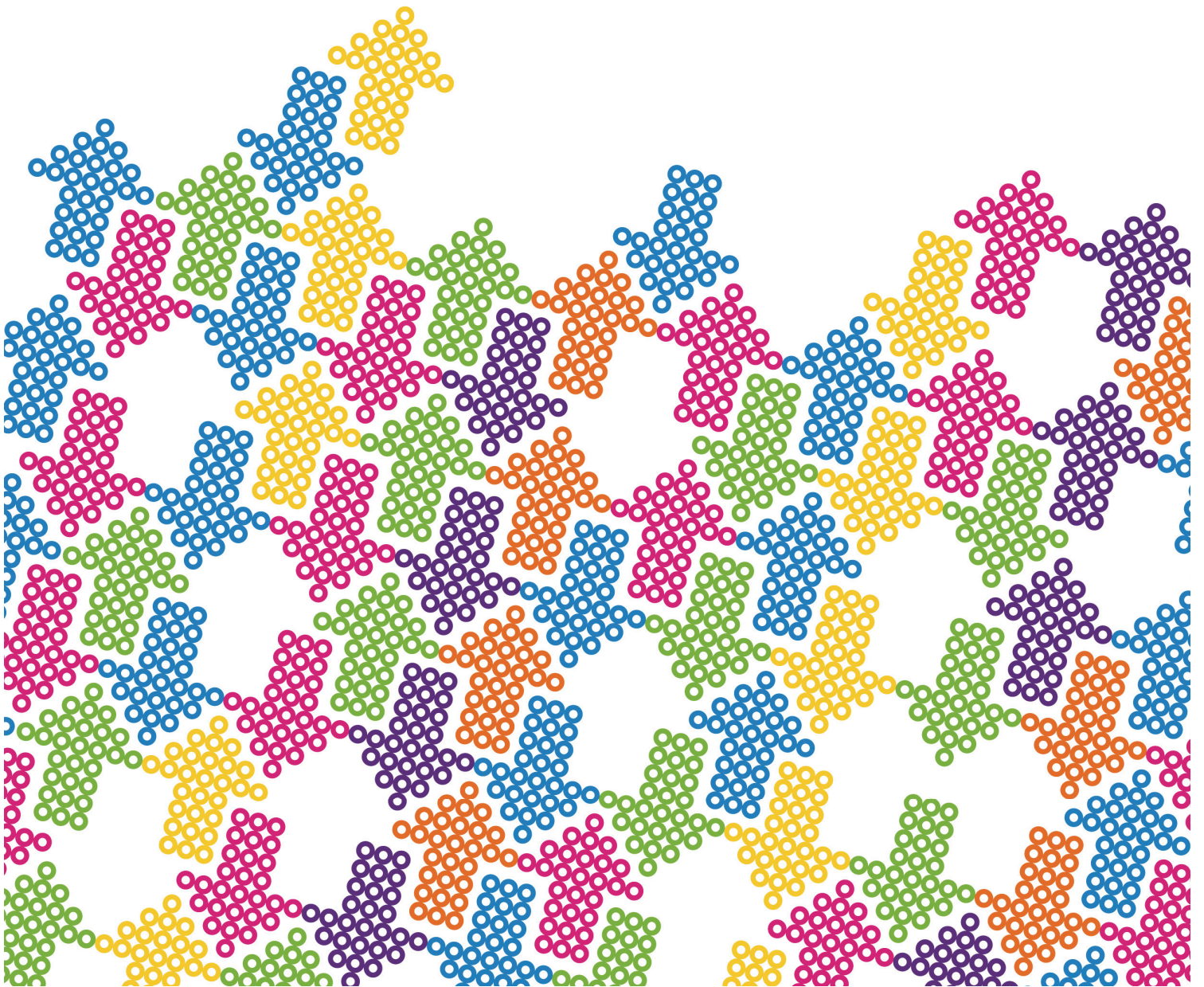




Costs of Doing Business in Ireland 2015

April 2015



Introduction to the National Competitiveness Council

The National Competitiveness Council reports to the Taoiseach and the Government, through the Minister for Jobs, Enterprise and Innovation on key competitiveness issues facing the Irish economy and offers recommendations on policy actions required to enhance Ireland's competitive position.

Each year the NCC publishes two annual reports.

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

As part of its work, the NCC also publishes an annual Submission to the Action Plan for Jobs and other papers on specific competitiveness issues.

The work of the National Competitiveness Council is underpinned by research and analysis undertaken by the Strategic Policy Division of the Department of Jobs, Enterprise and Innovation.

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Kevin Callinan	Deputy General Secretary, IMPACT Trade Union
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Executive Summary

This report is required under the Action Plan for Jobs 2015. Specifically, Action 247 requires the National Competitiveness Council to “*Benchmark key business costs and publish a report highlighting areas where Irish enterprise costs are out of line with key competitors*”¹.

The report concentrates on the costs that are largely domestically determined such as labour, property, energy, water, waste, communications and business services, and considers both price levels, and changes in those levels (i.e. price inflation).

Since 2009, Ireland’s cost base has improved significantly, making Irish firms more competitive internationally, and making Ireland a more attractive location for firms to base operations. However, despite improvements, Ireland remains a high cost location – 3rd highest in the euro area, for example, for consumer goods and services.

Over recent months, while relative cost competitiveness is improving (i.e. although costs are increasing, they are increasing at a slower rates than in many of our competitors), this improvement is largely being driven by external factors beyond the control of domestic policymakers. This is reflected in the improvements in Ireland’s Harmonised Competitiveness Indicator which captures the impacts of both exchange rates and relative price movements. In essence, a weak euro exchange rate, low ECB interest rates, and low international fuel prices have all combined to improve Irish cost competitiveness. These factors will not remain favourable.

On the other hand, there are a number of upward domestic cost pressures. Labour cost growth is modest but positive; it is vital that further increases in labour costs are underpinned by productivity improvements. While Irish unit labour costs are improving in relative terms compared with ULCs in the euro area, it is concerning that Irish ULCs are increasing, given the aforementioned modest wage growth.

Property costs are again emerging as a significant threat to sustained competitiveness – increases in commercial rents are occurring alongside rapid growth in residential rents and house prices. The continued shortage of Grade-A office space in prime city centre locations, in part, is a result of Ireland’s success in attracting significant foreign direct investment. At the same time, however, supply constraints could damage Ireland’s attractiveness in future, unless addressed. The link between house prices and wage expectations means that developments in the residential property sector have a direct impact on competitiveness.

While energy prices in Europe are higher generally than prices in the US, Ireland remains an expensive location for energy compared to most of our EU peers. This is a particular issue for energy intensive sectors. In terms of business services, upward cost trends are evident for many business services, after several years of price reductions. Specifically, while legal service costs have fallen recently after a long period of price stickiness, costs for a range of other services have increased – for example, air transport, computer consultancy, and postal services.

Looking forward, persistent low rates of inflation (and indeed, possible deflation) across euro area increases difficulty of achieving further improvements in Irish cost competitiveness through price reductions. There is also the very real risk that the price falls achieved since 2009 could be reversed as economy returns to growth.

Against such a backdrop, Ireland cannot depend on benign currency movements or other external factors beyond the direct influence of domestic policy makers to protect our international cost competitiveness. Such gains could be erased just as quickly as they were accrued.

¹ Department of Jobs, Enterprise and Innovation, Action Plan for Jobs 2015, January 2015

As a small open economy, dependent on exports and foreign investment as major drivers of growth, any loss of cost competitiveness will have a major negative impact upon both our economic prosperity and our standard of living. In order to protect gains made to date, we must focus on the controllable portion of our enterprise cost base, and continue to take action to address unnecessarily high costs (i.e. cost levels not justified by productivity) wherever they arise.

In this regard, there is a role for both the public and private sectors alike to proactively manage their cost base and drive efficiency, thus creating a virtuous circle between the costs of living, wage expectations and cost competitiveness. Measures that ensure open and competitive markets are also essential.

At the same time, productivity performance will assume an even more prominent role in driving Irish international competitiveness. Indeed, in the longer term, productivity growth is the preferred mechanism to improve competitiveness as it can support cost competitiveness in tandem with high and increasing income levels.

The policy implications of this analysis, and associated structural reforms required to address Ireland's cost base will be included in the Council's annual Competitiveness Challenge report.

Chapter 1 – How Does Ireland Perform?

Introduction

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

This report is required under the Action Plan for Jobs 2015. Specifically, Action 247 requires the National Competitiveness Council to “*Benchmark key business costs and publish a report highlighting areas where Irish enterprise costs are out of line with key competitors*”².

The report concentrates on the costs that are largely domestically determined such as labour, property, energy, water, waste, communications and business services, and considers both price levels, and changes in those levels (i.e. price inflation). *Costs of Doing Business 2015* is structured as follows:

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

In each chapter, a range of internationally comparable, enterprise-focussed cost indicators are collected for Ireland and a number of our key trading partners. We have endeavoured to collect data from high-quality, internationally respected sources, and where necessary, caveats on data issues are set out in the relevant text. Where possible, Irish cost levels are compared to a relevant peer group average (e.g. the OECD and euro area average³). The report also aims to use the most up-to-date data possible. However, as much of this data is collected on an annual basis, there may be a time lag in capturing recent changes in cost levels. Where this occurs and where more current national data is available, this is reflected in the text.

It is also worth noting that individual cost metrics have strengths and weaknesses (i.e. in terms of definitions used, in how the data is collected etc.). When analysing the individual metrics, it is important, therefore, to consider all of the data as a whole – does the analysis of the individual metrics combine to tell a coherent story about Ireland's current cost competitiveness performance?

Finally, in a new addition to this year's report two “special articles” on commercial insurance and waste costs are included. In the case of both sectors, only limited data on prices and costs is available. The Council, therefore, felt it appropriate to consider each sector in more detail, and to undertake some analysis to better understand the sectors, their cost performance, and the policy issues arising.

² Department of Jobs, Enterprise and Innovation, Action Plan for Jobs 2015, January 2015

³ Where relevant, euro area averages are calculated based on the number of countries for which data is available. These averages are un-weighted.

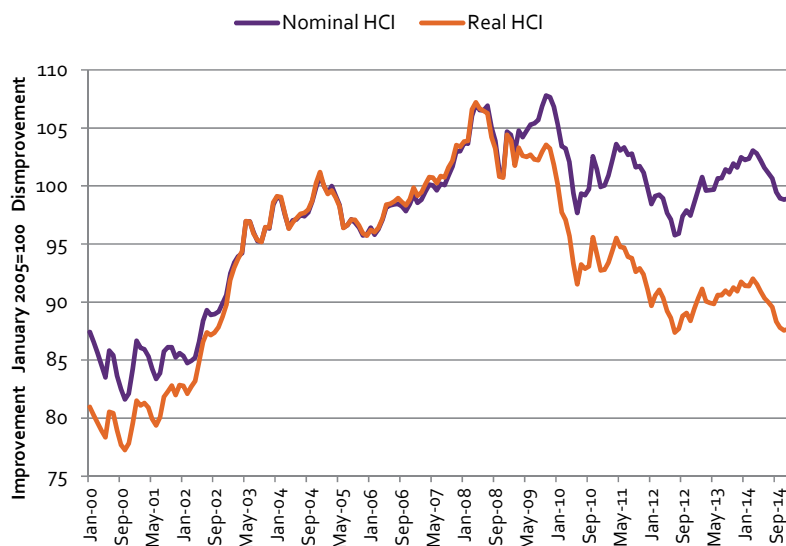
Measures of Overall Cost Competitiveness

Changes in international cost and price competitiveness depend on a combination of exchange rate movements and movements in relative prices between trading partners. Much of Ireland's competitiveness story can be illustrated using Harmonised Competitiveness Indices (HCIs)⁴. The HCI is prone to significant fluctuations – particularly over the last 18 months or so.

Between January 2000 and April 2008, Irish cost competitiveness (the real HCI) declined by over 32 per cent (while the nominal HCI declined by 22.5 per cent). This reflects a strong appreciation of the euro against the currencies of our trading partners (nominal HCI) and higher price inflation in Ireland. This confirms the loss in relative price competitiveness experienced throughout the mid-2000's in Ireland.

Since the onset of the financial crisis and the recession, Ireland's competitiveness has improved as a result of reductions in relative prices and favourable exchange rate movements⁵. Between April 2008 and July 2012, Ireland regained much of its competitiveness as the real HCI improved by 18.5 % (and the nominal improved by 10.6% - reflecting lower inflation in Ireland than amongst our trading partners, and in some case, price reductions). From mid-2012, partly driven by an appreciating euro, the HCI deteriorated again, eroding some of the gains made during the recession.

Figure 1: Harmonised Competitiveness Indicators, January 2000 – December 2014 (January 2005=100)



Between 2012 and 2014, the nominal HCI deteriorated by proportionately more than the real HCI, suggesting that euro exchange rates were the primary factor in Ireland's loss of competitiveness. From March 2014, renewed euro depreciation provided a boost to Irish cost competitiveness.

Source: Central Bank of Ireland, DJEI Calculations

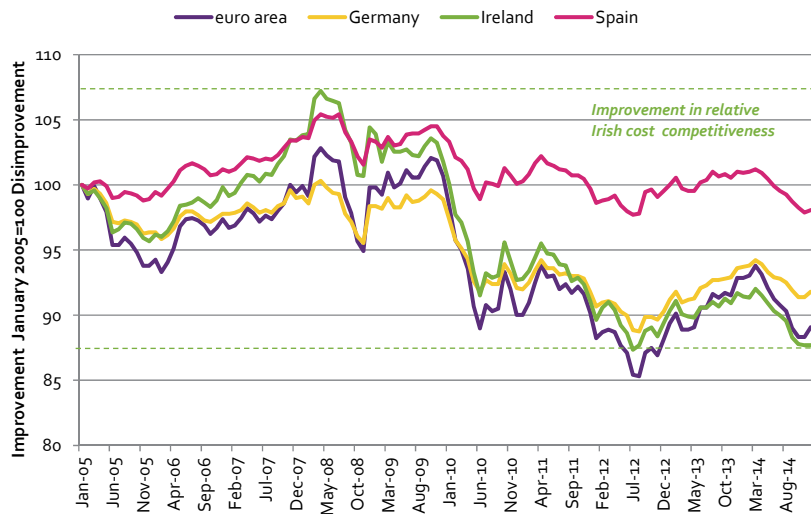
Figure 2 draws on European Central Bank data to compare the evolution of real HCIs across a range of selected euro area countries. In short, since 2008, Ireland has recorded a significant competitiveness improvement.

⁴ The purpose of HCIs is to provide meaningful and comparable measures of euro area countries' price and cost competitiveness that are also consistent with the real effective exchange rates (EERs) of the euro. HCIs are constructed using the same methodology and data sources as the euro effective exchange rates. The Central Bank of Ireland produces both a nominal and real Harmonised Competitiveness Index. The nominal HCI is a nominal effective exchange rate for the Irish economy that reflects, on a trade weighted basis, movements in the exchange rate vis-à-vis 56 trading partners. The real HCI (deflated by consumer prices) takes into account relative price changes along with exchange rate movements. In Figure 1, an upward sloping line indicates a loss of competitiveness, whilst a downward sloping line indicates improving competitiveness.

⁵ See Brendan Walsh, Regaining Competitiveness, 24th July 2012 at www.irishceconomy.ie/index.php/2012/07/24/regaining-competitiveness/

Euro area and German cost competitiveness has also improved significantly over the period in question. Mirroring Figure 1, cost competitiveness weakened in late 2012-2013 due to an appreciating euro.

Figure 2: Real HCI Movements in Ireland, Germany, Spain and euro area, January 2005 – December 2014 (January 2005=100)



This trend has reversed since early 2014 as the euro has once again weakened. As a result of the scale of Ireland’s non-euro denominated trade, movements in euro exchange rates have a greater impact on our relative international competitiveness, than is the case in many European countries.

Source: European Central Bank, DJEI Calculations

Prices in Europe and the Threat of Deflation

Deflation is a monetary phenomenon and refers to a situation in which the low level of inflation combined with nominal interest rates leads to an excessively high level of real interest rates relative to growth. Deflation has been recorded in the euro area over recent months; despite ongoing quantitative easing by the European Central Bank, the real long-term interest rate of the euro zone as a whole is probably too high relative to growth and so the risk of euro area deflation continues.

While it can be argued that falling prices might be a sign of innovation and increased productivity, these factors do not explain Europe’s current situation.

Deflation is a problem in a modern economy because it increases the real value of debt, and may aggravate recessions and lead to a deflationary spiral. A deflationary spiral is a situation where decreases in price lead to lower production, which in turn leads to lower wages (i.e. necessary adjustments in relative real wages between sectors or regions can only be achieved via widespread cuts in nominal wages) and demand, which leads to further decreases in price. It is worth noting that while short- and medium-term expectations are for low rates of inflation, long-term inflation expectations remain anchored at close to the 2 per cent that is defined as being consistent with price stability in the euro area as a whole.

The ongoing shift in monetary policy in the US, combined with a move towards greater easing in the euro area, and the reducing drag on demand from fiscal consolidation has already resulted in a depreciation of the euro against the dollar, and such depreciation contributes to upward pressure on the price level in Europe⁶.

Focus on Individual Cost Categories

Harmonised competitiveness indicators can be difficult to translate into real world experience. From the perspective of the firm or an individual, in order to fully appreciate changes in prices and costs, it is necessary to examine more tangible indicators such as wage rates, rents, and the prices paid for various utilities and services. In this regard, *Costs of Doing Business 2015* examines over 50 different metrics across a range of business cost categories to provide an overview of the cost environment for enterprise in Ireland. The key messages are summarised below.

Summary of Business Cost Trends in Ireland

<p>Labour Costs</p>	<p>Gross and net earnings are the 8th highest in the euro area. Gross earnings are below the euro area average but net earnings are 11.6% above average.</p> <p>Following a number of years of marginal decline, Irish labour costs increased in 2012 (+2.2%) and 2013 (+0.7%). In the first two quarters of 2014, labour costs grew by 1%. These rates are less than the euro area average. Further marginal increases in nominal compensation are forecast for 2015⁷.</p> <p>National data shows that wage growth is occurring across many sectors, particularly over the last year with strong growth in labour costs in manufacturing, financial and ICT sectors.</p> <p>Irish unit labour costs which measure the average cost of labour per unit of output (and thus capture both cost and productivity changes) increased by 1% in 2013, after several years of improvements. It should be noted that ULCs are subject to a range compositional factors – this can make it difficult to accurately interpret ULC data.</p> <p>Nominal ULCs grew at a slower rate than in the euro area, representing a slight improvement in Irish competitiveness. This trend is expected to continue in 2015 and 2016.</p> <p>Ireland has the 4th highest national minimum wage in the euro area (measured in euro terms), and the 9th highest when expressed as a percentage of average gross monthly earnings.</p> <p>The cumulative impact of increases in income taxes, changes to bands, the introduction of the Universal Social Charge etc. have weakened competitiveness since the onset of recession. However, taxes and social insurance rates for married couples with children, particularly for those on the average wage, remain competitive. The system is less competitive for higher earners (i.e. those earning 167% of average wages).</p>
<p>Property</p>	<p>Following several years of significant cost reductions – in terms of both construction and</p>

⁶ Quantitative easing also impacts upon price levels through other channels including wealth effects as asset prices increases and other wealth effects, and through the easier availability of credit, etc.

