relief to encourage entrepreneurs to reinvest the proceeds from the sale of a business in new start-ups
 - Remove the Employment and Investment Incentive Scheme from the list restricting the use of tax reliefs by high earners and revise the restrictions on connected persons
 - Reform taxation policies relating to investment at farm and dairy processing level to ensure that the opportunities available through the removal of milk quotas are fully maximised
 - Move quickly to reform Ireland's personal debt and insolvency regime in line with international best practice

5.3 Getting the cost base right for business

Despite some improvements, Ireland's cost base remains high relative to our main trading partners. The competitiveness gains over the past two to three years have arisen mainly from firm-level productivity improvements, while state-controlled or influenced costs have, at best, remained static. There are a number of specific issues Government must address in order to get Ireland's cost base right to ensure sustained economic recovery.

Local authority charges

Local authority charges remain in many cases a significant burden on business, amounting in some cases to 50% of the rent the company pays on its premises. IBEC surveys find that 14% of companies had seen their local authority rates increase over the past year, while for 62% of companies the rate had remained unchanged. This is despite the fact that turnover in many firms has fallen by over 25%. Moreover, the wide variation in annual rates and water charges for similar businesses in different areas (see figure below) reflects a lack of transparency and accountability on how charges are levied.

Figure 5.1 Annual rate of valuation in 2011 for selected local authorities

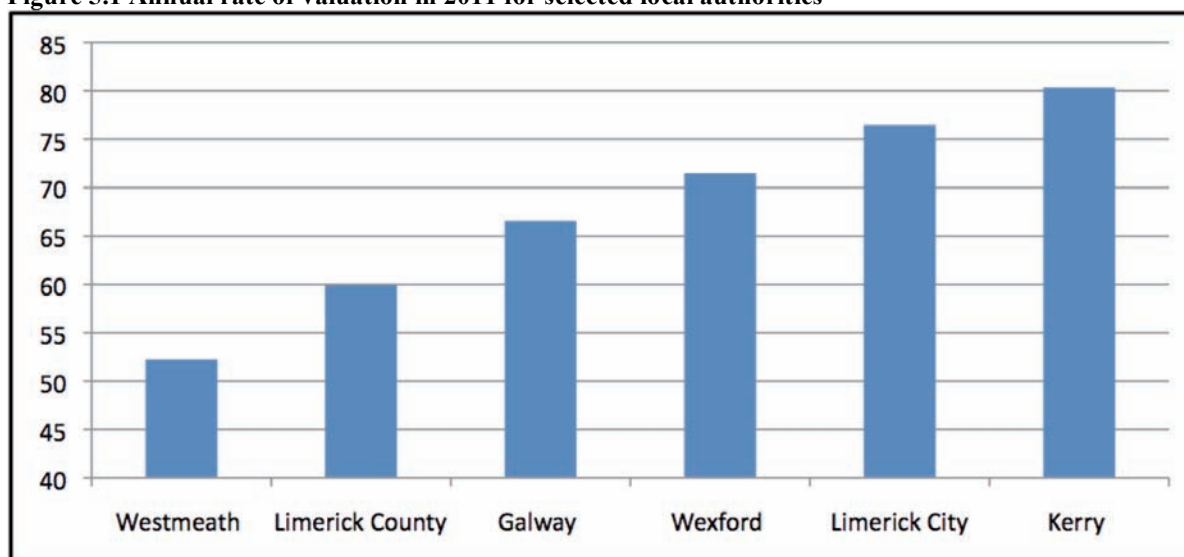
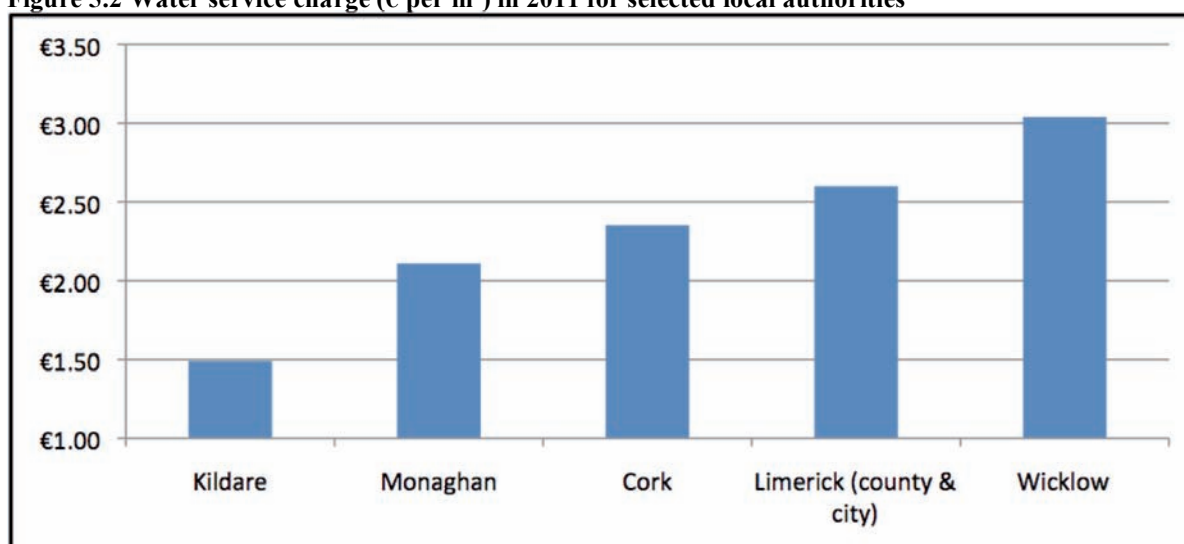


Figure 5.2 Water service charge (€ per m³) in 2011 for selected local authorities



To redress the excessive burden that local authority rates place on business, IBEC calls for a 25% reduction for all businesses and greater transparency in how the fee is calculated. The shortfall in local authority funding should in the first instance be recouped through greater efficiency in service delivery and in the second instance through a broadening of the local tax and charges base.

Energy costs

Electricity prices for medium and large business consumers fell below the EU average in 2010, from having been second highest in 2007. This was thanks to fuel price movements, a necessary rebalancing of network costs, increased competition, and consumer rebates over the period 2008-2010. Ireland's recent relative competitiveness improvement in electricity is welcome, but its continuation is by no means guaranteed and some gas and electricity price increase have already been announced.

Relative energy costs remain a challenge in restoring our international competitiveness, securing inward investment and protecting existing jobs. Issues such as commodity prices, weather events and the current population distribution are beyond our control. However, there are a number of areas that are under the Government's control and need reform in order to achieve and maintain a balanced, secure, sustainable and competitive energy system in the period 2012-2020 and into the future.

Recommendations:

- Develop an overarching Government strategy (across all relevant departments and agencies) for meeting climate change and energy objectives in the most cost-effective way, underpinned by robust economic analysis

- Implement policy in an effective and co-ordinated way, avoiding protracted and costly delays in, for instance, the planning process
- Regulatory certainty is key for firms' investment decisions. For instance, Government should ensure an orderly transition of Irish electricity and gas markets to the EU target model arrangements for gas and electricity in 2014 and 2016. Inclusive engagement with industry is essential in this process
- Revenue from taxing carbon in Ireland should be hypothecated and recycled back to business through energy initiatives that promote employment and economic growth
- Ensure that competitive market forces minimise controllable costs such as operational overheads to provide demonstrable cost savings and efficiency gains for business consumers

Regulatory burden

The high level group on business regulation is delivering on reducing the administrative burden. For instance, the CSO, Company Registrations Office and Revenue have made good progress in reducing the burden on business. However, progress has been more disappointing in the area of the general burden of regulation. The roll-out of regulatory impact assessments (RIAs) which would analyse the need for new regulations, has been too slow and commitment to it by government departments has been patchy. While the administrative burden emanating from certain pieces of legislation has been reduced, the overall regulatory burden remains significant and stronger adherence to RIAs would help contain the regulatory spread which in turn would anticipate and deal with any resultant administrative burden.