⁷ The European Commission are forecasting growth of 1.7 per cent in 2015 in compensation per employee in Ireland, compared with 1.3 per cent growth in the euro area. The ESRI forecast growth of 1 per cent while the Central Bank is forecasting growth of 2.2 per cent for 2015. See Duffy, D., et al, Quarterly Economic Commentary, Winter 2014, December 2014, and Central Bank of Ireland, Quarterly Bulletin Q1 2015, February 2015

<p>Costs</p>	<p>rental costs - the commercial property market is rebounding.</p> <p>Capital values increased strongly in all commercial sectors (e.g., office, industrial, and retail) and were up 31.4% over the year, with a particularly strong performance in the retail sector⁸.</p> <p>Commercial rents for both office and retail space grew strongly in 2013/2014.</p> <p>Concerns persist about the shortage of available prime office space for rent in Dublin, Cork and Galway as the market tightens and vacancy rates decline – this could result in future rent increases and any shortage of supply of new commercial space could adversely impact our competitiveness in attracting FDI⁹. Costs are also increasing in the hotel accommodation sector, particularly in Dublin, threatening the competitiveness of our tourism sector.</p> <p>The importance of commercial rates (which differ by location) as a source of revenue for Local Authorities continues to grow as funding from Central Government is reduced.</p>
<p>Transport Costs</p>	<p>Diesel prices are 5.5% more expensive in Ireland than in the euro area. The weak euro may result in further fuel price increases (since crude oil is priced in dollars).</p> <p>While the cost of many transport services in Ireland has remained stable, air transport prices increased significantly (by 12.4%) in the past year.</p> <p>While it is more expensive (excluding tariffs) to export and import to and from Ireland by sea, Irish administrative processes are efficient and compare favourably with processes in our key competitors.</p>
<p>Utility Costs</p>	<p>Energy comprises a significant component of non-wage costs for enterprises in a range of growth sectors¹⁰.</p> <p>The EU is among the most expensive locations for electricity and gas globally, and within the EU, Ireland is one of the most expensive countries for electricity: Ireland is the 6th most expensive location in the euro area 17 for both SMEs and large electricity users.</p> <p>While Ireland is mid-table in the euro area in terms of industrial gas prices, gas prices in the US are substantially lower than in the EU.</p> <p>On average, water and waste water costs for enterprise in Ireland compare favourably to those in competitor markets. Within Ireland, water costs vary significantly by local authority.</p> <p>In terms of waste costs, the cost of landfill has increased from €93 per tonne in 2010 to €113 in 2014 because of increases in the landfill levy. Irish landfill costs are amongst the most expensive of the benchmarked countries/regions. Thermal treatment costs (gate fees) in Ireland, although lower than landfill costs, are also among the most expensive in the benchmarked countries/regions.</p> <p>Telecom costs are relatively competitive although some concerns persist in relation to the quality (speed) of services available. The data available, however, is based on purchasing power parities which may over estimate Ireland's competitiveness.</p>

⁸ Jones Lang LaSalle, JLL Irish Property Index -Q42014, January 2015

⁹ According to SCSl, the strong increase in office take up in 2013 was largely driven by multi-national organisations engaged in the Telecoms, Media and Technology (TMT) and Financial Services sectors. See SCSl, Annual Commercial Property Review and Outlook 2014

¹⁰ Energy is an essential input to the entire enterprise base across the State, both the internationally trading and domestic sectors of the economy. In particular, energy can comprise a large component of the direct non-wage costs for heavy energy consumers in key growth sectors such as food, ICT, medical devices, pharmaceuticals, construction and engineering, many of which are large and important regional employers. Energy is also important for data centres which play a key role in supporting growth opportunities across a range of sectors (e.g. ICT, digital media). Energy is also a key input in terms of the costs of transporting people and goods. Many energy intensive companies are large and important regional employers, operating in low margin markets where prices are determined globally. As a result, the large increases in energy costs have to be absorbed, thereby putting them under serious pressure to continue to trade successfully in global markets.

	<p>From an enterprise perspective, the widespread availability of advanced broadband services is more of a concern than cost issues. There are some concerns of the lack of competition in the backhaul market which is resulting in higher costs and poorer quality than is desirable.</p>
Credit and Financial Costs	<p>New business interest rates for non-financial corporations are higher in Ireland than in the euro area – rates are 60% higher for loans up to €1 million and are 81% higher for loans above €1 million.</p> <p>In November 2014, interest rates in Ireland for revolving loans and overdrafts were 42% above the euro area average.</p>
Business Services and Other Input Costs	<p>Throughout the 2012 to 2014 period, prices for a range of business services (e.g. transport, postal and courier, and computer consultancy services) have been increasing in Ireland. This follows a period of significant price declines over the course of the recession.</p> <p>In Q3 2014, prices for a basket of business services were 6.5% above 2010 levels.</p> <p>Overall since 2010, service prices have risen by more than manufacturing prices. Manufacturing products sold within Ireland, however, have increased at faster pace than both services and internationally traded manufacturing products (i.e. exposed to competition). Despite reductions in legal costs in recent quarters, Ireland is an expensive location to enforce a business contract.</p> <p>Insurance density (premiums per capita) in Ireland is below the euro area average. There appears to be a degree of concentration in the market in terms of the number of providers, but concentration levels are not excessive when compared with other small markets.</p> <p>The fall in premium has resulted in significant reductions in underwriting profits for commercial insurance providers in Ireland. The level of profitability in the Irish market makes it somewhat unattractive to prospective new entrants.</p>
Broader Cost Environment	<p>Ireland's current price level and inflation profile can be described as high cost but rising slowly.</p> <p>In 2013, Ireland was the 3rd most expensive location in the euro area for consumer goods and services.</p> <p>Irish prices were 16.8% above the euro area average, and prices were above euro area averages for 10 out of 12 categories of goods and services.</p> <p>The principle contributors to Irish inflation over the last 12 months are "Miscellaneous goods and services" which is driven by health insurance, "Alcohol and tobacco", "Education", and "Restaurants and hotels".</p> <p>After significant price falls over recent years, house prices and rents are on an upward trend again with potentially significant consequences for affordability and knock on impacts on wage demands.</p>

Conclusions

Ireland's cost base has improved across a range of metrics since 2009, making Irish firms more competitive internationally and making Ireland a more attractive location for firms to base their operations in. However, despite these improvements, Ireland remains a high cost location. Addressing Ireland's international cost competitiveness must, therefore, remain a key economic priority for Government.

At the same time, while the Council aims at enhancing cost competitiveness, this does not mean that Ireland should strive to become a low cost economy; rather cost competitiveness refers to a state where prices reflect quality and productivity (i.e. high costs can reflect high productivity rates and high quality goods and services).

The Council is concerned that recent price falls in Ireland are at risk of being reversed as the economy returns to growth, demand increases and constraints emerge. Already there are warning signs: after a number of years of cyclical cost reductions (reflecting the fall off in demand as a result of the financial crisis and associated recession), progress has stalled somewhat and domestically determined cost competitiveness is no longer improving.

It is also clear that the Irish economy cannot depend on benign currency movements and fuel prices to protect our international competitiveness. The gains which accrued as a result of a weak euro can just as quickly be erased¹¹. It would be prudent, therefore, to minimise those costs that we have some degree of control over. In this regard, there is cause for concern.

While positives persist – external positive factors include recent improvements in Ireland’s HCI, and potentially lower energy costs, based on international fuel prices; internally driven positives include our internationally competitive communications costs - a series of upward cost pressures have emerged over the last 18 month or so.

Based on the summary cost profiles considered in Chapter 2, it is clear that the cost of labour is the most significant driver of business costs for most firms – particularly for services firms¹². While labour cost growth has remained modest in recent quarters, it is to be expected that as the labour market tightens (albeit, from a situation where unemployment remains in double digits), upward pressures will increase. From a competitiveness perspective, it is vital that any increases in labour costs are underpinned by productivity improvements.

Property is once again emerging as a significant threat to sustained competitiveness – increases in commercial rents are occurring alongside rapid growth in residential rents and house prices. There is a direct link between house prices and labour costs; rapid increases in the former will, if left unchecked, result in upward pressure on the latter. Such a negative spiral would threaten Ireland’s overall competitiveness offering.

In relation to transport prices, the continuation of a weak euro could have an adverse impact on petrol and diesel prices (although crude oil prices are currently low, crude is priced in dollars). Diesel represents a significant cost component for haulage firms, and thus impacts upon the cost base for any company seeking to transport goods or people.

In terms of utility costs, there are many variables at play making it difficult to judge future trends. With respect to water, for example, the development of a new business pricing framework in Irish Water has led to a degree of uncertainty – there will undoubtedly be winners and losers from any changes. The need for significant investment in water infrastructure, however, allied to the cost associated with meeting environment targets has the potential to result in increases in prices (offset to a degree through potential efficiency gains which may arise as a result of the reforms).

Looking at business services, the upward cost trend evident for many services after a number of years of decline serves as a reminder of just how quickly the wheel can turn. While legal service costs have fallen in

¹¹ Indeed over time, a weak euro could result in euro area inflation: a more competitive euro would strengthen demand in all the euro area countries by increasing exports, and causing domestic buyers to substitute local goods and services for imports. Although a depreciating euro would not change relative prices amongst euro area countries, it would have a significant impact because nearly half of euro area trade is with countries outside of the single currency. The increase in demand as a result of favourable exchange rates could increase economic activity and ultimately inflation.

¹² Across manufacturing, a range of other inputs also play an important role – in particular, transport, utilities and property costs.

recent quarters, after a long period of stickiness, the cost of a range of other services has increased – for example, air transport, computer consultancy services, and postal services.

It is notable that the price trend for internationally traded goods is generally flat; on the other hand, the price of domestically traded goods and services (largely determined domestically), is increasing. Services, in particular, represent the primary driver of inflation in Ireland.

Placing Irish developments into a broader European context, low rates of inflation (or possible deflation) across the whole euro area increases the difficulty of achieving further improvements in cost competitiveness through price reductions¹³. It remains vital, however, that Ireland protects the gains made to date, and that we continue to take action to address unnecessarily high costs (i.e. cost levels not justified by productivity) wherever they arise. In this regard, there is a role for both the public and private sectors alike to proactively manage their cost base and drive efficiency, thus creating a virtuous circle between the costs of living, wage expectations and cost competitiveness. Measures that ensure open and competitive markets are also essential.

At the same time, productivity performance will assume an even more prominent role in driving Irish international competitiveness. Indeed, in the longer term, productivity growth is the preferred mechanism to improve competitiveness as it can support cost competitiveness in tandem with high and increasing income levels.

The policy implications of this analysis, and associated structural reforms required to address Ireland's cost base will be included in the Council's annual Competitiveness Challenge report.

¹³ According to the most recent European Commission forecasts, inflation is set to remain subdued in 2015 as low commodity prices dampen the headline figure. Inflation should increase from mid-2015 and during 2016, as economic activity strengthens, wages increase and economic slack is reduced. In the EU, inflation is projected at 0.2 per cent in 2015 and 1.4 per cent in 2016. Inflation in the euro area is forecast to be -0.1 per cent in 2015 and 1.3 per cent in 2016. See European Commission, *European Economy 1/2015, Winter 2015*, February 2015

Chapter 2 – How Do Costs Impact on Enterprise?

Why Costs Matter

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

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

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

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

More broadly, all sectors of the economy are interlinked and interdependent - high and increasing business costs have implications for the costs of living. These in turn, have knock on implications for wage demands, and so the cycle continues.

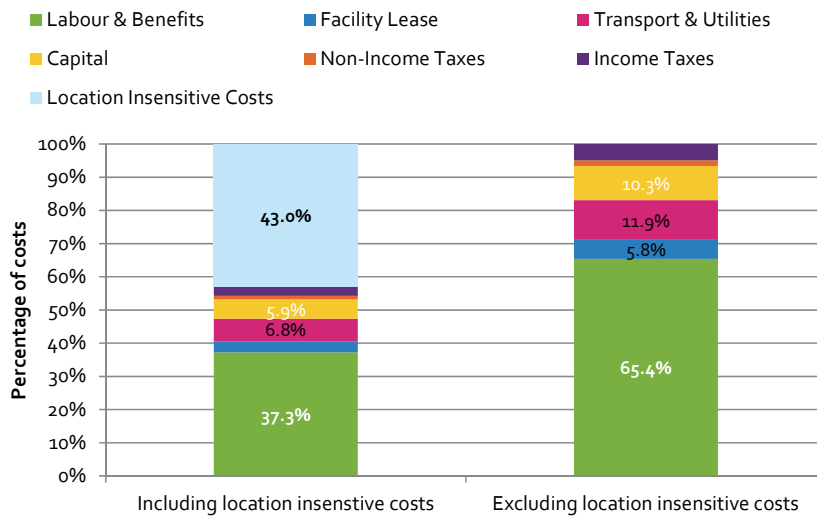
Given Ireland's return to growth, and the reductions in business costs which have been achieved to date, further across-the-board reductions in costs will be difficult to attain. It remains vital, however, that Ireland protects the gains made to date, and that we continue to take action to address unnecessarily high costs (i.e. cost levels not justified by productivity) wherever they arise. In this regard, there is a role for both the public and private sectors alike to proactively manage their cost base and drive efficiency, thus creating a virtuous circle between the costs of living, wage expectations and cost competitiveness.

Which Costs Matter Most?

From a competitiveness perspective, it is essential that policymakers focus on maintaining cost competitiveness, particularly in relation to those goods and services that comprise a significant percentage of business costs and that are out of line with those in competitor countries. Figure 3 and Table 1 provide an enterprise cost profile based on data for a range of sectors and locations.

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

Figure 3: Summary of Enterprise Cost Profiles, 2014



The column on the right hand side, strips out cost elements determined internationally and focuses instead on costs which are primarily determined domestically. The significance of the location-sensitive cost factors differs by sector, with significant variations occurring between services and manufacturing firms.

Source: KPMG Competitive Alternatives 2014, DJEI Calculations

These differences are elaborated upon in Table 1, which provides a range of magnitude for each cost category.

Table 1: Relative Significance of Location Sensitive Costs (% of total location sensitive costs)

	Services	Manufacturing
Labour & Benefits	74-90%	44-60%
<i>Of which: Salaries & Wages</i>	52-64%	31-42%
<i>Statutory Plans</i>	9-11%	5-7%
<i>Other Benefits</i>	13-16%	7-10%
Facility Costs	4-16%	2-6%
Transportation Costs	-	7-24%
Utility Costs	1%	2-8%
Capital Costs	0-7%	9-21%
Taxes	2-10%	6-14%

Source: KPMG Competitive Alternatives 2014

Taking these in turn:

- Labour costs include wages and salaries, employer-paid statutory plans, and other employee benefits. KPMG research indicates that labour costs represent the largest category of location-sensitive cost factors for all industries examined. For the services sub-sectors examined, labour costs typically range from 75 to 90 per cent of location-sensitive costs, while for manufacturing operations the typical range is from 45 to 60 per cent of total location-sensitive costs.
- Facility or property costs represent the next significant cost factor. For services sub-sectors, office lease costs represent 4 to 16 per cent of total location-sensitive costs. For manufacturing sub-sectors, industrial lease costs range from 2 to 6 per cent of location-sensitive costs.
- Transportation costs are only assessed for manufacturing operations. For the manufacturing sub-sectors examined, transportation costs represent 7 to 24 per cent of total location-sensitive costs.

- Utility costs represent 1 to 8 percent of location-sensitive costs. Electricity and natural gas costs are more significant for manufacturers than for non-manufacturers.
- Costs of capital include both depreciation and interest. These are major cost items for manufacturers, ranging from 9 to 21 per cent of location-sensitive costs across sub-sectors. Capital-related costs are much less significant for services sub-sectors, at 0 to 7 per cent of location-sensitive costs.
- Taxes typically represent 2 to 10 per cent of total location-sensitive costs for the services sub-sectors examined, and 6 to 14 per cent for manufacturing sub-sectors.

What Drives Costs?

During a boom such as Ireland experienced in the early and mid-2000s, it is to be expected that prices and costs will increase. Wealthy countries are generally expensive countries. Recent analysis, however, suggests that price rises in Ireland were not necessarily a result of price convergence between Irish and European price levels, arising from faster growth rates here¹⁴ - Irish price levels were above the euro area average in 1999, and so movements in price levels between 1999 and 2008 served to widen the existing gap¹⁵. This mirrors analysis by the European Commission which has found that even allowing for Ireland's relatively high level of GDP per capita, the price level in Ireland prior to the recent crisis had been relatively high in comparison with other euro area economies. Notwithstanding the price adjustments which have occurred as a result of the recession, the Irish price level remains elevated compared with many of our competitors (see Figure 46)¹⁶.

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

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

With the onset of recession, many of these cost drivers dissipated. However, there are signs that upward cost pressures are emerging again across a range of business inputs.

¹⁴ Higher inflation due to this 'convergence effect' is not, in itself, a major concern, reflecting a natural rise in the cost of domestic services justified by higher incomes and living standards. In an economy catching up with its richer neighbours, labour productivity tends to rise faster in sectors producing internationally tradable goods (particularly in capital intensive manufacturing industry) than in those involved in the more labour intensive and generally non-traded service sector. Increases in labour productivity growth in traded manufacturing industries are usually followed by wage growth throughout the economy. Thus, a combination of wage growth across both traded and non-traded sectors, but lower labour productivity gains in the services sector, leads to more rapid increases in the cost of services. In this way, services inflation is often higher in those regions of a monetary union enjoying the most rapid growth in productivity and incomes. This is known as the 'Balassa-Samuels effect'.

¹⁵ Forfás, Consumer Costs and Inflation, February 2013

¹⁶ Directorate-General for Economic and Financial Affairs, The Economic Adjustment Programme for Ireland, European Economy, Occasional Papers 76, February 2011, page 14.

Chapter 3 – Labour Costs

Figure 4: Growth in labour costs, 2001-Q2 2014

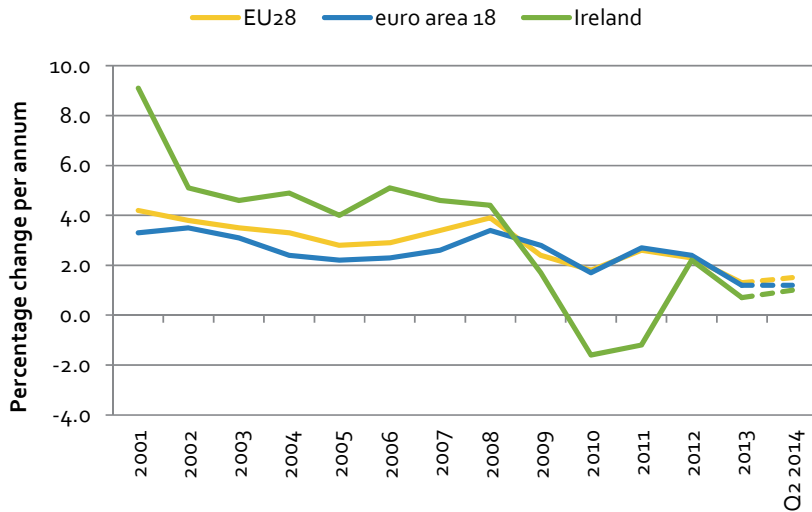
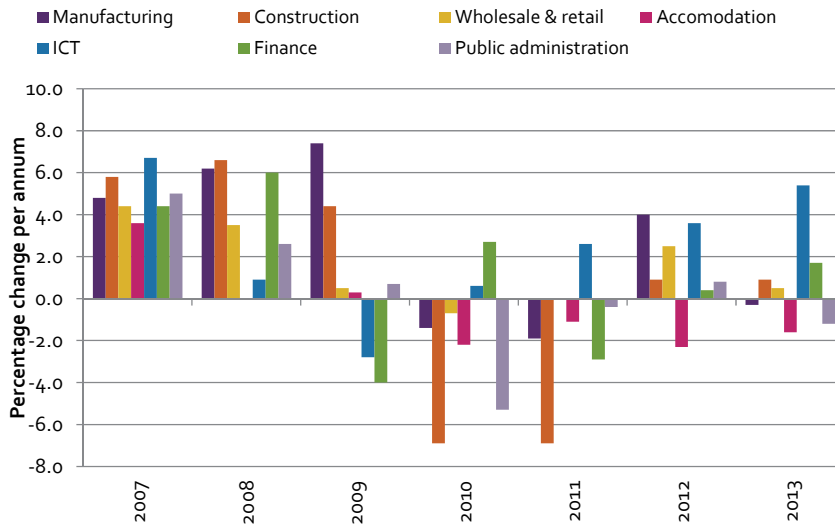


Figure 4 compares trends in labour costs in Ireland with the euro area-18 and EU-28. From a high of 9.1% growth in 2001, Irish labour costs fell in both 2010 (-1.6%) and 2011 (-1.2%). While there was a return to growth in 2012 (2.2%), growth rates were below EU and euro area averages. In 2013, wage growth in Ireland once again slowed (but remained positive) to 0.7%. In the year to Q2 2014 (represented by the broken line), Irish labour costs grew by 1%, compared with growth of 1.2% in the euro area.

Source: Eurostat

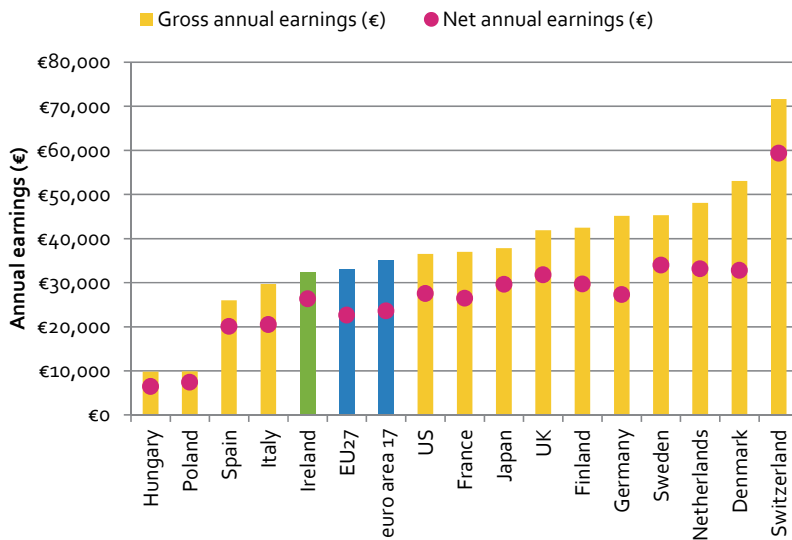
Figure 5: Average growth rate in labour costs in Ireland by sector, 2007-2013



In 2010 and 2011, average growth rates in labour costs fell across most sectors in Ireland. In 2012 growth in labour costs resumed, particularly in the manufacturing (+4%) and ICT (+3.6%) sectors. Growth slowed again in 2013, although it remained particularly strong (+5.4%) in ICT. In contrast, wages in accommodation (-1.6%) and public administration (-1.2%) both fell.