One critical problem is transposition of EU legislation into Irish law. An example is the Safety, Health and Welfare (Construction) Regulations 2006 and the associated requirements regarding competency and specific skills training. The domestic legislation defined "construction" much broader than the Directive so that even general mechanical maintenance is considered "construction". In addition, the lack of recognition by the State of training and qualifications from outside Ireland means that employers have to pay an additional premium when engaging experienced maintenance contractors from other member states for them to attend training in Ireland in aspects they are extremely experienced and competent in. Some employers have reported additional costs in the region of €10,000 for this per contract.

An additional significant aspect of some regulation is its prescriptive and absolute nature. There are examples where the legislation sets unreasonable standards that cannot be fully complied with by any employer and do not add any benefit to workplace risk reduction. While these requirements do not feature in prosecutions, *Thompson V Dublin Bus and SDCC: High Court.*, June 2010 highlights that in a civil case these prescriptive requirements mean an employer has no defence and even when, as described by the judge, there is no fault on the employer.

To improve the quality of new regulation to be introduced and to ensure effective outcomes, the role of the better regulation unit should be refocused away from advocacy to enforcement. This should include giving the unit the ability to sanction departments that do not meet the required standards, including publishing in a timely manner. To improve the quality of existing regulation, reviews of heavily regulated areas such as health and safety, the environment and transport should be prioritised in an effort to reduce the regulatory burden on business in cases where regulation does not result in improved outcomes.

Recommendations:

- Reduce business rates by 25%
- In order to reduce energy costs, ensure that climate change targets are met in the most cost-effective manner and hypothecate carbon taxes to support energy efficiency measures in business
- Roll out RIAs across all new regulation and give the better regulation unit sanctioning powers where departments fail to conduct or publish REAs meeting the required standard
- Prioritise reviews of areas such as health and safety, environment and transport to improve the quality of existing regulation and reduce the burden on business

5.4 Measures to support the tourism sector

Tourism is one of Ireland's most important indigenous sectors. Total revenue from overseas visitors was €3.4 bn in 2010 and total revenue for the sector was €4.7 bn⁴. Although the sector suffered as a result of the global

⁴Fáilte Ireland, Tourism Facts 2010 preliminary version.

downturn, economic recovery coupled with an improvement in competitiveness has resulted in a recovery in tourism numbers. CSO data show that in the first half of 2011, visitor numbers were up 13% on 2010.

The tourism sector has reduced its cost base aggressively; hotel prices are down over 20% on the peak and restaurant prices are down almost 5%. The sector has also benefitted from the July 2011 reduction in the lower rate of VAT to 9.5%.

Since much of tourism revenue comes from outside of Ireland, the sector should be treated as an exporter, in terms of state supports and strategy. The sector has the capacity to play an important role in the regeneration of the domestic economy, thanks to its labour intensive nature. However, to realise its full potential the sector needs a more targeted suite of supports and a strategy for the short, medium and long term. Some of the key areas that need to be addressed include:

Costs

Like many other businesses, firms in the retail sector have aggressively tackled their cost bases in order to remain viable. Firms have achieved significant reductions and passed these on to customers, but some problem areas remain. State-controlled or influenced costs in particular have not come down; local authority rates and energy costs remain a substantial burden.

There were substantial economic benefits arising from the alcohol excise reductions in Budget 2010. The excise cut in 2010 was passed on to the consumer and it led to a reduction in alcohol prices, as shown in CSO data at the time. The lower prices in the on-licensed premises, slowed but did not reverse the decline in this sector - in the absence of the price decrease in 2010, the decline in the hospitality sector, caused by reduced incomes and higher unemployment, would have been greater. In addition, the excise cut in 2010, allied with exchange rate movements, significantly reduced the cross-border trade at the time, as it was generally accepted that lower alcohol prices in Northern Ireland were a key driver of cross border trade.