Source: Eurostat

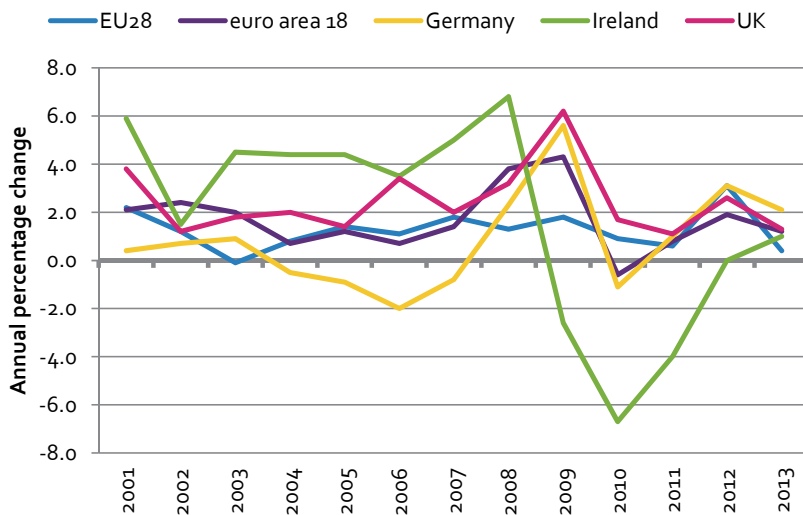
Figure 6: Average annual gross and net earnings, single individual, no children, 100% of average earnings, 2013¹⁷



Gross wages include wages, taxes on income and employer and employee social security contributions. Ireland has the 8th highest gross and net wage level in the euro area-17 (in 2008, the net wage was the 3rd highest). While gross earnings are 8% below the euro area average, net earnings are 11.6% above average, partly a result of the relatively small gap between before and after-tax wages in Ireland.

Source: Eurostat

Figure 7: Annual change in nominal unit labour costs (ULC), 2001-2013¹⁸



Between 2009 and 2011, significant reductions in nominal ULCs were recorded in Ireland, while across most of the euro area, increases were recorded, representing a competitiveness gain for Ireland. In 2012, Irish nominal ULCs remained flat and while there was an increase of 1% in 2013, growth was below the euro area average. Irish ULC growth in 2015 and 2016 is also forecast to remain below the euro area average¹⁹.

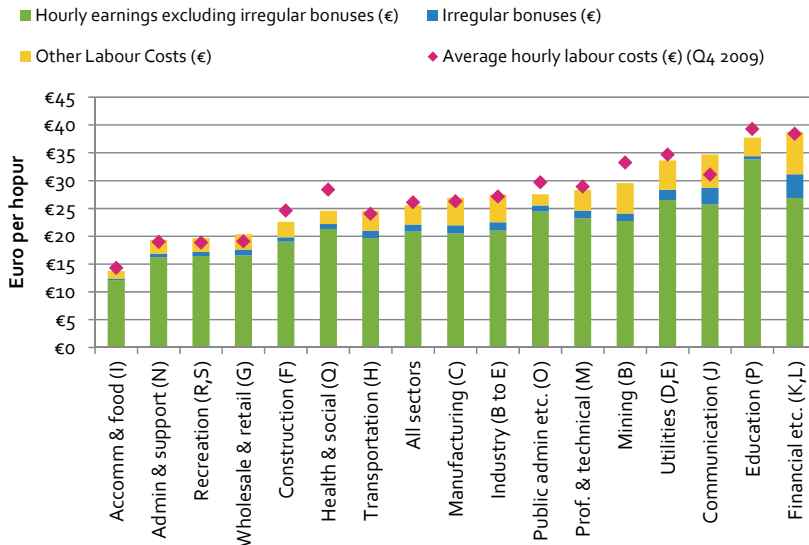
Source: Eurostat

¹⁷ EU27 and euro area 17 excludes Cyprus

¹⁸ ULCs measure the average cost of labour per unit of output. ULCs represent a direct link between productivity and the cost of labour used in generating output. Nominal ULCs are defined as total wage compensation per unit of output. This is equal to the nominal wage rate per worker divided by labour productivity. Real ULCs are derived by dividing nominal unit labour costs by the price level and are therefore identical with the wage share in GDP.

¹⁹ European Commission, European Economy 1/2015: Winter Forecast, February 2015

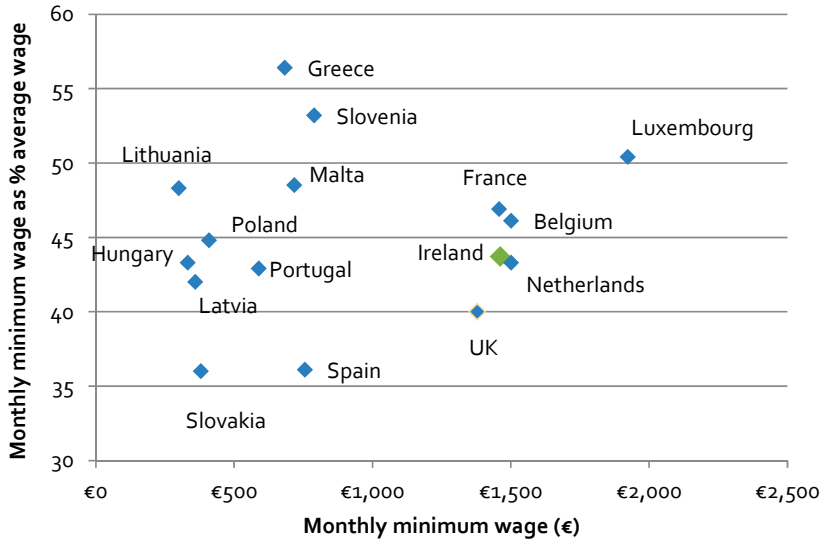
Figure 8: Average hourly labour costs in Ireland by sector, Q4 2009 – Q4 2014



Since Q4 2009, average hourly labour costs have fallen by over 2%. The construction, health and public sectors have experienced the greatest reduction in hourly labour costs²⁰. Hourly labour costs have increased in ICT (+11.7%), wholesale and retail (+6.7%), and manufacturing (+2.6) over the period. Over the last 12 months, stronger wage growth has been recorded across a wider range of sectors.

Source: CSO, Earnings, Hours and Employment Costs Survey

Figure 9: Monthly minimum wage (2015) and minimum wage as a percentage of average wage (2013)²¹



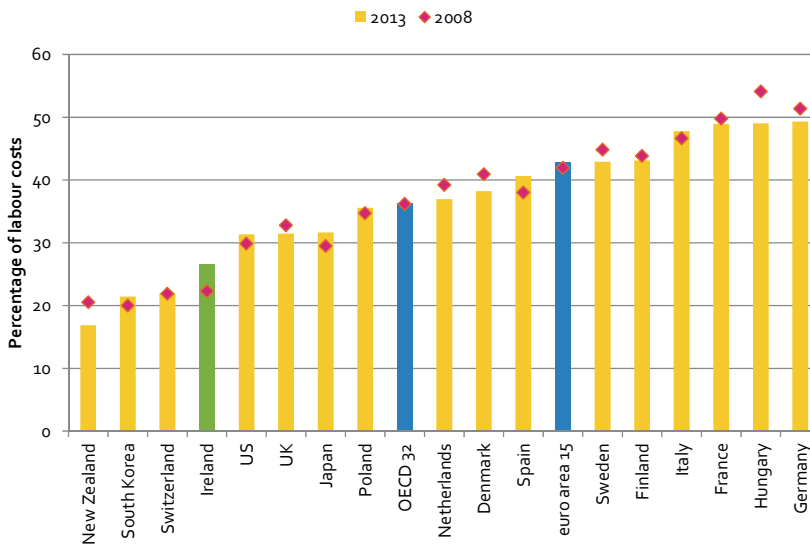
In 2013 the minimum wage as a percentage of average wages ranged from 36% in Slovakia to 56.4% in Greece. As a percentage of average wages, Ireland has the 9th highest minimum wage (out of 21 countries). Of the 21 countries for which data was available, Ireland had the 5th highest minimum wage in PPS terms and 4th highest in euro terms (€8.65).

Source: Eurostat

²⁰ Hourly labour costs are total labour costs divided by the total number of hours paid during the quarter. At the same time, both hourly and weekly earnings have fallen (hourly earnings are equal to the sum of regular earnings, irregular earnings, and overtime earnings for the quarter divided by total paid hours).

²¹ Data relating to the minimum wage as a percentage of average wages is based on the latest year available between 2011 and 2013. All data measuring monthly minimum wage levels relates to the first half of 2015 (i.e. S1 2015). It is also worth noting that many countries have sectoral and regional minimum wages in addition to national minimum wages (e.g. Denmark). Ranking of PPS data is based on data for 20 countries.

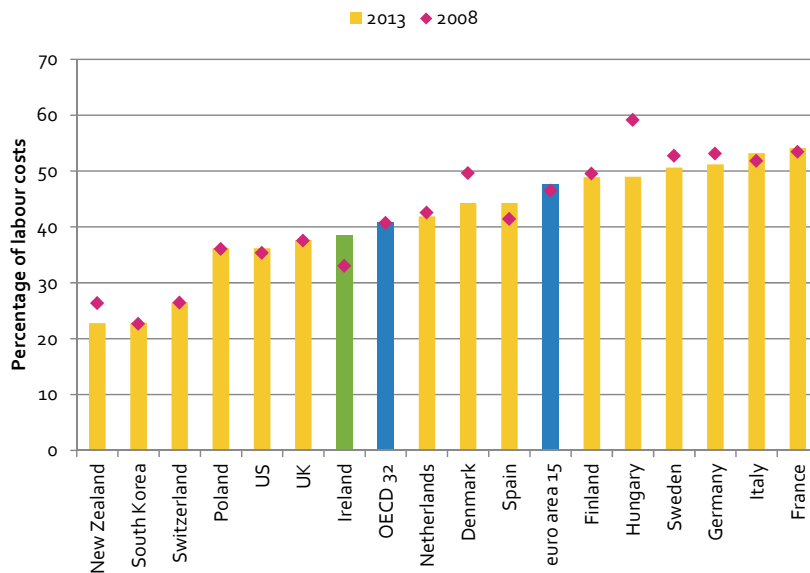
Figure 10: Average income tax plus employee and employer contributions less cash benefits – single individual earning 100% of average earnings, 2013²²



For a single person with no children on 100% of the average wage, the combined total of income tax plus social security contributions (the gap between what the employer pays and what the employee receives) is the 6th lowest in the OECD. At 25.6% it remains well below the OECD average of 36.3% (and the euro area average of 42.8%), despite the upward trend since 2008.

Source: OECD, Taxing Wages 2014

Figure 11: Average income tax plus employee and employer contributions less cash benefits – single individual earning 167% of average earnings, 2013

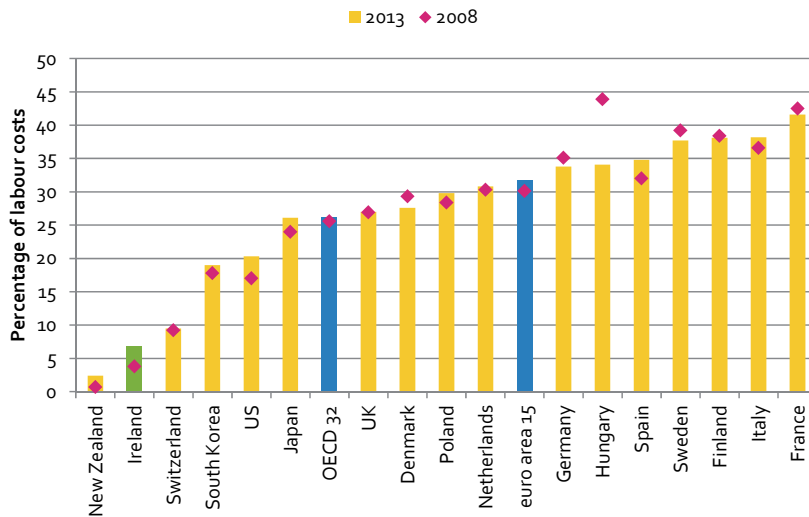


The combined total of income tax and social security contributions is the 13th lowest in the OECD for single individuals with no children earning 167% of average earnings, down from 9th lowest in 2008. For this higher income cohort, the total income tax on labour (plus social security contributions) in Ireland (38.5%) is much closer to the OECD average (40.8%), but still significantly lower than the euro area average (47.7%).

Source: OECD, Taxing Wages 2014

²² Where relevant, the Universal Social Charge is included in the Irish data. Euro area 15 excludes Cyprus, Latvia, Malta and Lithuania

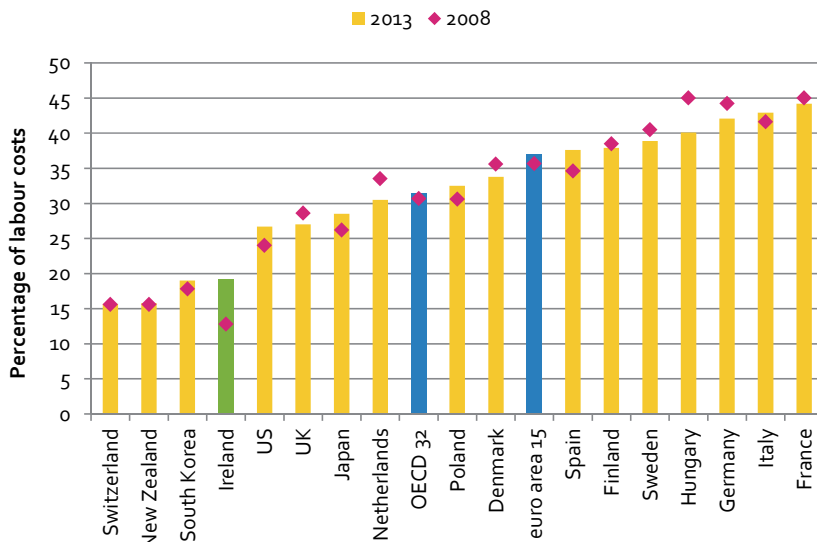
Figure 12: Average income tax plus employee and employer contributions less cash benefits – married couple with two children, 100% of average earnings, 2013



For married couples with two children, the total average rate of income tax plus social security contributions is much less pronounced at 6.8%. At this income level, Ireland had the second lowest average rate in the OECD for this family cohort. This ranking remained unchanged relative to 2008, although the rate has increased from 3.8%.

Source: OECD, Taxing Wages 2014

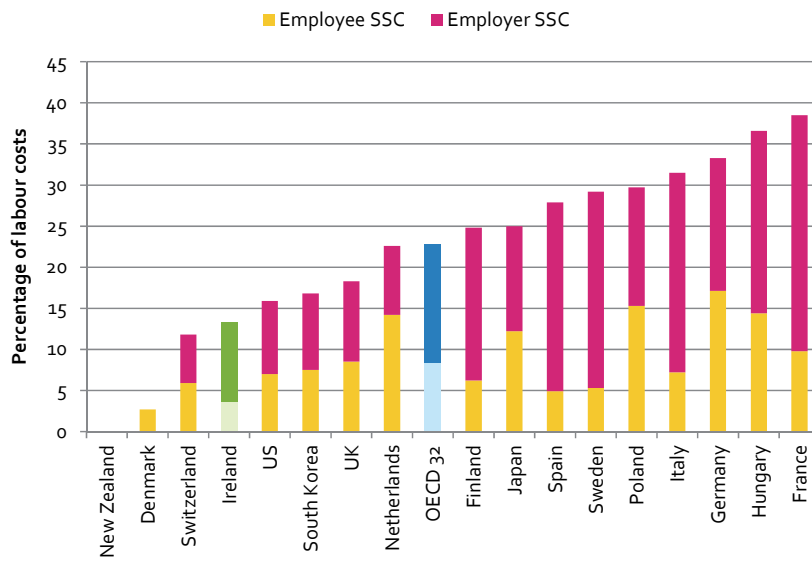
Figure 13: Average income tax plus employee and employer contributions less cash benefits – married couple with two children, 100%-67% of average earnings, 2013



19.2% of labour costs for a married couple with two children earning 167% of average earnings (i.e. the first earning 100% and the second earning 67% of average earnings) were accounted for by income tax and social security contributions. This is up from 12.8% in 2008. This is below the OECD average of 31.4% (and euro area average of 36.9%). As a result, the gap between the cost to the employer and net take home pay is now the 6th lowest in the OECD (it was 2nd lowest in 2008).

Source: OECD, Taxing Wages 2014

Figure 14: Employer and employee social security contributions, 2013

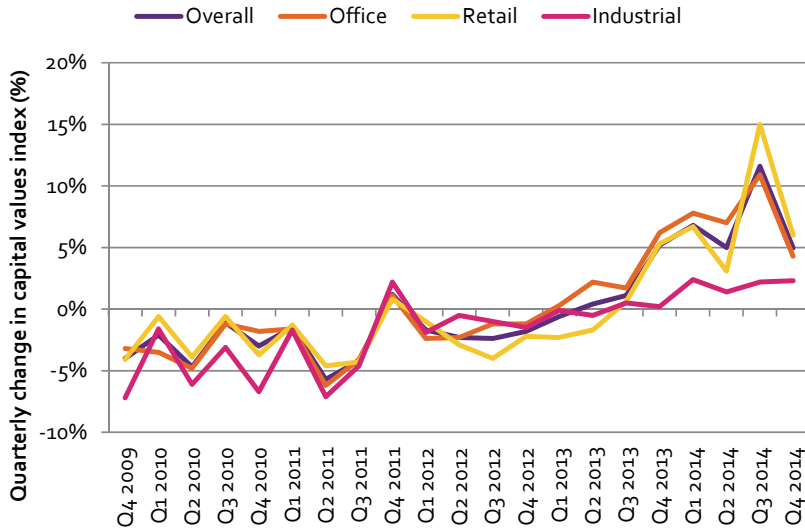


Ireland has the 8th lowest rate of total social contributions in the OECD-32. Employer's social security contributions are the 11th lowest, while employee contributions are the 6th lowest. In many countries, however, there is either a cap on employer social security costs or a reduced rate above a certain income threshold. In Ireland, a flat rate is charged on the full salary: as salaries increase, Ireland's competitive position is quickly eroded.

Source: OECD, Taxing Wages 2014

Chapter 4 – Property Costs

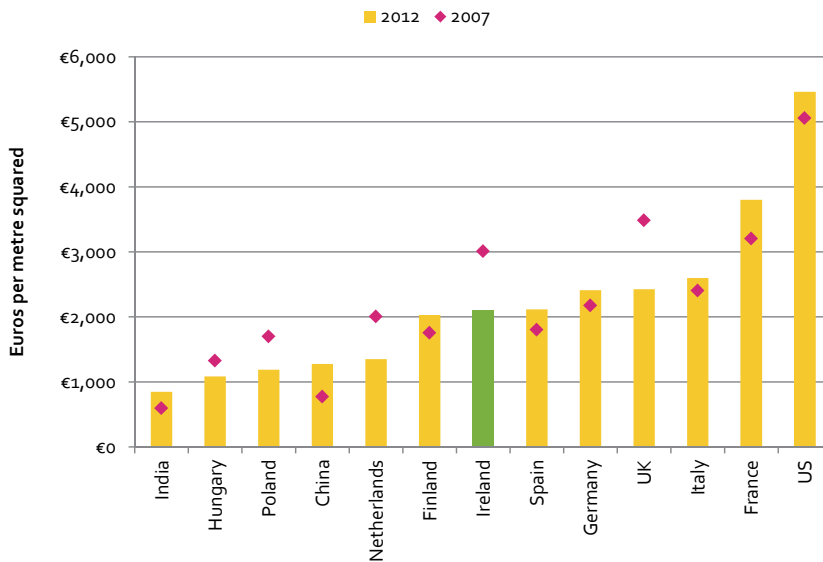
Figure 15: Quarterly change in capital values in Ireland, 2009-2014



This indicator illustrates the change in capital values in Ireland for a range of commercial property classes. Since Q3 2013, values across all categories have consistently increased. While growth was volatile on a quarterly basis, overall values increased by 31.4% over the year to Q4 2014, driven by strong growth in retail and office values.