The drinks sector contributes significantly to the national and international tourism performance. The extensive network of public houses, hotels and restaurants provide facilities and services for tourists in many cities and rural locations and contributes to the tourism experience in a positive way. It is an extensively available source of hospitality, personal services, food and information which is provided without any government support. The pub is mentioned by 7% of all visitors and by 10% of German visitors (Germany is the largest mainland European market for Irish overseas tourism) as a positive distinguishing feature of Ireland. Overseas visitors spent 35 % of their total expenditure on food and drinks in 2010. Therefore, a cut in excise for alcohol, in the region of 10%, would contribute further to tourism and hospitality competitiveness and build on the positive messages given to domestic and international tourists by the recent VAT reduction for other elements of the hospitality sector.

Labour market regulation

IBEC has laid out in detail its position in relation to JLCs in its comprehensive submission to the Independent Review of ERO and REA Wage Setting Mechanisms and in related submissions made since the Report of the Independent Review. In short, the JLC system is archaic and should not be reinstated. The system of registered employment agreements (REAs) should be reformed, so that sectors that wish to do so can avail of the mechanism to agree standards and conditions, without the need for trade union recognition.

Emerging markets

While tourism spend from traditional markets is likely to be relatively flat over the medium term (and Ireland's strategy will rightly remain focused on growing market share in these markets), emerging economies offer a growing market opportunity. The number of mid to high-income individuals is increasing rapidly. Though Ireland is gaining recognition as a destination in countries such as China and India, the focus of the tourism promotion agencies remains largely focused on Ireland's traditional markets of UK, US, France and Germany. Given that these markets require a lot of location-specific knowledge, Tourism Ireland should seek synergies with other state agencies such as the IDA and Bord Bia, as well as the higher education institutions. While the traditional markets will continue to provide the bulk of visitors over the coming years and there will be potential in those markets to grow market share, a greater proportion of promotional effort should now be targeted at emerging markets.

Innovation

Much of Ireland's innovation supports are targeted at the high-tech sector, risking neglect of lower technology industries that require help to upskill in order to be able to utilise new technologies. The tourism sector in

particular needs appropriate innovation supports in areas such as product development, management, marketing, back office processes and new technology platforms.

Recommendations:

- Not reinstate the JLC system, but comprehensively reform the REAs as a mechanism of collective voluntary sectoral agreements
- Take a medium to long-term view and make efforts to capture rapidly-growing emerging markets. All state promotional agencies should seek synergies in this area
- Reduce excise on alcohol to match the price reductions delivered to other parts of the hospitality sector by the recent VAT cut
- Provide innovation and up-skilling supports for the tourism sector in areas such as product development, management, marketing, back office processes and new technology platforms

6. Tackling the jobs crisis

6.1 Introduction

Although the economy has stabilised and has started to grow modestly again, the labour market remains very weak. It will most likely be 2013 before meaningful employment recovery returns. Government urgently needs to roll out a comprehensive jobs strategy to target this crisis over the next five years or so. A paradigm shift is needed and in order to make progress policy makers must acknowledge that: firstly, the current social welfare model is a significant barrier to employment and must be reformed; and secondly, active labour market policies and systems in Ireland have underperformed for decades and need urgent repair.

6.2 Incentive to work

The tax and welfare systems designed by Government have a significant influence on the labour market and an economy's overall efficiency and competitiveness. The interaction between the tax and welfare systems has a major impact on the incentive to work. As a result of recent necessary wage and tax developments, the incentive to work has been greatly reduced and this is a major stumbling block to successfully getting people back to work.

IBEC members continually report that they are having difficulty filling vacancies due to applicants stating that their welfare benefits are worth more than the salaries on offer. Our analysis shows that for an individual with a dependent partner and two children there is no financial incentive to work for a gross salary of less than about €35,000. While this particular case is likely to represent only about 10% of those in receipt of unemployment assistance, it illustrates a major flaw in the social welfare system and is indicative of the barriers which many face in seeking to return to work. Weak labour demand is undoubtedly the main cause of high unemployment but unless the supply-side problems are addressed, unemployment will remain high even when the economy and labour demand improves.

Urgent reform is needed in the social welfare system for those of working age. Ireland is most out of line with competitor countries in relation to the very high long-term replacement rate in the social welfare system. This has been identified by OECD, IMF and others and needs reform. In particular, issues around supplementary welfare benefits and rent relief should be addressed. Options should also be examined in relation to a radical reform of the Family Income Supplement (FIS), which has failed to support the transition from welfare to work.

In international terms, Ireland also has an exceptionally poor track record in delivering an effective conditionality model for those in receipt of unemployment assistance. Despite the stated policies, there is no proper enforcement system in place to ensure that those in receipt of assistance are actively seeking work, presenting for interviews or taking up job offers or training places. This lack of enforcement allows the informal economy to grow and is a major cause of long-term unemployment. The recently launched National Employment and Entitlements Service (NEES) must urgently address this issue.

Single social assistance payment for people of working age

Trends in the social welfare population of working age indicate persistent welfare dependency, even during Ireland's earlier period of sustained economic growth. Therefore IBEC welcomes the Department of Social Protection report on the desirability and feasibility of introducing a single social assistance payment for people of working age. The report acknowledges that the current contingency based payments to people of working age can confirm a person's status as a person outside of the workforce rather than an unemployed member of it. It also supports the need for rationalisation of the social welfare assistance scheme into a single payment, which is in line with best practice in other OECD countries.

The report promotes an overarching framework for all people of working age including those who would currently be classified under a contingency approach as unemployed, sick, disabled, or lone parents. The principle of a single working age payment is that people are given or directed to the support and services they need in order to return to, or take up, work or training opportunities, matched by a requirement that they avail of that support. IBEC fully supports this approach and urges Government to expedite its introduction.

Recommendations

- Deliver an effective conditionality model for those in receipt of unemployment assistance in line with international best practice
- Reform the FIS in order to aid the transition from welfare to work
- Proceed with plans to introduce a single social assistance payment for people of working age

6.3 Labour market reform

National Employment and Entitlements Service

IBEC has repeatedly made the case for the complete integration of welfare payment and employment services into one-stop shops. Employment service officers should be responsible for taking claim details, monthly signing-on, initial sanction decisions, as well job-search monitoring, employment counselling and job-brokering. Therefore IBEC welcomes the publication of the project plan for the development and implementation of the National Employment and Entitlement Service (NEES). The plan's inclusion of detailed project milestones, performance measures and timelines up to May 2012 is also welcome. In total the Department has identified almost 800 discrete tasks that need to be completed over the next three years in order to give full effect to the NEES model.

It is critical that there is no slippage on the timelines and that the pace of service integration is accelerated. The key project dependencies – including the significant cultural change that will be required within the constituent organisations to ensure a high quality service – must be acknowledged and addressed at the outset. International research warns that the formal merger of employment services and benefit administration at ministerial level do not necessary result in the seamless, co-ordinated and improved level of service for the unemployed and prospect employers that is ultimately sought. The service should include a robust, all-encompassing case management system which includes an individualised brokerage service to support those who are further away from the labour force to make their way back to the workplace.

The project also depends on the availability of staff training and IT resources. As the OECD has pointed out: 'an increase in expenditure on the public employment services, devoted to activation measures, may pay for itself several times over through reduced benefit expenditures and several times again through increased tax and social insurance contribution receipts'.

Labour market activation funding

In 2010-2011, the Department of Education and Skills funded the Labour Market Activation Fund, a €20 mn fund which aimed to support nearly 7,000 unemployed people to gain new skills to return to employment or educational opportunities. The fund targeted less-skilled individuals and those formerly employed in declining industries such as construction, retail and manufacturing.

A competitive tendering programme delivered the potential for innovative and cost-effective labour market interventions and, while a final evaluation report has not yet been published, it would seem that the outcomes of the fund are very positive. The Labour Market Activation Fund 2010 operated as a useful and effective pilot. Such a fund should now be introduced on a permanent footing, with possible extension to a wider population of unemployed people. The tendering process ensured an outcomes-driven approach to the provision of employment supports which delivered very positive results. The potential returns on the investment for such a programme are clear – effective labour market activation programmes support people back into employment, remove them from the live register and ensure that they become net contributors to the economy once again.