Source: Jones Lang LaSalle, Irish Property Index

Figure 16: Cost of constructing a prime office unit, € per square metre²³, 2012

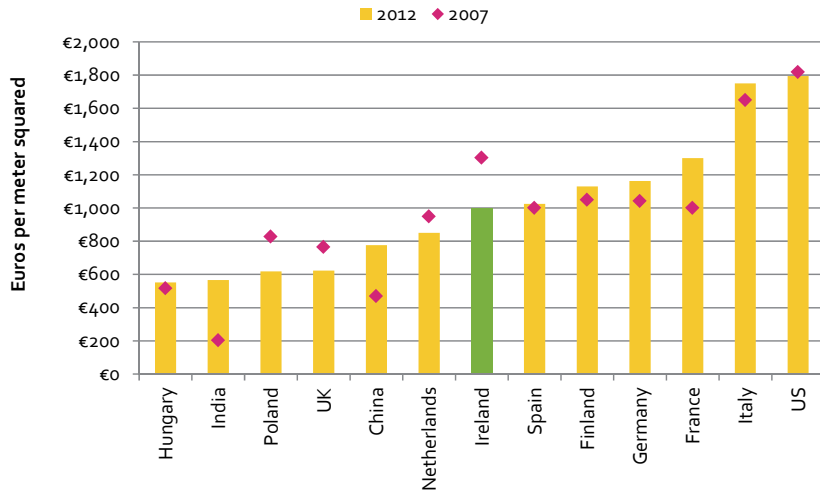


Construction costs data takes account of building, labour and material costs. The cost of constructing a prime office unit in Ireland has fallen by 30% since costs peaked in 2007. Amongst the locations surveyed Ireland was the 7th most expensive location (out of 13) to construct a prime office unit in 2012, compared to 4th most expensive in 2007.

Source: Gardiner and Theobald, International Construction Cost Survey

²³ Prices quoted are the upper boundary of the cost of the constructing a prime office unit. A prime office unit refers to a city centre, self-contained building of a size and height typical of major cities in a country; building costs include for accommodation to a good finish with raised floors, carpet, suspended ceilings, air conditioning, lighting and power, but excluding partitioning.

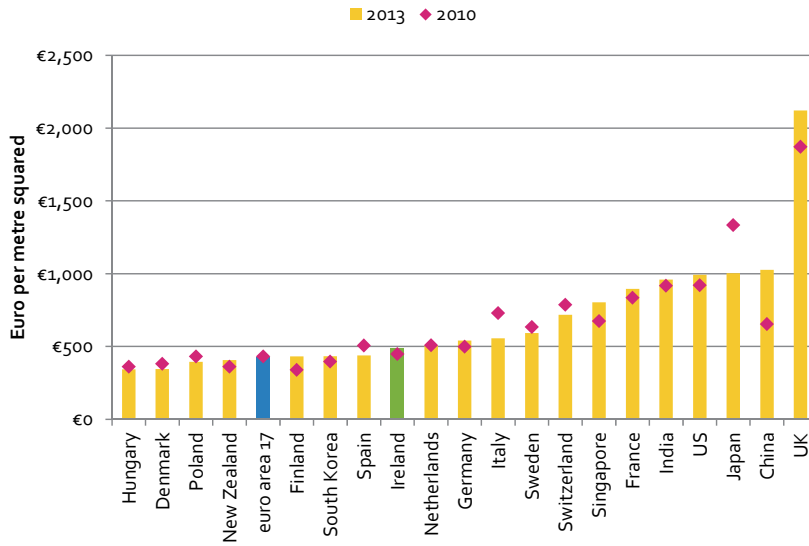
Figure 17: Cost of constructing a prime industrial unit, € per square metre²⁴, 2012



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

Source: Gardiner and Theobald, International Construction Cost Survey

Figure 18: Cost of renting a prime office unit, € per square metre per year²⁵, 2013



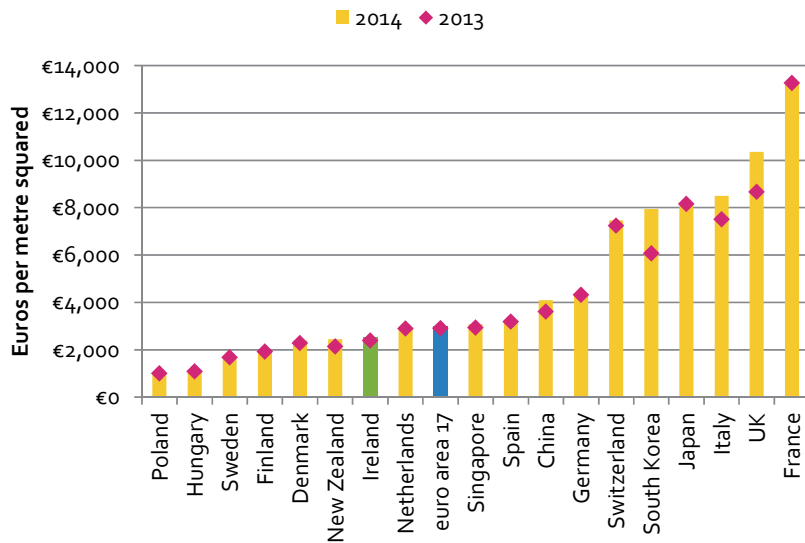
Office rents on new leases in Dublin fell by 47% between their peak in 2007 and 2012. The majority of this decline was realised early in the recession. Thereafter prices stabilised. Between 2012 and 2013, however, rents began to rise again and an 11% increase was recorded. In 2013, Ireland was the 6th most expensive location in the euro area. As set out in Figure 15, rents have continued to grow strongly.

Source: Cushman and Wakefield, Office Space Across the World, 2014

²⁴ Prices quoted are the upper boundary of the cost of the constructing an industrial unit. An industrial unit for the purposes of this data is referred to as a large single-storey unit of steel portal frame and profiled aluminium cladding, with an eaves height of at least 6m, on an out-of-town site, finished to a basic shell with services and heating to the office space.

²⁵ Euro area 17 excludes Cyprus and Malta

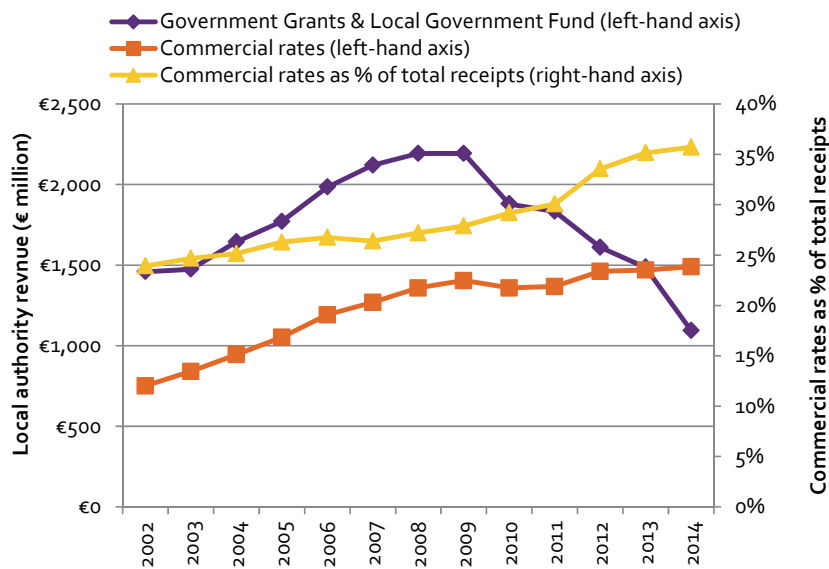
Figure 19: Cost of Renting a Prime Retail Unit, € per square metre per month²⁶, 2014



While trading conditions and occupier activity improved across Europe in 2014, rents remained relatively stable. In Ireland, prime retail rents increased by 6% over the year, with strong increases recorded in Galway and to a lesser degree, Dublin. Ireland was the 7th most expensive location in the euro area and rents range from €500 per square metre in O’Connell Street Limerick to €4,500 in Grafton Street, Dublin.

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

Figure 20: Commercial rates, receipts from central government, and rates as a percentage of total local authority revenue, 2002-2014



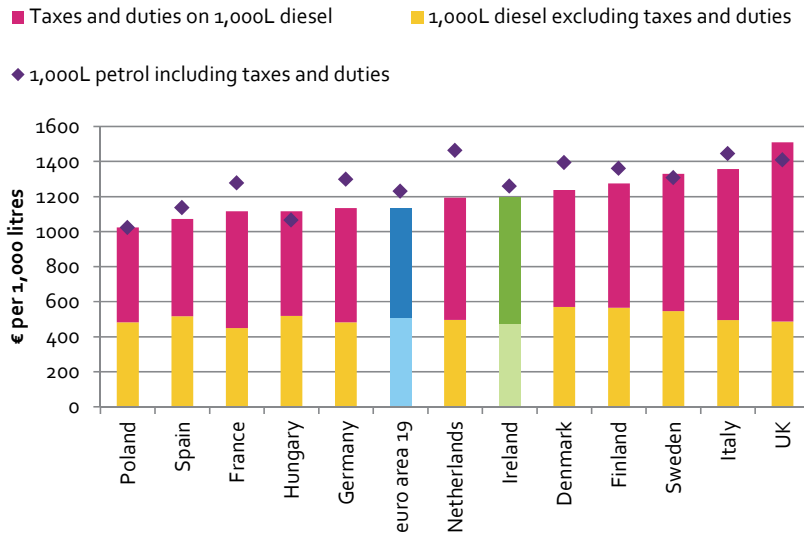
The revenue collected by Local Authorities through commercial rates has doubled over the period 2002 to 2014 (the bulk of this growth occurred between 2002 and 2009). As a proportion of total Local Authority revenue, commercial rates grew from 24% in 2002 to 36% in 2014. At the same time, the proportion of revenue received from Central Government fell from 46% to 26%.

Source: Department of the Environment, Community and Local Government

²⁶ The chart is based on the most expensive retail location in each country, and uses data collected in September 2014. Data for retail rents relates to the expected rent obtainable on a standard unit and/or shopping centre in a prime pitch in 330 locations across 65 countries around the world. Rents in most countries are supplied in local currency and converted to a common currency for purposes of international comparison. Data for Ireland is based on rents for Grafton St. in Dublin. The chart excludes data on the US (New York - €29,822 per metre squared) for presentational purposes.

Chapter 5 – Transport Costs

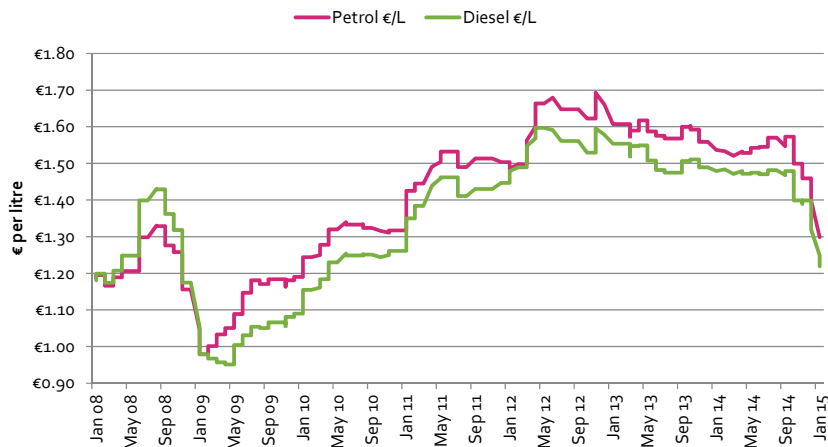
Figure 21: Diesel and petrol costs per 1,000 litres, February 2015



Some sectors are more sensitive to fluctuations in fuel costs than others (e.g. the haulage industry). The cost of 1,000 litres of diesel in Ireland (€1,199) was 5.5% above the euro area-19 average (€1,136) in February 2015, making Ireland the 4th most expensive country. Taxes levied on diesel account for a significant proportion of the cost differential – making up 60.3% of total diesel costs in Ireland, the 3rd highest proportion in the euro area.

Source: European Commission, Energy Statistics & Market Observatory

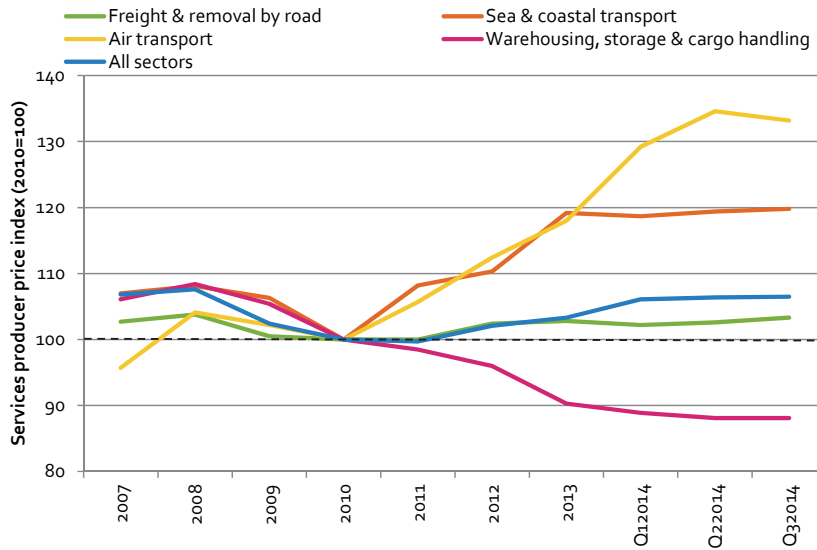
Figure 22: Average diesel and petrol costs per litre in Ireland, 2008-2015



The fall in oil prices in global commodities markets in 2014 has led to a reduction in consumer prices for petroleum products across the EU. In Ireland, petrol and diesel prices decreased by 10% and 11% respectively in the 12 months to December 2014. Government taxes and duties account for 67% of the petrol price in Ireland – more than the euro area average of 63.5%.

Source: European Commission, Energy Statistics & Market Observatory

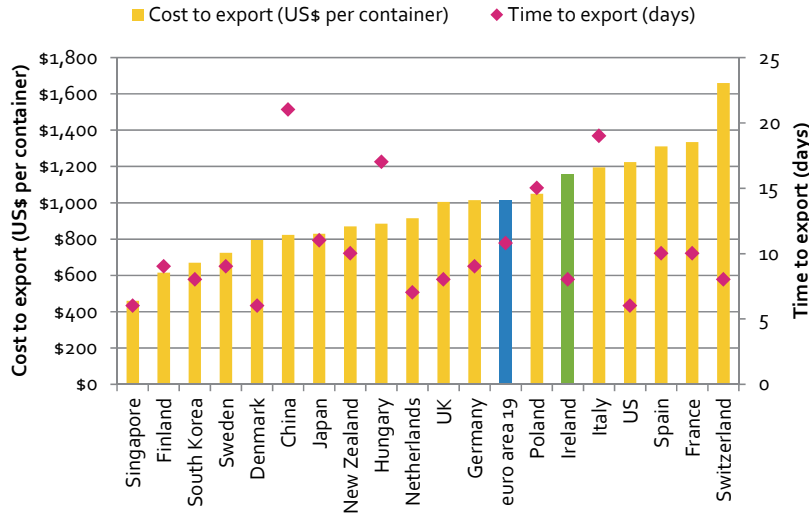
Figure 23: Trends in Transport Related Prices In Ireland, 2007-Q3 2014



In the 12 months to quarter 3 2014, overall services prices were 2.9% higher. In the transport sector, prices have been relatively stable in recent quarters. Air transport is the notable exception: prices in Q3 2014 were 12.4% higher than in Q3 2013. Following significant increases between 2011 and 2011, prices for sea and coastal transport appear to have stabilised.

Source: CSO, Services Producer Price Index

Figure 24: Administrative costs and time to export²⁷, 2014



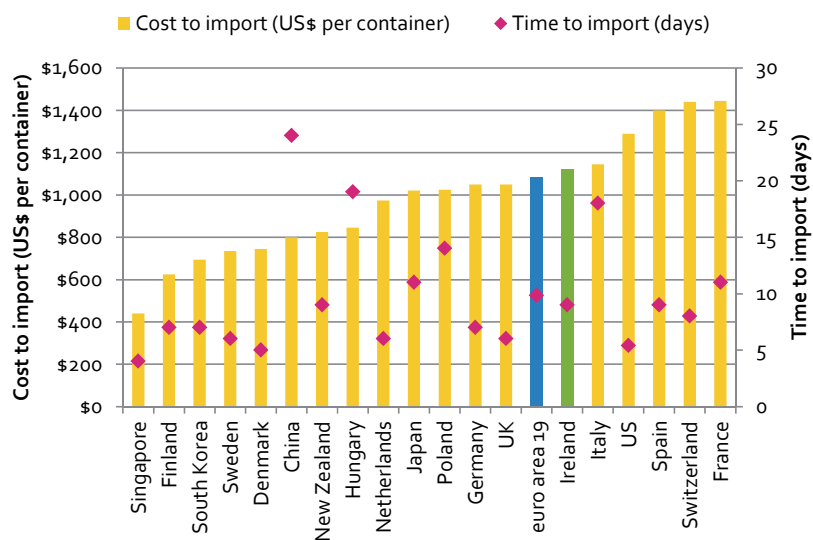
The ease and cost of customs and administrative procedures has a significant impact on trade flows. Compliance costs to export a 20-foot container (\$1,160) remain unchanged in Ireland since last year. These costs, however, are more expensive than in the euro area (\$1,015). It takes 8 days to complete the required procedures in Ireland – amongst the quickest in the euro area²⁸.

Source: World Bank, Doing Business 2015

27 The World Bank's Doing Business index measures the time and cost (excluding tariffs) associated with exporting and importing a standardized cargo of goods by sea transport. The time and cost necessary to complete 4 predefined stages (document preparation; customs clearance and inspections; inland transport and handling; and port and terminal handling) for exporting and importing the goods are recorded; however, the time and cost for sea transport are not included. All documents needed by the trader to export or import the goods across the border are also recorded. The most recent round of data collection was completed in June 2014.

28 There is some concern that future shortages of suitable refrigerated containers could represent a potential constraint on the growth of sectors such as agri-food.

Figure 25: Administrative Costs and Time to Import 2013

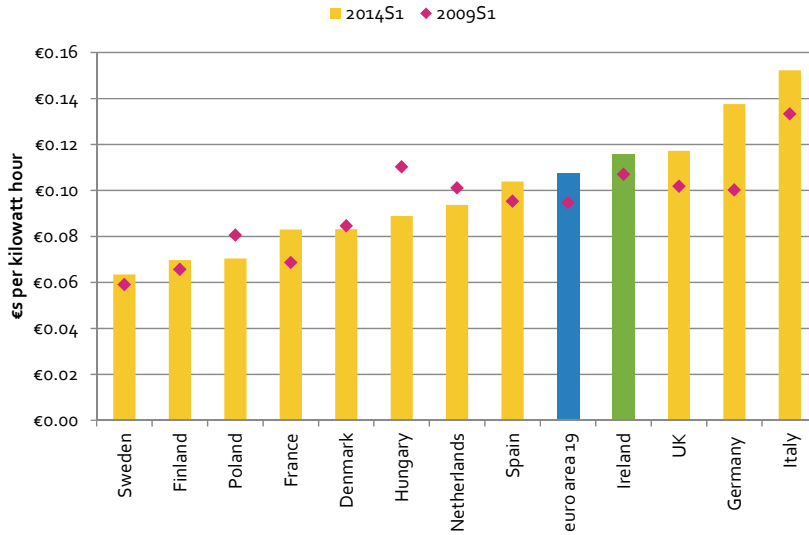


In terms of the cost of importing, Irish costs have remained constant since 2010 (\$1,121 per container). The time taken to complete the necessary procedures, however, has been reduced from 10 days to 9 days since last year. While costs are slightly higher than the euro area average (\$1,082), the time taken in Ireland is below the euro area average (10 days).

Source: World Bank, Doing Business 2015

Chapter 6 – Utility Costs

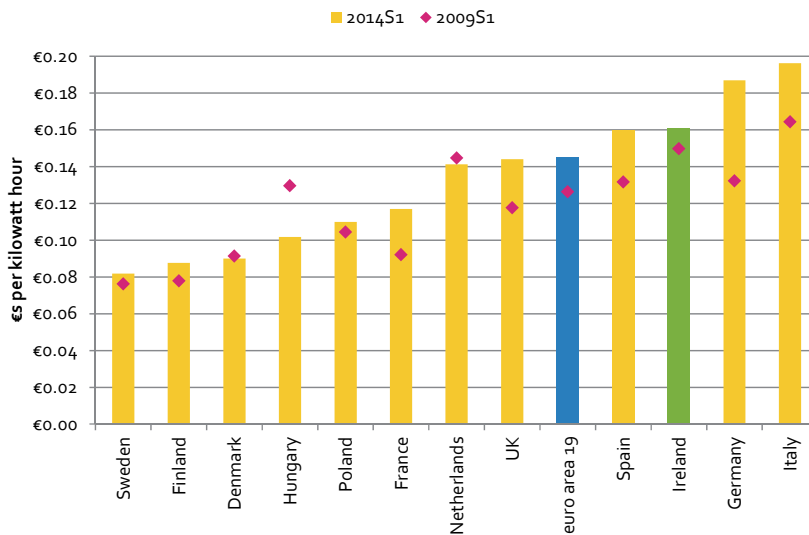
Figure 26: Industrial electricity prices for large energy users²⁹ (excluding VAT), S1 2014



In 2014, industrial electricity prices for larger energy users in Ireland were 7.8% higher than the euro area average, Ireland is the 6th most expensive location in the euro area. Prices in 2014 are 8.2% higher than prices in 2009.