Recommendations

- Prioritise at cabinet level the roll-out of improved labour market services under NEES
- Ensure the NEES provides a robust, case management system which emphasises and facilitates positive, individual employment-related outcomes
- Provide the necessary IT, training and staffing resources to ensure that the project succeeds
- Introduce a Labour Market Activation Fund for 2012 to invest in outcomes-driven employment and training supports to equip unemployed people with the skills required to return to work.

6.4 Education and skills

Ireland's economic recovery is contingent on a world class education and training system. This does not imply that education can be exempted from the consequences of the need for ongoing fiscal adjustment. It does mean, however, that we should avoid damaging cuts to education budgets, while also increasing focus on cost-effective solutions that yield the best returns on investment, improve the effectiveness of our system and ensure excellent outcomes. Education policy must emphasise the ongoing requirements of the labour market and the ongoing training requirements of workers. Training and education programmes must equip individuals with both specific vocational and more generic transferable skills. This should be the case in all training and education programmes. For example, more comprehensive apprenticeship programmes should seek to up-skill individuals in the specific vocational area but should also ensure they develop transferable work-related skills, and valuable literacy and numeracy skills.

Second level

IBEC believes that radical reform of teaching methods and curriculum content in the secondary school system could have a profound impact on education outcomes including the development of critical thinking and moving away from the dominance of rote learning. The Confederation welcomed the publication of the National Literacy and Numeracy Strategy as an acknowledgement of the challenges in these areas and a road map of reforms to improve education outcomes. It is estimated that the cost of implementing the strategy will be €6 mn in 2012 rising to €19 mn per annum by 2017 and IBEC fully supports this expenditure.

The announcement of a parallel series of reforms focused on a new junior cycle curriculum is also anticipated in the near future. The introduction of a less extensive central junior cycle state examination must not be viewed as an opportunity to save money. The junior cycle represents a major missed opportunity to encourage the types of creativity, flexibility, independent thinking and appetite for learning that are so critical in later stages of education and work. However, the success of these, and similar reforms, depends on teaching quality and support provided through continuous development programmes (CPD) for teachers. IBEC welcomes the publication of the recent Teaching Council report Policy on the Continuum of Teacher Education and notes that the Council intends 'to work towards a position... where renewal of registration with the Teaching Council will be subject to the receipt of satisfactory evidence in relation to engagement in CPD.' This work should be expedited.

Higher education

The decision by the Minister of Education and Skills to implement the higher education strategy of the Hunt Report is welcome but this process will be undermined unless the critical issue of funding is addressed.

Over two years ago, the Department of Education and Skills published a comprehensive report on the different options for a student contribution system. However the idea was shelved in October 2009. This decision did a serious disservice to both students and higher education institutions.

Students and their families have been faced with significant increases in registration charges without any support system, while universities and colleges are trying to cope with increased enrolments on an unsustainable funding model. If Ireland wants to meet demand for education and to retain quality, it needs to broaden its funding base. The time for prevarication on this issue is over and the Government should introduce a tuition fee system supported by income-contingent student loans. Government should avoid damaging cuts to education budgets, while also increasing focus on cost-effective solutions that yield the best returns on investment, improve the effectiveness of our system and ensure excellent outcomes. For example, a lengthening of the academic year has the potential to improve learning outcomes by spreading student and academic staff workload, increase student intake and throughput and make better use of facilities (e.g. laboratories).

Recommendations

- Government should introduce a tuition fees system supported by income-contingent student loans
- Reform the approach and methods of learning in the second level education system, including a reform of the junior certificate exam process
- The proposal to make renewal of teacher registration with the Teaching Council subject to the receipt of satisfactory evidence in relation to engagement in CPD should be implemented immediately
- Allocate sufficient resources to support training and up-skilling for teachers
- The National Strategy for Higher Education implementation group should develop proposals to lengthen the academic year in higher education institutions

- Ensure all training programmes equip individuals with transferable skills which enable them to be flexible to the requirements of a rapidly changing employment market in line with the recommendations of the Expert Group on Future Skills Needs (EGFSN)

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IBEC promotes the interests of business and employers in Ireland by working to foster the continuing development of a competitive environment that encourages sustainable growth, and within which both enterprise and people can flourish.



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