Source: Eurostat-Environment and Energy

Figure 27: Industrial electricity prices for SMEs (excluding VAT)³⁰, S1 2014



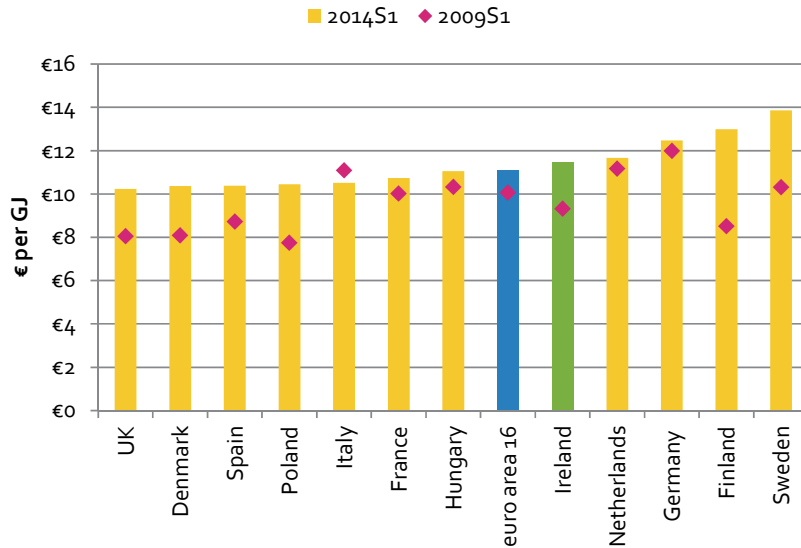
At €0.1607 per kilowatt hour, industrial electricity prices for SME energy users in Ireland are 10.8% higher than the euro area average, making Ireland the 6th most expensive location. Since 2009, Irish prices have increased by just over 7% - this is less than the average increase across the euro area over the same period (14.7%).

Source: Eurostat-Environment and Energy

²⁹ Electricity prices for large users are based on an annual consumption of 2,000 to 20,000 MWh (Band ID). Data refer to half-yearly prices for each year. S1 represents the first six months of the year. Prices exclude VAT and other recoverable taxes and levies. Euro area averages are based on a simple average for all 19 countries.

³⁰ Electricity prices for SMEs are based on an annual consumption of 20 and 500 MWh (Band IB). Prices exclude VAT and other recoverable taxes and levies.

Figure 28: Industrial gas prices for (excluding VAT)³¹, 2014



In 2014 the cost of industrial gas in Ireland was the 9th highest in the euro area 16 (and 3% above the average euro area price). The UK provided 91% of Ireland's gas demand in 2012/13.

Source: Eurostat-Environment and Energy

Figure 29: Business water service costs in Ireland by Local Authority³², 2014

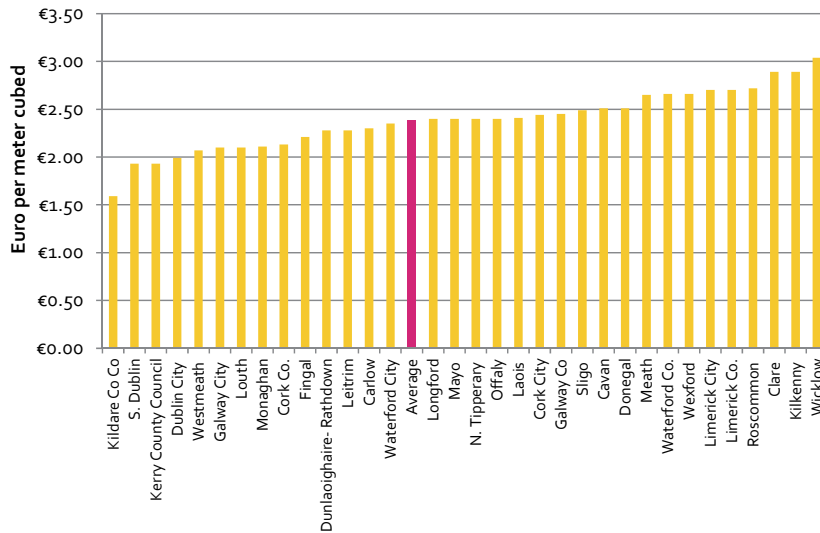


Figure 29 shows the combined (water and waste water) charge per cubic meter of water across Irish Local Authorities. The average cost of water for business in Ireland is €2.38 per metre cubed - an increase of 39% since 2007. Wicklow is the most expensive location for water services at €3.04 compared to just €1.59 in Kildare.

Source: Local Government Management Agency

³¹ Based on band I3: 10 000 GJ < Consumption < 100 000 GJ. Euro area 16 excludes Cyprus, Greece and Malta. Prices are based on data for the first half of the year (S1).

³² Due to the limited information on the tariff/consumption profiles of non-domestic users available when the CER undertook its review of water tariffs in 2014, it was decided to defer designing the new tariff framework until that information is available. Non-domestic tariff arrangements as set by the local authorities prior to 1st January 2014 will apply until the CER approves the new tariff framework. It is expected that the new tariff framework will be developed during 2015.

Figure 30: Water services costs³³, 2013

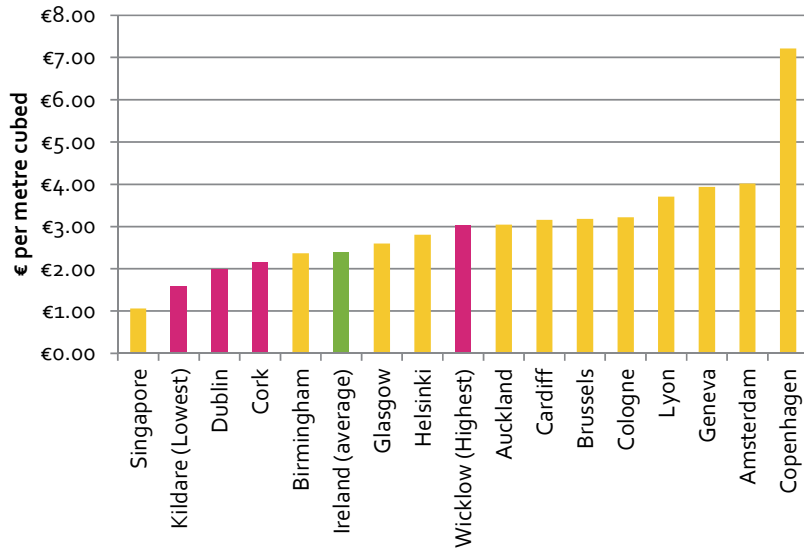
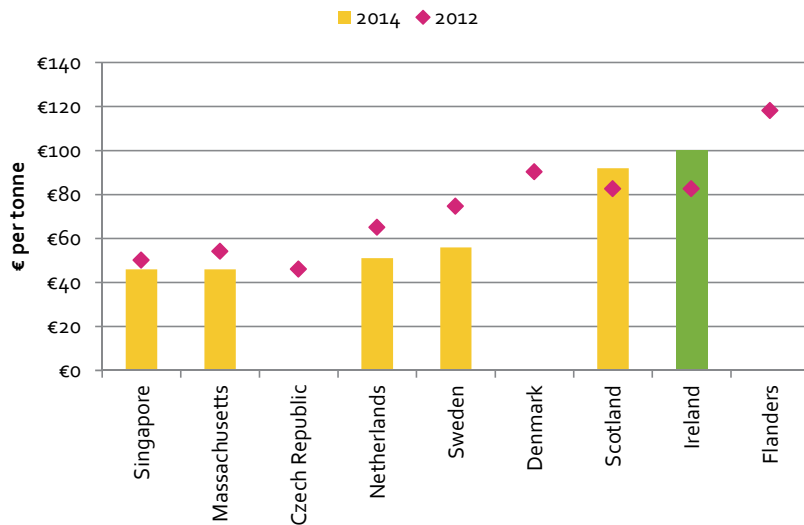


Figure 30 places Irish water and waste water costs for industrial users into an international context – data for Dublin, Cork and the cheapest, average and most expensive locations in Ireland is compared with similar data for a range of comparators. On average, water and waste water costs in Ireland compare favourably to those in competitor markets.

Source: DKM/ RPS Consulting for DJEI

Figure 31: Non-hazardous thermal treatment gate fees³⁴, € per tonne, 2014



Until very recently, landfill had dominated waste treatment in Ireland. However, our reliance on landfill is at its lowest rate in the history of the State. The importance of thermal treatment (incineration) is growing. Thermal treatment costs (gate fees) in Ireland are amongst the most expensive in the benchmarked countries/regions.

Source: RPS Consulting for DJEI

³³ Data for Dublin relates to Dublin City Council; data for Birmingham is based on > 50,000 m³ annual water consumption in May-Sept and 50,000-249,000m³ waste water annual consumption; data for Glasgow is based on > 25,000 m³ annual water consumption 23,750m³ waste water annual consumption; data for Auckland is based on 10,000-88,310 m³ annual waste water consumption; data for Cardiff is based on 50,000 -99,000 m³ annual water consumption; data for Brussels is based on >5,000 m³ annual water consumption.

³⁴ Note that 2014 data was not available for the Netherlands, Singapore or Sweden - 2013 data is used instead. Neither 2013 nor 2014 data was available for the Czech Republic or Denmark. The 2012 fee for Denmark includes a levy of €44 per tonne. Data for Ireland 2012 and 2014 is based on a simple average of price range data.

Figure 32: Business DSL and cable basket (>10 Mbps), €s per Month excluding VAT, September 2013³⁵

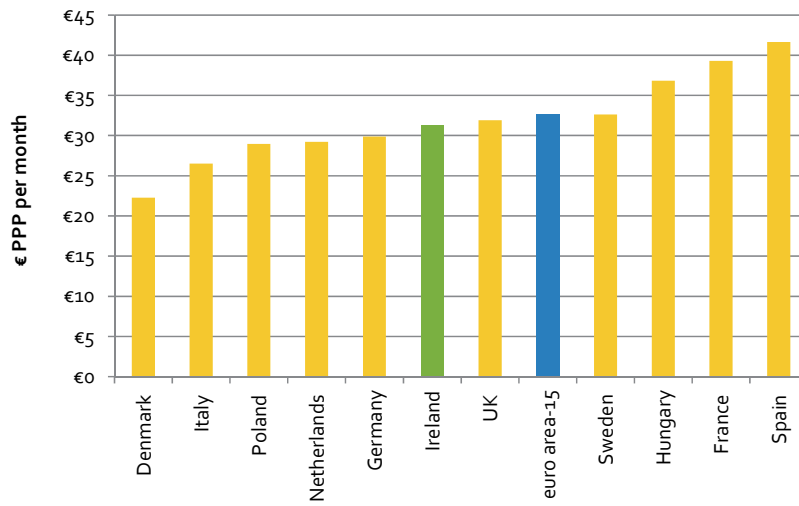


Figure 32 shows the lowest monthly business pricing for DSL and cable in the >10 Mbps speed category. Ireland is the 5th most expensive country amongst the euro area-14; costs in Ireland are 13% above the euro area-14 average. It should be noted that PPP data (data adjusted to take account of differences in cost of living) exaggerates Ireland's competitiveness³⁶.

Source: ComReg

Figure 33: Post-pay business mobile broadband, €s per month excluding VAT, August 2013³⁷

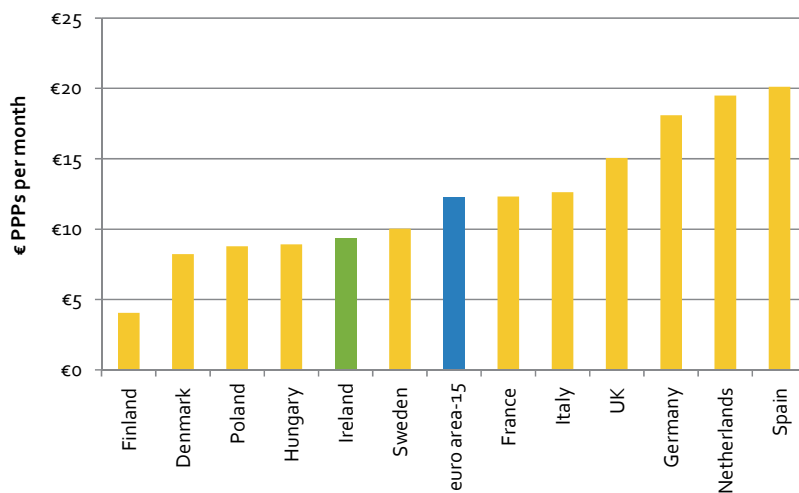


Figure 33 compares the price of a post-paid business mobile broadband basket across a range of countries. Ireland appears cost competitive on this metric. It is the 6th cheapest amongst the 15 euro area countries benchmarked (in PPP terms) and is 23% cheaper than the euro area average. It should be noted that PPP data exaggerates Ireland's competitiveness.

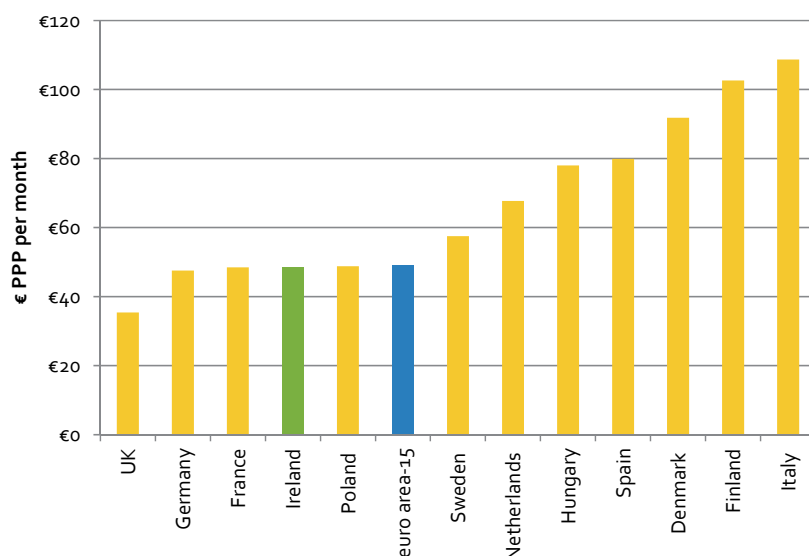
Source: ComReg

³⁵ Euro area 15 excludes Cyprus, Finland, Latvia and Lithuania

³⁶ Non-PPP price data is not currently available for the telecommunications indicators.

³⁷ Euro area 15 excludes Cyprus, Latvia, Lithuania, and Malta

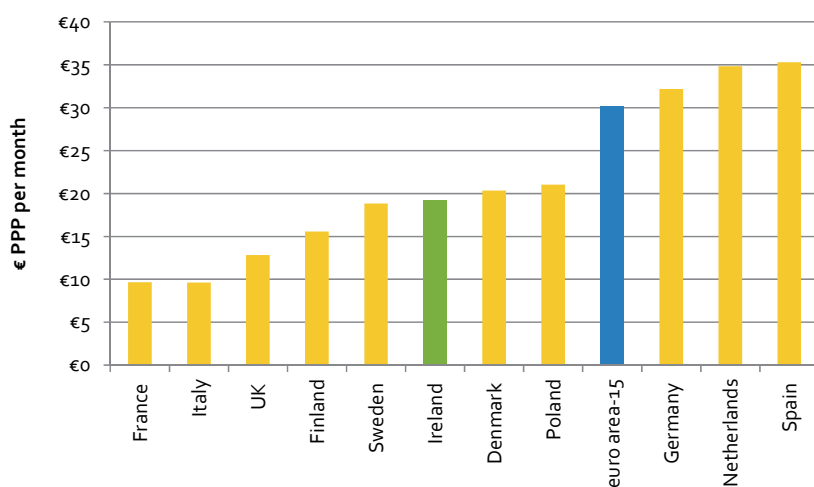
Figure 34: PSTN business basket of calls (260 calls), €s per month excluding VAT, August 2013³⁸



In August 2013, the cost of a business basket of calls in Ireland (in PPP terms) was marginally below the euro area-15 average. Ireland was the 5th cheapest location in the euro area for a business basket. It should be noted that PPP data exaggerates Ireland's competitiveness.

Source: ComReg

Figure 35: Monthly mobile telephone costs, high usage post-paid basket, €s per month, August 2013³⁹



The monthly cost of a high usage mobile basket (300 calls) in Ireland was the 5th cheapest (in PPP terms) amongst the 15 euro area countries benchmarked, 36% below the euro area average. The mobile market represented approximately 74.1% of all voice and internet subscriptions (fixed and mobile) in Ireland. It should be noted that PPP data exaggerates Ireland's competitiveness.

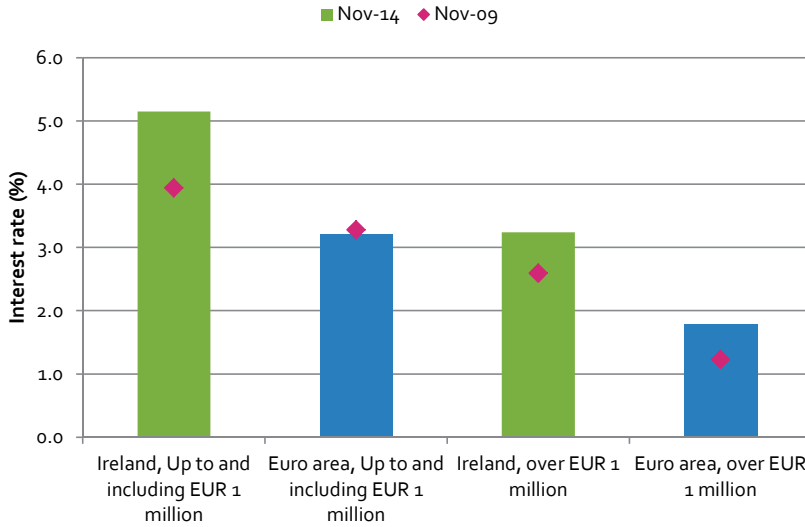
Source: ComReg

³⁸ This metric includes a fixed charge for access as part of a bundled service. Euro area 15 excludes Cyprus, Latvia, Lithuania and Malta.

³⁹ The basket also includes 225 SMS per month. Euro area 15 excludes Cyprus, Latvia, Lithuania and Malta.

Chapter 7 – Credit and Financial Costs

Figure 36: Interest rates for non-financial corporations (new business) by loan size, November 2014



Irish interest rates on business loans have been consistently higher than equivalent euro area rates. In November 2014, loans of up to €1 million (often used as a proxy for the rate applying to SME loans) are 60% more expensive in Ireland compared the euro area, and this differential has increased from 31.5% in 2013 and 20% in 2009. In 2014, loans of over €1 million are 81% more expensive in Ireland.

Source: European Central Bank

Figure 37: Interest rates for non-financial corporations (new businesses) by loan size, January 2009- November 2014

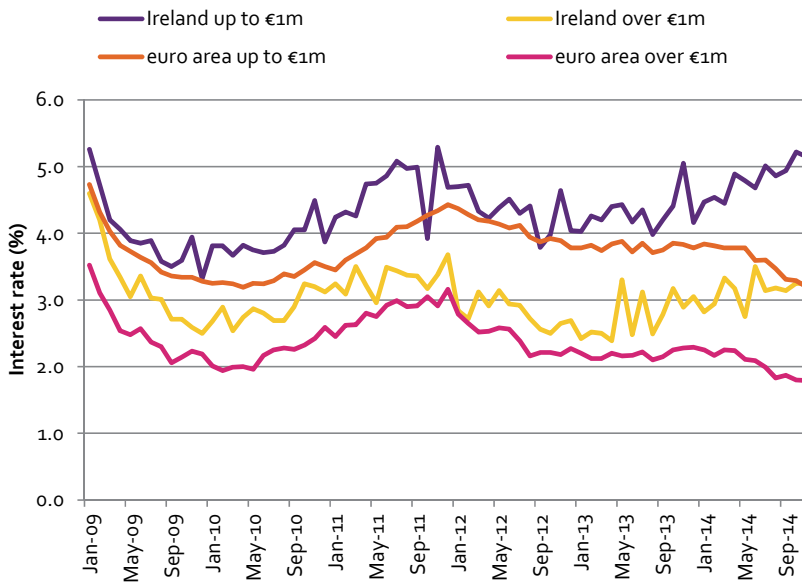


Figure 37 compares the interest rates for non-financial corporations in Ireland and the euro area over a 5 year period. Over the period in question, Irish rates have tended to be higher and more volatile than euro area rates. Irish and euro area rates diverged further in 2014 for loans both less than and more than €1 million.

Source: European Central Bank

Figure 38: Revolving loans and overdraft interest rates for non-financial corporations, November 2010- November 2014

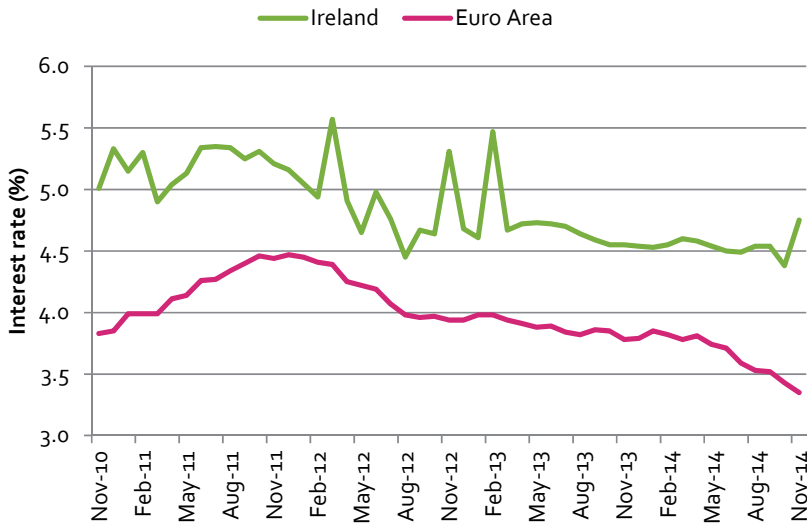
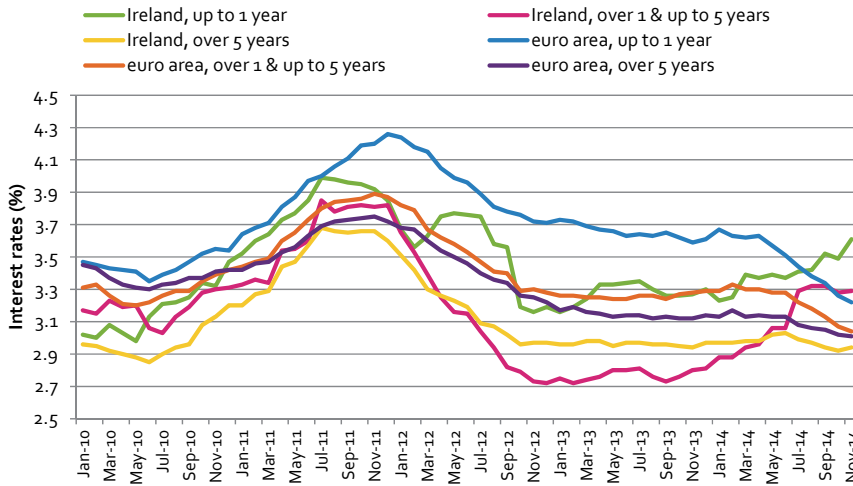


Figure 38 highlights the continuing difference between Irish and euro area interest rates for revolving loans and overdrafts. As of November 2014 Irish interest rates were 42% higher than the euro area. On average, Irish rates in the past three years have been 0.82 basis points higher than the euro area average.

Source: European Central Bank

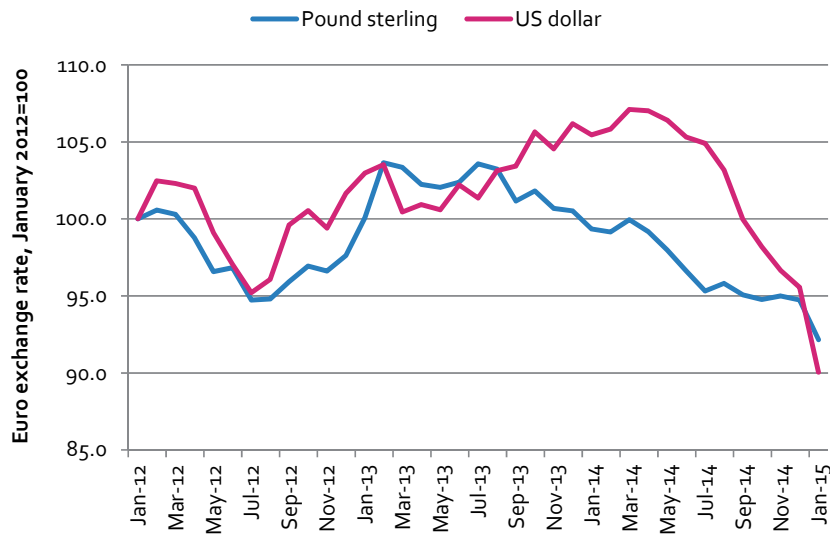
Figure 39: Retail interest rates (%), outstanding amounts by loan size, November 2010- November 2014



There is a strong level of convergence between retail interest rates in Ireland and the euro area, for loans of 1 year, 1 to 5 years and over 5 years' duration. These three categories accounted for €66 billion in outstanding loans in November 2014. The value of outstanding loans has decreased by 27% since 2013 as corporations repay outstanding debts.

Source: European Central Bank

Figure 40: Euro/pound sterling and euro/dollar exchange rate, January 2012 – January 2014

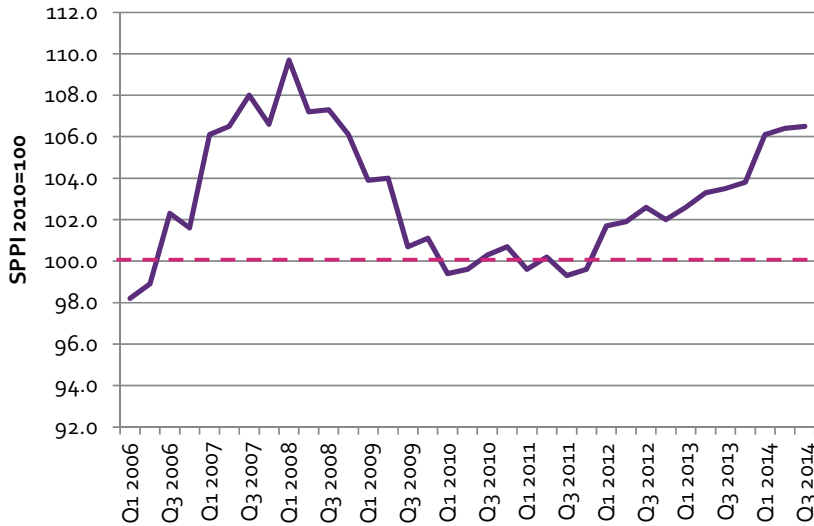


Between mid-2012 and early 2014, the euro appreciated in value, particularly against the dollar. Since then (and since mid-2013 in the case of sterling), renewed euro weakness has boosted Irish competitiveness. Given the importance of both the UK and US markets as destinations for Irish exports, changes in the value of the euro have a significant impact upon Irish competitiveness and on Irish based exporters.

Source: Eurostat

Chapter 8 – Business Services and Other Input Costs

Figure 41: Services producer price index⁴⁰, Q1 2006-Q3 2014



The SPPI measures changes in the average prices charged by domestic service producers to other businesses for a selected range of services. Since the end of 2011, the price of a range of business services has generally been increasing. This follows a period of significant price declines over the course of the recession. As of Q3 2014, prices were 6.5% above 2010 levels.

Source: CSO, Services Producer Price Index (SPPI)

Figure 42: Comparison of business services prices and wholesale manufacturing prices, 2010-Q4 2014

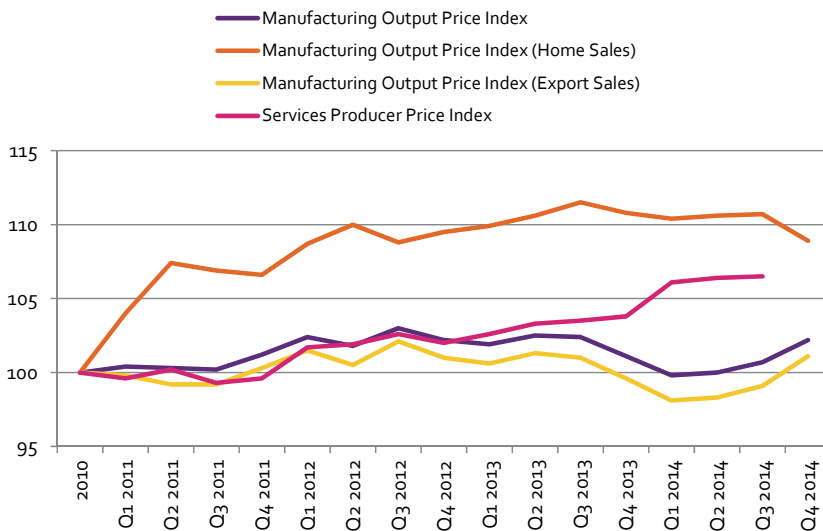
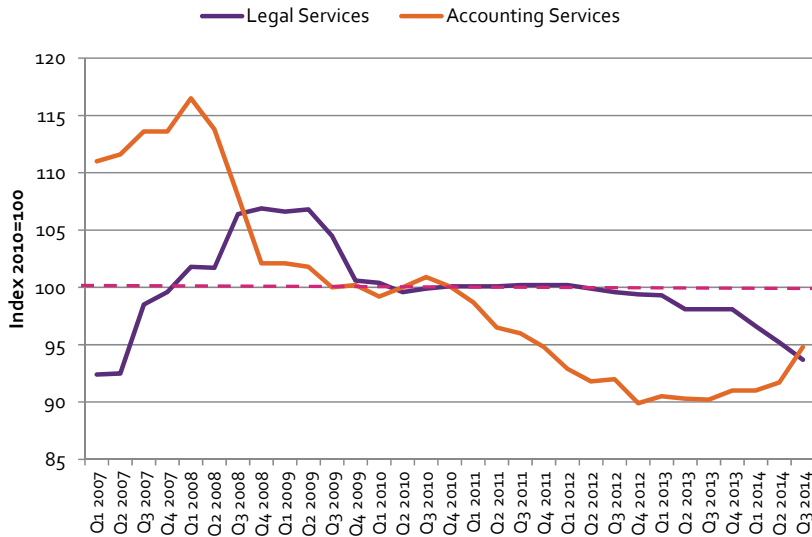


Figure 42 compares the evolution of prices for manufacturing products and services – both of which input into the overall cost base for enterprise. Overall since 2010, service prices have risen by more than manufacturing prices. Manufacturing products sold within Ireland, however, have increased at faster pace than both services and internationally traded manufacturing products (i.e. exposed to competition).

Source: CSO, Services Producer Price Index & Wholesale Price Index

⁴⁰ The SPPI is an experimental data set and the indices are still under development. In most cases the services measured are provided to business customers only and so individual price indices should not be considered indicative of more general price trends in the economy. The index covers transaction costs from business to business and excludes consumers who are covered in the Consumer Price Index (CPI). Individual price indices are aggregated together to create a "service industry" index that is limited in coverage.

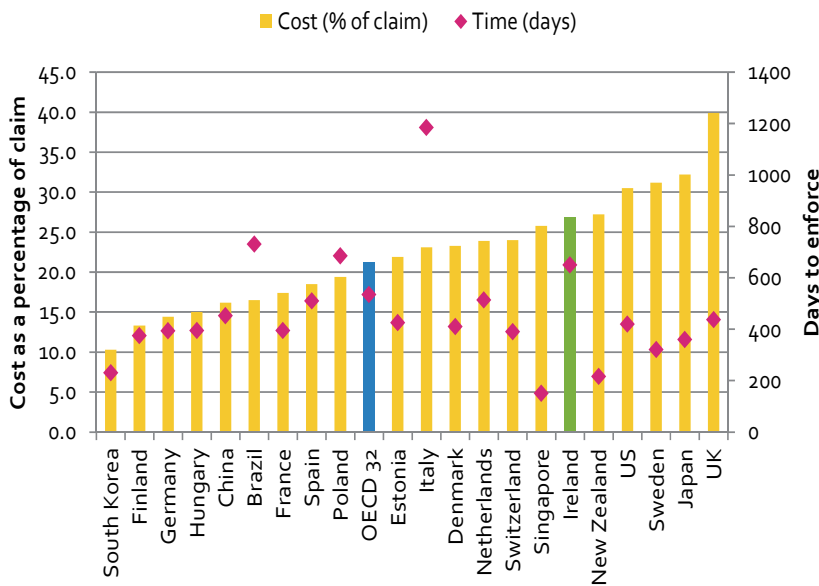
Figure 43: Accountancy and legal services⁴¹ costs, Q1 2007-Q3 2014



This indicator examines the evolution of accountancy and legal costs. Following a long period of steady decline, the cost of accountancy services has begun to increase in recent quarters (although prices remain more than 5% below 2010 levels). Reported legal service costs (solicitor fees) have fallen in late 2013 and the first 3 quarters of 2014 and are now 6.3% below 2010 levels.

Source: CSO, Services Producer Price Index

Figure 44: Legal fees – the cost of enforcing a business contract, 2014

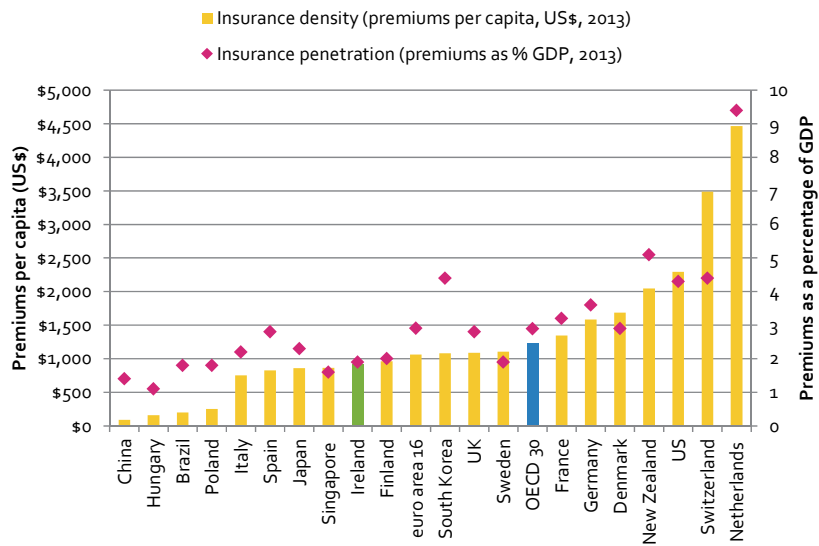


Ireland is an expensive location to enforce a business contract (ranked 9th most expensive in the OECD-32). The World Bank estimates that the total cost of contract enforcement in Ireland amounts to 26.9% of a claim, compared with 21.2% in the OECD. It also takes significant time to enforce a contract in Ireland – the 6th longest in the OECD.

Source: World Bank, Doing Business 2015

⁴¹ Note that the legal services data is based on 16 respondents to the CSO survey and 96 separate price observations.

Figure 45: Non-life insurance density and penetration⁴², 2013



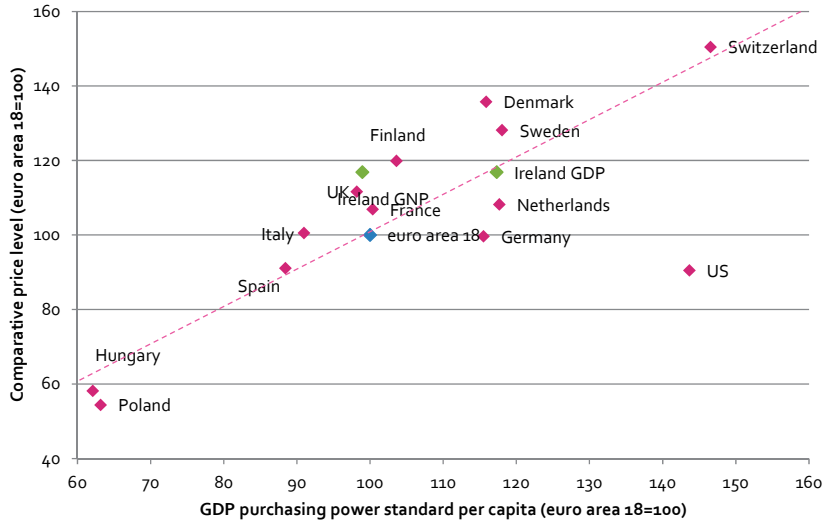
High insurance density (premiums per capita) can be a function of both high insurance costs and the requirement for high coverage levels. Non-life insurance relates to motor, property, employer's liability, public liability, travel and other business insurance. The density of non-life insurance in Ireland (\$914) is below that of the euro area 16 (\$1,062). At 1.9% of GDP, insurance penetration in Ireland is relatively low compared to the euro area average of 2.9%.

Source: Swiss Re, Sigma No.3, 2014

⁴² OECD 30 excludes Estonia, Iceland, Mexico and Turkey

Chapter 9 – Broader Costs Environment

Figure 46: Price levels and GDP per capita, 2013



While consumer prices in Ireland have adjusted downward in recent years, Ireland remains an expensive place to live – Irish price levels are 16.8% above the euro area 18. In 2013, Ireland was the 3rd most expensive location in the euro area for consumer goods and services. Costs relative to national income (in GNP terms) remain particularly high when compared to the euro area average.

Source: Eurostat

Figure 47: Irish price levels relative to the euro area 19 (including indirect taxes), 2013

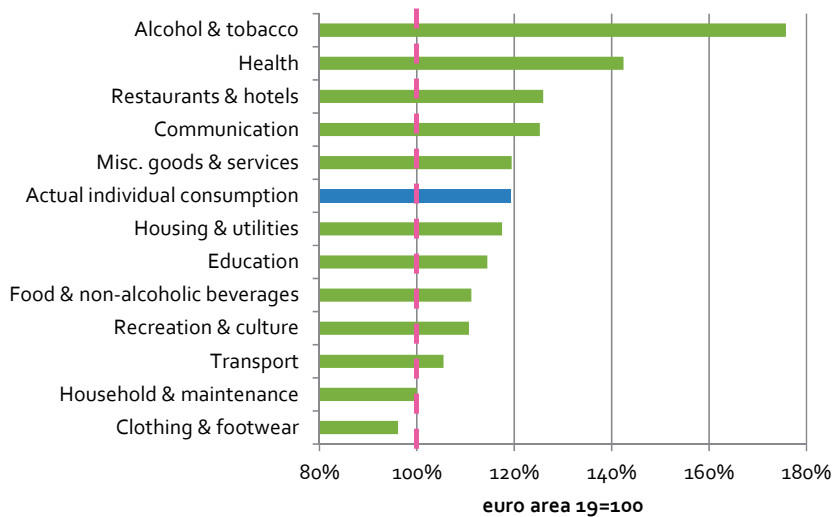
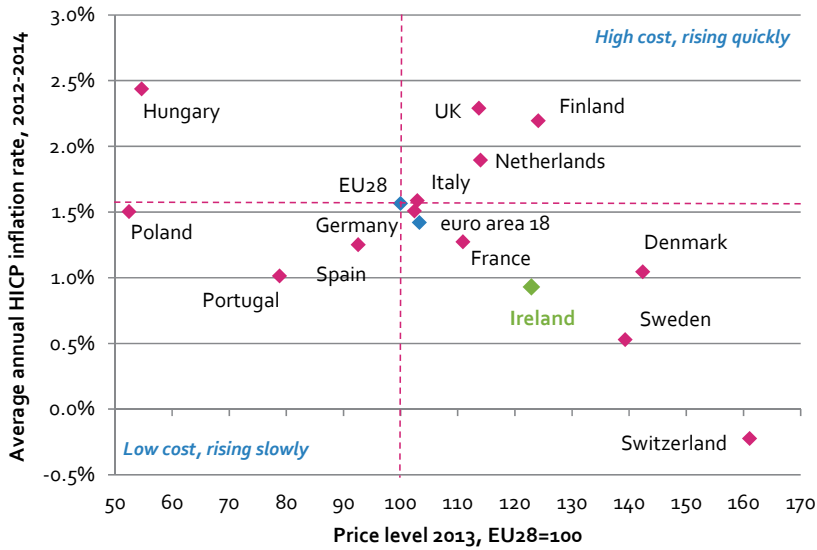


Figure 47 illustrates relative prices for a range of goods and services categories in Ireland compared with the euro area average. Irish price levels remain above the euro area average in 10 of the 12 categories (shown by the red line). The wide variance in alcohol and tobacco prices across the EU is driven significantly by tax policies.

Source: Eurostat

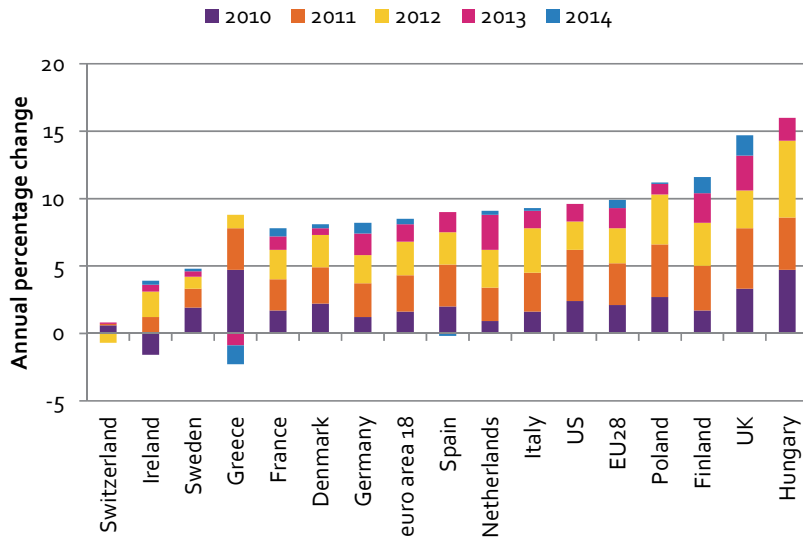
Figure 48: Consumer price levels, 2013 and average annual inflation, 2012-2014



In assessing competitiveness, it is necessary to consider both changes in prices (inflation) and the actual price level. Figure 48 shows that Ireland's current price profile can be described as "high cost, rising slowly". Europe, in recent years, has been characterised by low inflation – indeed, the threat of deflation persists across the euro area and in several members states.

Source: Eurostat, DJEI Calculations

Figure 49: Harmonised index of consumer prices⁴³: annual percentage change, 2010-2014



Most of Europe has recorded low levels of (HICP) inflation in recent years. However, during the course of the recession, Ireland's inflation rate (in some years Irish prices actually experienced deflation⁴⁴) was consistently amongst the lowest in Europe, resulting in a narrowing price differential. Inflation remains muted. As Europe struggles to return to growth, inflation across the euro area fell to just 0.4% in 2014.

Source: Eurostat, DJEI Calculations

⁴³ The European Union-Harmonised Indices of Consumer Prices (EU-HICP) is calculated in each Member State of the EU. The purpose of this index is to allow the comparison of consumer price trends in the different Member States. The methodology adopted for the construction of the national CPI is identical to that recommended for the HICP. Thus the two indices only differ in respect of the coverage of certain goods and services and the treatment of insurance.

⁴⁴ The HICP in Ireland fell by 1.7 per cent in 2009 (not shown in the chart) and by 1.6 per cent in 2010.

Figure 50: Annual CPI inflation and contribution to total CPI inflation, 2014

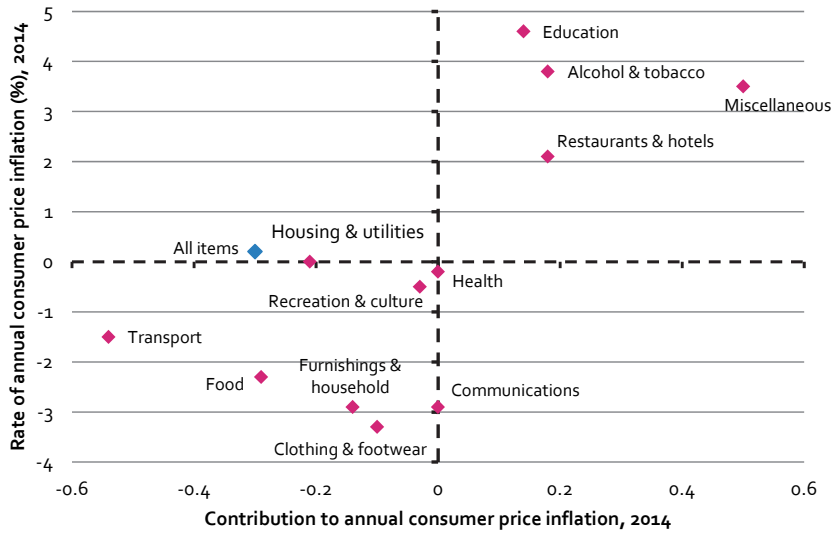
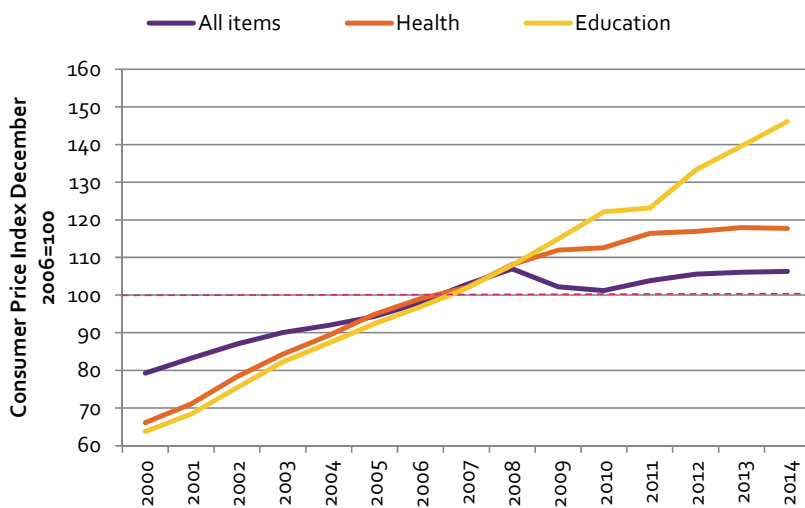


Figure 50 considers the primary contributors to inflation in Ireland. This measure takes account of both rates of inflation and the weighting (or importance) attached to individual goods and services in the average consumer basket. In 2014, miscellaneous goods and services were the largest contributor to overall inflation – this is primarily comprised of health insurance costs⁴⁵. Alcohol and restaurants (which are impacted by alcohol sales) and transport were other important drivers.

Source: CSO, DJEI Calculations

Figure 51: Consumer price inflation in health and education (December 2006=100), 2000-2014



Health⁴⁶ and education⁴⁷ consumer costs have increased at a significantly faster rate than overall consumer costs since 2000. In 2014, education costs were 46.1% above what they were in 2006 while health costs were approximately 17.7% above 2006 prices. By comparison, the overall consumer price level increased by 6.3% over the same period.

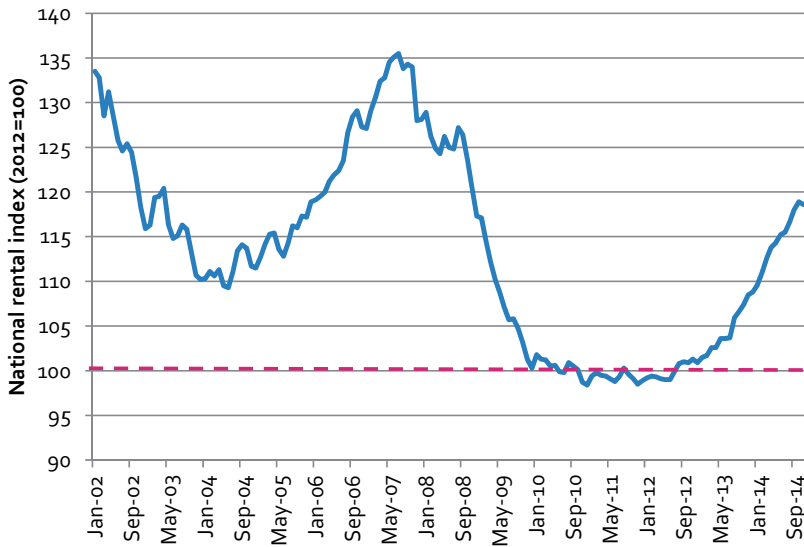
Source: CSO

⁴⁵ Health insurance is the most significant element within the “Miscellaneous goods and services” category; in 2013 it accounted for 30.5 per cent of the category and 3.5 per cent of the total CPI basket. See Forfás, Consumer Costs and Inflation, January 2014

⁴⁶ “Health” includes medical products, appliances and equipment, hospital charges and outpatient services supplied by doctors, dentists, opticians, physiotherapists and practitioners of alternative and complementary medicine.

⁴⁷ “Education” includes pre-primary and primary (comprised of playschools and private primary fees), secondary (private second level day fees), third level fees (third level tuition fees and third level accommodation), and other education and training such as night courses and examination fees.

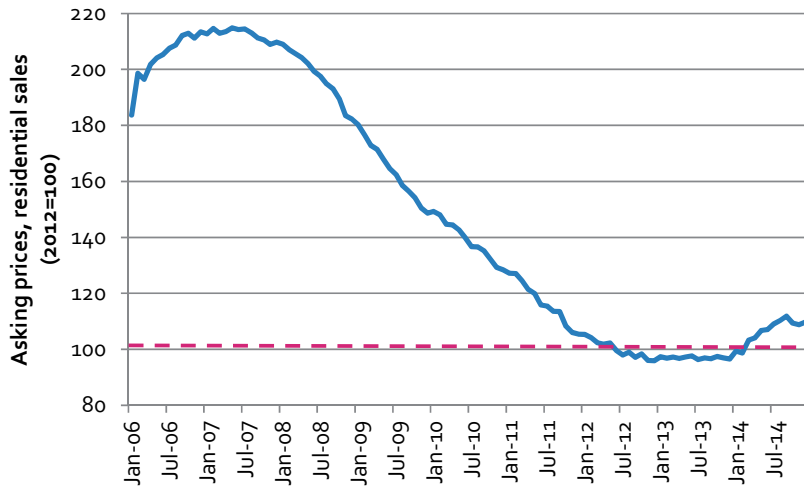
Figure 52: National rental index (2012=100), January 2002-December 2014



Rents continued their steady rise throughout 2014, are now almost 20% above their 2012 trough (rents nationally were 9.7% higher in Q4 2014 than a year previously). In Dublin, rents are now almost 30% above their lowest point in 2012 and just 6% below their 2007 peak. While still high (11% per annum), rent growth in Dublin slowed in both Q3 and Q4 2014.

Source: Daft.ie

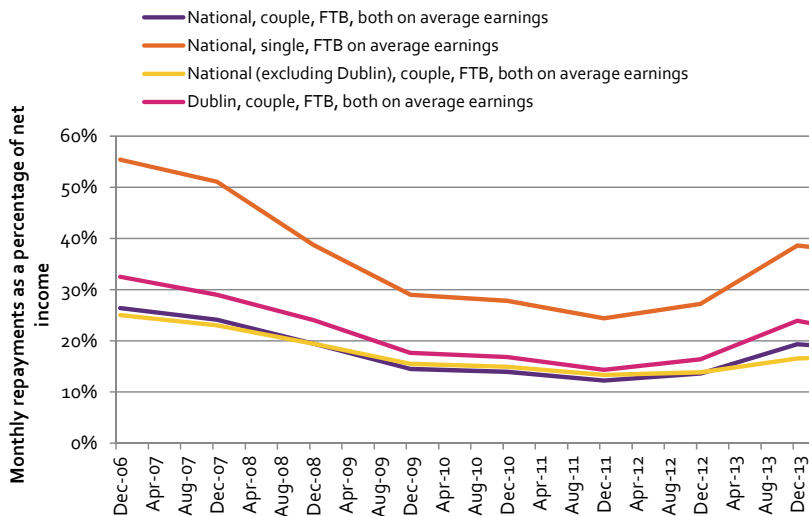
Figure 53: Residential sales asking prices (2012=100), January 2006-December 2014



In December 2014, the average asking price nationwide was €193,000, 12.8% higher than a year earlier. This compares to €378,000 at the peak in 2007. Particular concerns persist about the market in Dublin – while there was a fall between September and December, significant increases earlier in the year mean that prices remain higher than a year previously. Annual inflation in the capital has eased from a high of 25% in September to 20% in December.

Source: Daft.ie

Figure 54: House price affordability: monthly repayments as a percentage of net income⁴⁸, December 2006-February 2014



Increases in prices are adversely impacting affordability – the degree of impact depends on both geography and family type. Overall, housing affordability nationally is currently estimated at 19.3% of net income for a (first time buyer) working couple. In Dublin the proportion of net income required to fund a mortgage for the average FTB working couple was 23.3%. However, affordability in Dublin is still some way off the peak reached in December 2006 (32.5%).

Source: EBS - DKM Affordability Index

⁴⁸ Affordability refers to the potential buyer's ability to fund a mortgage.

Special Article: Commercial Insurance for Enterprises in Ireland

Introduction

Insurance costs are relevant to businesses of all sizes and in all sectors of the economy to one degree or another. This paper examines the nature of the commercial insurance market in Ireland and provides an overview of the competitiveness of the commercial insurance market in Ireland, compared to European and non-European counterparts.

Ultimately, the issue of greatest concern to businesses is the cost they pay for the cover they receive. There are, however, a number of challenges in undertaking any analysis of the insurance market which limit such analysis. It has not been possible to provide statistics on commercial insurance prices in the Irish and broader European markets due to the lack of publicly available information in this area. Commercial insurance prices tend to be agreed on a company-by-company basis with insurers, reflect the idiosyncrasies of the companies insured and the coverage purchased (i.e. the range of commercial insurance products is wide, and the nature and type of coverage provided in commercial insurance policies is non-homogeneous⁴⁹), and the final price charged is generally not publicised. International comparisons can also prove problematic as a result of differences in law, in fiscal regime, in policyholder behaviour and in the expectations of policyholders from their insurance provider.

Nevertheless, this paper identifies the key insurance types purchased by Irish firms, analyses the operation of the market here, identifies a range of potential actions which could enhance cost competitiveness and also proposes a number of areas for further study.

Contribution of Irish Insurance Sector to the Economy

The Irish Insurance sector makes a significant contribution to the Irish economy.

Fiscal: Insurance companies pay a range of taxes and levies – corporation tax, taxes on income of employees, VAT and insurance and pension levies. The total tax payments by the insurance sector in 2012 are estimated at c€1.6bn, consisting of c€0.2bn in corporation tax and c€1.4bn in other taxes⁵⁰. It should be noted that insurance premiums in Ireland are exempt from VAT but are subject to a 3 per cent non-life insurance levy plus a 2 per cent contribution to the Insurance Compensation fund. Overall, insurance companies contributed directly 4.4 per cent of total net tax receipts. Significant further tax payments were made by third party providers to the industry.

Employment: The total number of people working in the insurance sector in Ireland amounts to c. 27,000, of which those employed directly by insurance companies is estimated at c. 14,000, with additionally c. 13,000 working for companies directly related to the industry (e.g. outsourced professionals and service centres, financial advisors, consultants)⁵¹.

49 Comparisons are difficult even between policies sold within the same product class. The Employer's Liability (EL) policy sold to a major multinational will naturally differ to that sold to an SME. The policy sold to a construction and engineering company will have different coverage, exposed limits and inherent risks than a policy sold to a professional services firm.

50 Revenue Annual Report 2012

51 CSO, Employment statistics, April-June 2013

Investment: Insurance companies in Ireland have just under €200bn of assets under management for policyholders⁵². Of total insurance assets, €46bn is invested in Ireland with €16bn invested in Irish government debt and €19bn in Irish companies and property.

Principal Types of Commercial Insurance in Ireland

A number of different types of commercial insurance are available for purchase, some compulsory, some optional. Table 2 provides an overview of the main categories while Figure 54 illustrates the proportions of the total commercial insurance market, corresponding to each of the key commercial insurance products, by Net Premium volume (NEP).

Table 2: Principal Types of Commercial Insurance

<p>1. Commercial Motor Insurance (including Motor Fleet) Cover can be provided as (i) Third Party, (ii) Third Party, Fire & Theft and (iii) Comprehensive, and is often sold as part of the overall business insurance programme. Third Party cover is compulsory in Ireland and many other European countries. If a business uses vehicles, then that business is legally required to hold commercial motor insurance.</p>	<p>2. Commercial Property Non-compulsory insurance (though often viewed as essential) that will usually cover a range of risks including protection against damage to premises, machinery, contents and loss of profits (e.g. when sold in conjunction with business interruption cover). Additional cover may also be provided for accidental loss or damage to money, stock and personal belongings of employees and owners.</p>	<p>3. Professional Indemnity (PI) Covers the cost of compensation to clients (and the resultant legal fees) for any loss or damage to the client, as result of negligence or errors in the provision of a service or advice, by a business or an individual professional service provider. Purchase of PI insurance, although not compulsory under law, is effectively compulsory for many professions and many public tenders will require the tenderer to have a minimum amount of PI insurance cover in place.</p>
<p>4. Employer's Liability (EL) Provides indemnity against the risk of employees suffering injury, disease or death during the course of their employment, as a result of negligence on the part of the employer. Cover is not compulsory in Ireland but under The Safety, Health And Welfare at Work Act (2005), all employers are responsible for creating and maintaining a safe and healthy workplace for their staff. Many firms consider EL cover as a de facto requirement.</p>	<p>5. Public Liability (PL)⁵³ Covers claims made against a company if its owners, directors, employees or sub-contractors are shown to be responsible for injury or damage to third parties or to their property. This is not compulsory in Ireland but most companies also view this as an essential insurance coverage. Often PL policies pick up residual exposures that are not covered by other more specific protections.</p>	<p>6. Director's & Officers (D&O) Covers claims against a company's directors and officers for breaches in their fiduciary and legal duties under those offices. It is much more prevalent for larger companies than for smaller companies.</p>

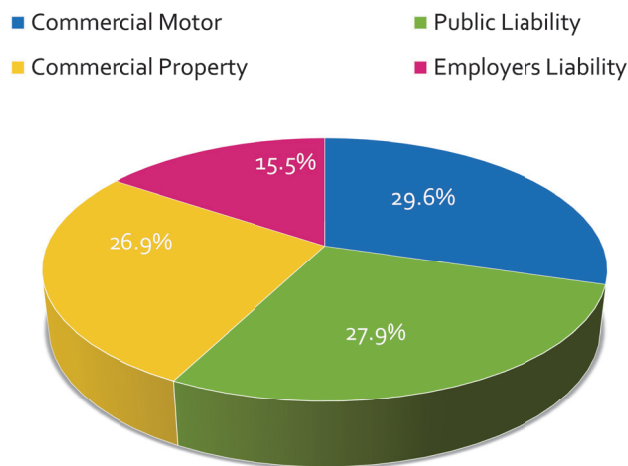
Source: KPMG

⁵² This figure includes life assurance business assets plus non-life assets. See Central Bank of Ireland, Insurance Statistics 2012

⁵³ PL cover can often be extended to include claims arising out of defective products or design, often referred to as "product liability insurance".

The largest share of the market relates to Commercial Motor cover - since third party motor cover is compulsory in Ireland this is to be expected.

Figure 55: Net earned premiums in Ireland by insurance category, 2013



Commercial Property and Public Liability insurance each represent just over a quarter of the market. Employers' Liability insurance accounted for 16 per cent of the Irish commercial insurance market in 2013⁵⁴.

Source: Insurance Ireland, PwC Derived

How the Insurance Market Operates

Insurance is a product that is designed to transfer risk. The policyholder exchanges the possibility of an uncertain cost (the loss arising from an insured event) for the certainty of a fixed cost (the insurance premium). In other words, they weigh the cost of their insurance premiums and the probability of an insured event occurring against the expected value of the loss that would arise from such an event.

Insurers profit by pooling those premiums⁵⁵, paying the aggregate losses, covering their own expenses and generating an acceptable return on the capital invested. Since loss experience from year-to-year can be volatile, insurance companies will typically purchase reinsurance protection (i.e. insurance for insurance companies) against particularly large losses or an aggregation of losses. This is especially the case for relatively smaller insurers whose smaller capital bases may not be able to withstand large loss events or an accumulation of smaller events. Reinsurance costs are therefore an important factor for relatively smaller Irish insurers. The cost of reinsurance is driven by external factors, largely beyond the control of domestic policy makers, including the supply of capital to the reinsurance industry at a global level⁵⁶.

Insurers measure their profitability on underwriting activity by looking at metrics such as underwriting profit (premiums less losses less expenses) and also by considering the combined ratio ((Losses plus Expenses) /

⁵⁴ Employment liability claims tend to account for some of the largest and most uncertain types of risks faced by companies.

⁵⁵ Other sources of revenue, sometimes referred to as ancillary revenue, may also be generated. Insurers can generate revenue through referral activity e.g. by referring customers from their direct channels to other financial service providers such as banking or to specialist insurers such as Pet or Travel insurance providers. Revenue may also be generated by referring customers to car repair services, building contractors or credit-hire firms.

⁵⁶ At present the supply of insurance capital is at an all-time high and reinsurance pricing is relatively soft (cheap) as a result.

Premium)⁵⁷. A combined ratio of more than 100 per cent means an insurer is making a net underwriting loss on that business.

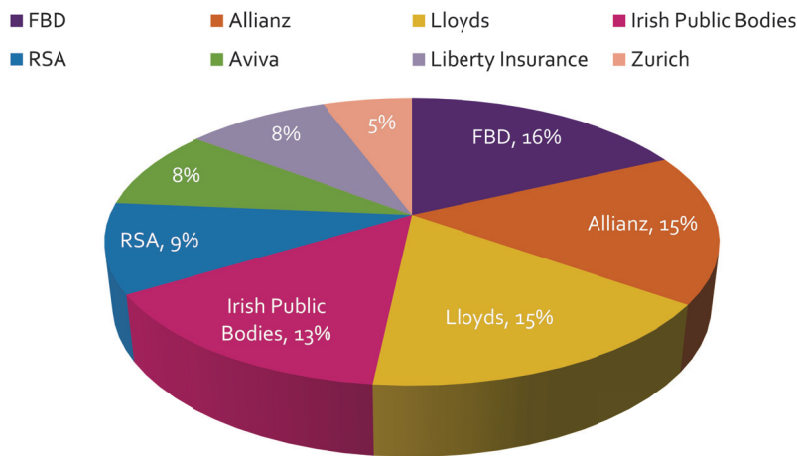
Since premiums are received before claims need to be paid, the insurer generates assets that it holds until the claims are due for payment. These assets can be invested to generate investment returns which contribute, often significantly, to overall insurer profitability. For certain types of business, insurance companies are often prepared to underwrite at a loss if the investment income they can generate more than offsets that underwriting loss⁵⁸.

Investment returns on the cash and fixed income have been at historically low levels since the onset of the financial crisis. Non-life insurers have been obliged, therefore, to return to underwriting discipline to generate an underwriting profit in the absence of such investment returns.

The Market in Ireland

The “Domestic Non-Life and Health” insurance sector includes companies writing both commercial and personal non-life insurance business to Irish customers. Figure 56 shows the market shares of the principal players that are active in the Irish commercial insurance market.

Figure 56: Market shares of the total commercial insurance market (based on net earned premiums), 2013



There are 56 companies with their head office in Ireland and a further 27 that are branches of companies with their head office in another EU state. Many companies are owned by multinationals with only one company in the top eight (FBD), being Irish owned.

Source: PwC Derived

Of the 56 companies with head offices in Ireland, 37 have made the decision to stop writing new insurance business and are exclusively managing their existing portfolio until all business activity has terminated, or had

⁵⁷ The combined ratio is also referred to as the operating ratio.

⁵⁸ There are, however, constraints on insurer’s freedom to invest. They are obliged to hold liquid asset classes in order to be able to meet unforeseen claims contingencies when they fall due. There are also restrictions imposed by regulators in terms of the safety and liquidity of the asset classes that are permitted for investment. Non-permitted asset classes will attract a capital charge or in some cases are not eligible for inclusion in the register of assets to demonstrate solvency coverage. The result is that non-life insurance companies’ assets are dominated by cash, relatively short-term fixed income securities and (much less so) highly liquid blue-chip equity and property holdings.

premium income less than €1m in 2012. There are four companies servicing the domestic private health insurance market; of these VHI is the largest with 56 per cent market share⁵⁹.

While consumers can purchase cover directly (through company branches, internet, phone etc.), historically, the Irish commercial insurance sector has been dominated by intermediaries/ brokers. The role of intermediaries' is to understand the needs of the consumer and to then tailor insurance products and solutions to these identified needs.

The major players in the commercial insurance intermediary market in Ireland and globally, are Willis, Aon and Marsh. The Irish Brokers Association (IBA) is the primary representative body for insurance brokers in Ireland. IBA members cover 70% of the general insurance market in Ireland in terms of insurance distribution.

Competition, Premia and Profitability

In the absence of cost data, other metrics must be considered when making a determination about the competitiveness of the Irish commercial insurance market. Specifically, looking at the degree of competition in the market, trends in premia and levels of profitability can provide an indication of competitiveness.

Competition

Looking first at competition, market share data can be an insightful metric: stable market shares may indicate a lack of competition in the market, while conversely if market shares are changing over time it may be that there is active competition from insurers to attract business from consumers.

Figure 57: Market shares of the main insurers in the Irish commercial insurance market, 2005-2013

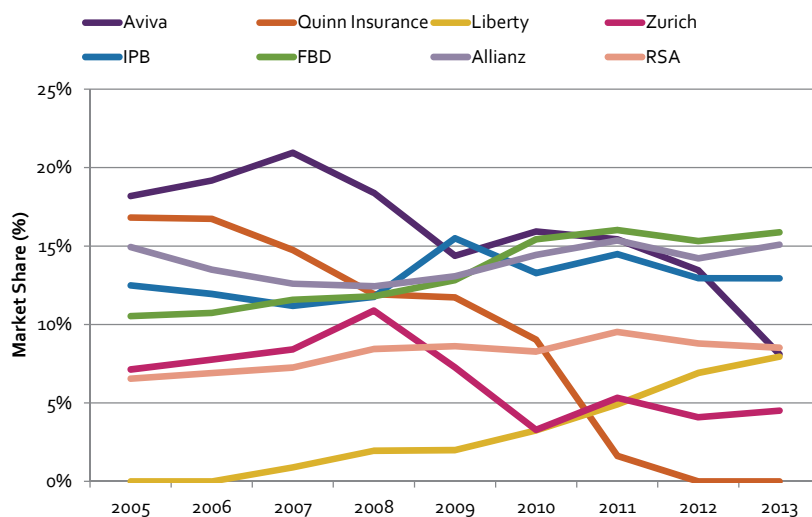


Figure 57 analyses the trend in market shares of the 8 main insurers in the Irish commercial insurance market over the period 2005 to 2013 (based on their share of total Net Written Premiums in the commercial insurance market in Ireland). Overall the graph shows a lot of change over time.

Source: CBI Insurance Statistical Reviews, PwC Derived

⁵⁹ There has been a significant reduction in the number of private medical insurance policyholders due to the economic downturn, price increases due to medical cost inflation and higher public hospital charges, and reductions in tax relief.

Often the change was prompted by significant one-off events such as insurer failure (Quinn), restructure (AVIVA⁶⁰ and AIG) or some difficulty leading to adverse press coverage (RSA). By contrast, the growth in FBD's and Allianz's market shares over the same period may correspond with their acquiring some of the AVIVA and Quinn business. Liberty Insurance, who purchased the renewal rights to the Quinn business, also showed strong growth over the period.

These one-off events or dislocations may be driving some of the change rather than being the result of significant competition and innovation. Nevertheless the data indicates some support for the existence of competition in the commercial insurance market, with the market shares of a number of insurers growing, whilst others have reduced, over the period.

Looking at levels of market concentration, the two most commonly used concentration ratios in competition analysis are the CR(4) and CR(8), which measure the market shares of the 4 largest firms and 8 largest firms in the market, respectively. Concentration ratios range from 0 to 100 per cent: a CR(m) close to zero indicates a very competitive market, since the m largest firms in the market each have insignificant market shares. Conversely, a CR(m) over 80 per cent would indicate an extremely concentrated oligopoly or monopoly⁶¹.

The CR(4) and CR(8) for the commercial insurance market in Ireland have remained relatively stable between 2005 and 2013⁶². The CR(4), which is based on the market share of the 4 largest insurers in the market, has remained at an average level of 59 per cent over the past 9 years, whilst the CR(8) has remained around 88 per cent. By most classical economic descriptions, the Irish commercial insurance market would be classified as an oligopoly on an assessment of these ratios⁶³.

60 AVIVA's market share has more than halved since its peak at around 20% of the market in 2007. AVIVA changed its structure from a locally regulated insurance company to a branch of the UK in 2012.

61 Lipczynski et al. (Industrial Organisation: Competition, Strategy, Policy, 2005) provides the following classification in terms of the CR(4) measure of competitiveness in an industry: CR(4) = 0 - Perfect Competition; $0 < CR(4) < 40$ - Effective or Monopolistic Competition (unconcentrated); $40 \leq CR(4) < 60$ - Loose or Monopolistic Competition (moderately concentrated); $60 \leq CR(4) < 90$ - Tight Oligopoly (concentrated); $90 \leq CR(4)$ - Effective/ near Monopoly (highly concentrated); CR(4) = 100 - Monopoly.

62 These concentration ratios are calculated using market share data in the Irish liability insurance market, reflecting the proportion of Net Written Premiums applying to each of the liability market participants.

63 In their 2005 report, the Competition Authority found that in general non-life insurance markets were not greatly concentrated in Ireland. See The Competition Authority, Competition issues in the non-life insurance market, 2005

Figure 58: Concentration ratios for selected countries, 2013⁶⁴

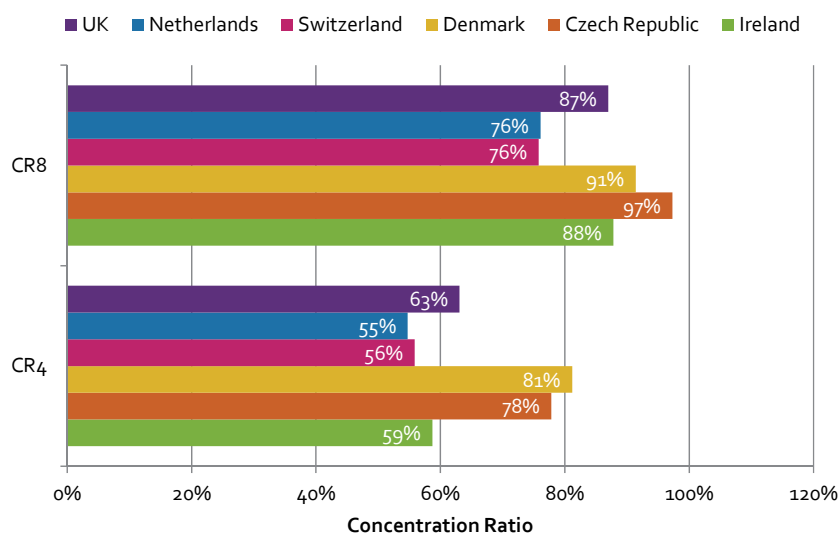


Figure 58 compares the concentration ratios with ratios in a range of European countries. The smaller markets of Denmark and the Czech Republic have fewer competitors and are more concentrated than the larger markets. Ireland has a lower concentration ratio these markets. In terms of the countries benchmarked, Ireland is ranked somewhere in the middle in terms of concentration levels.

Source: CBI Insurance Statistical Reviews, Misc. International Sources, PwC Derived

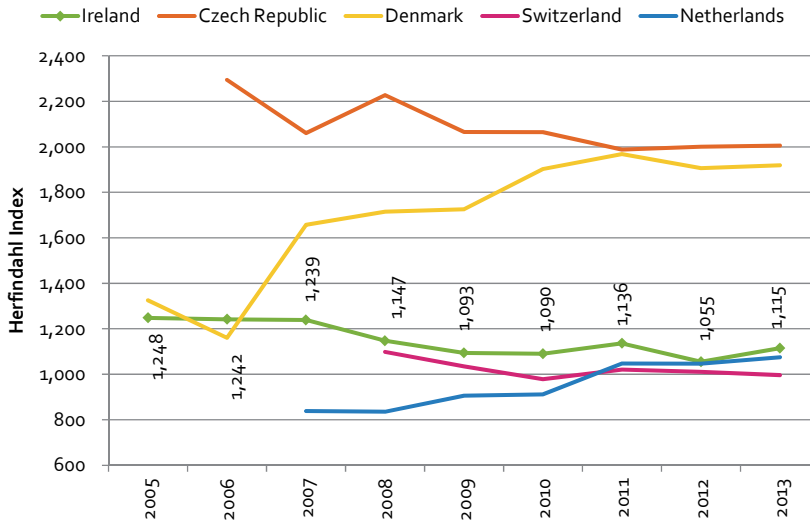
The Herfindahl-Hirschman Index (HHI) is a measure of market concentration that takes account of the differences in sizes of firms in the market⁶⁵. The HHI ranges from 0 when there are a lot of firms with very small market shares to 10,000 when a monopolist has 100 per cent of the market share (i.e. the higher the HHI for a specific market, the more concentrated that market is).

Figure 59 compares the HHI index for Ireland with a number of other European countries. The index for Ireland was around 1,240 for 2005 to 2007 and then began to drop off, to a low of 1,055 in 2012 as concentration increased.

⁶⁴ The concentration ratios for the UK above are the CR5 and CR10, respectively, based on the data available from the ABI.

⁶⁵ The HHI is calculated by adding the sum of the squares of the market shares of each firm in the market and has been calculated based on the market shares of participants in the liability insurance market in Ireland, over the period 2005 to 2013 (the same approach as is used to calculate the concentration ratios above).

Figure 59: Herfindahl-Hirschman Index for selected countries, 2005-2013



The index has remained at a level over the period that would indicate a “moderately concentrated” market for commercial insurance in Ireland. The HHI scores for Denmark and the Czech Republic are outliers (i.e. lower levels of competition) with other territories in a narrow band around 1000.

Source: CBI Insurance Statistical Reviews, Misc. International Sources, PwC Derived

Premia

In most developed markets the level of commercial insurance penetration tends to be at a high level and remains relatively constant over time. Therefore the level of insurance premium will often track the overall level of activity in the economy. In times of recession purchasers of insurance will often review which insurance protections are essential and which are discretionary, and will cut back accordingly.

Figure 60: Net earned premiums on commercial business, 2005-2013

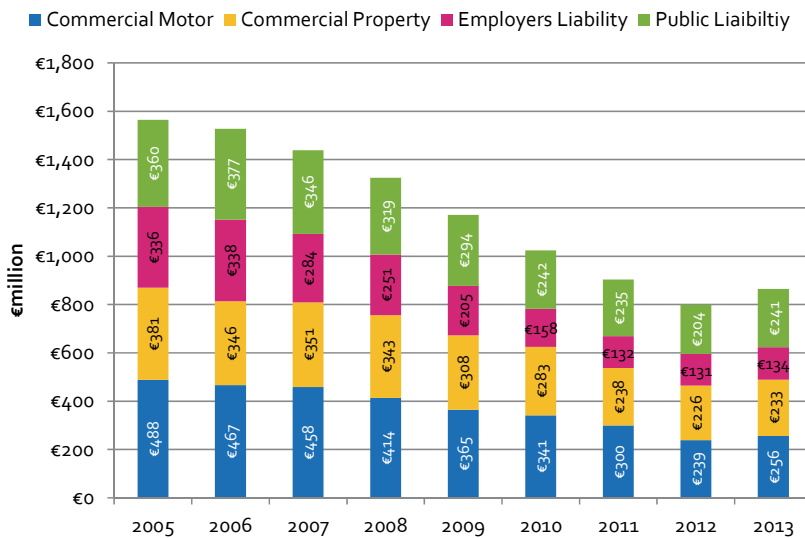


Figure 60 demonstrates the fall in Net Earned Premium (NEP) for Commercial Insurance business in the period from 2005 to 2013 and includes the impact of the recession commencing in 2008. In the period between 2005 and 2013 NEP fell by 45 per cent.

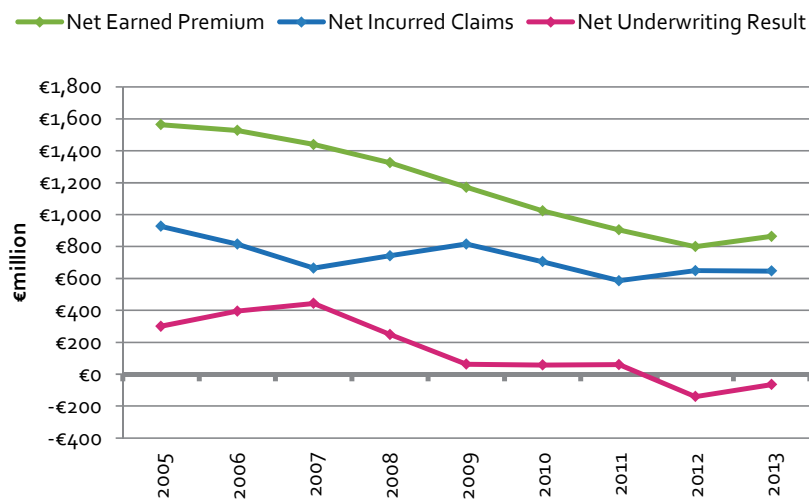
Source: Insurance Ireland, CSO, PwC Derived

Similarly, insurance penetration (total NEP as a proportion of Irish GDP) and insurance density (total NEP per capita) for have both fallen in Ireland over the 2005 to 2013 period.

Profitability

The fall in premium has resulted in significant reductions in underwriting profits for commercial insurance providers in Ireland, with the industry producing break-even results or losses from around 2009 and onwards for this class of business (Figure 61).

Figure 61: Underwriting results (€m) on commercial business in Ireland



It should be noted however that the period before 2008 was very profitable for insurance companies. This feature of periods of high profits followed by periods of low profits or losses is characteristic of insurance markets (“the insurance cycle”). During periods of higher insurance profitability new entrants and capital are attracted to the market.

Source: Insurance Ireland, PwC Derived

The additional supply reduces prices but capital can also be withdrawn relatively easily if profitability diminishes thus reducing supply and restarting the cycle⁶⁶. At present the level of profitability in the commercial insurance market is not attractive to insurance capital providers.

Another of the key ratios used to assess the cost of claims and the profitability of non-life insurance business is the net combined or net operating ratio. This combines the claims ratio and the management expenses and commissions ratio. In 2013, the net claims ratio for the non-life commercial insurance market in Ireland was 75 per cent, and the management expenses and commissions ratio was 32 per cent⁶⁷.

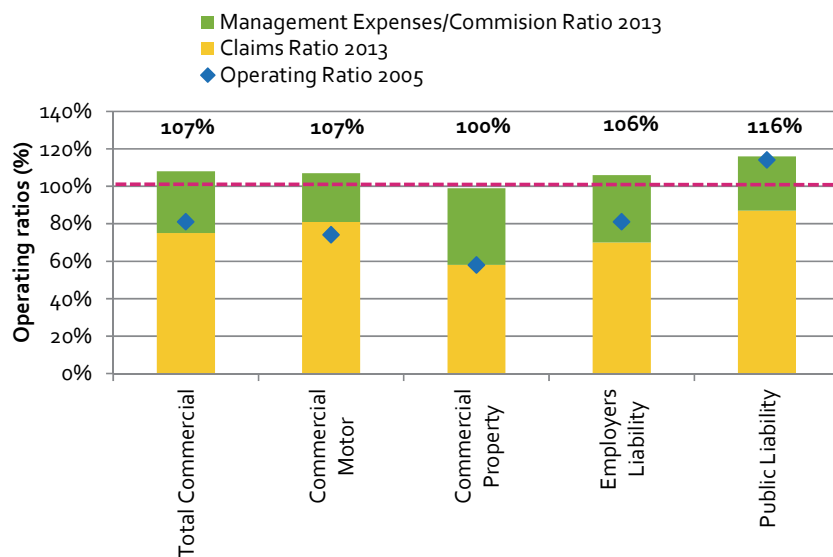
The net operating ratio for the commercial insurance market was, therefore, 107 per cent in 2013 (i.e. the commercial insurance market made a loss of 7 cents for every €1 of premium for underwriting insurance business). This contrasts with a net operating ratio of 81 per cent in 2005, and demonstrates the substantial

⁶⁶ An important assumption is that there are no constraints on capital being added or subtracted to the system. However this is not always the case. While there are few constraints to adding capital into the system there are many regulatory constraints on taking capital out.

⁶⁷ Commission refers to fees paid to third party brokers and intermediaries.

drop in profitability on non-life insurance business since the recession. The results are similar regardless of which sub-sector of the market is considered.

Figure 62: Commercial insurance operating ratios in Ireland, 2013



In 2013 the combined ratio for all sectors was in excess of 100 per cent meaning none of the sub-sectors generated an underwriting profit. Investment yields over the same period have been low meaning investment income has not compensated for poor underwriting results.

Source: Insurance Ireland, PwC Derived

Limited international data on operating ratios is available. However, based on a comparison with Danish and UK data, the commercial insurance industry in Ireland is currently slightly less profitable than these two comparators (i.e. Irish operating ratios are higher than ratios in the UK and Denmark), making the Irish market a less attractive proposition for new entrants.

Policy Priorities

A number of issues have emerged, which can be influenced by domestic policy makers and which require further, more detailed consideration.

Data Collection

The absence of price data makes it very difficult to assess market conditions and competitiveness. There is a need to comprehensively benchmark insurance costs in Ireland with costs in our key competitors. Ideally, data would be collected from both the industry (using standard definitions etc. of insurance classes across countries) and from customers.

Further, it would be particularly useful if a benchmarking exercise was conducted comparing award levels in Ireland with awards in other European jurisdictions, taking different legal, administrative and social security arrangements into consideration. Such an exercise would complement the planned review of the Book of Quantum (see below) and would provide valuable context for the judiciary and those undertaking the review.

Regulation

The Central Bank of Ireland (“CBI”) is the single financial regulator, covering banks, insurance companies and fund managers. As well as ensuring that it is equipped to deal with the prudential side of insurance regulation, it is also important that the Central Bank has sufficient in-house claims expertise (i.e. to understand the “nuances of the claims book”).

As a result of the lessons learned from the recent financial crisis, the approach of the CBI has become deliberately more assertive and actively challenging, which has represented a significant transition for industry from the previously lighter regulatory approach. For instance, the introduction of a “Probability Risk and Impact System” (PRISM_{TM}) is the Central Bank’s risk-based framework for the supervision of regulated firms. Under PRISM_{TM}, the most significant firms - those with the ability to have the greatest impact on financial stability and the consumer - receive a high level of supervision under structured engagement plans, leading to early interventions to mitigate potential risks. Conversely, those firms which have the lowest potential adverse impact are supervised reactively or through thematic assessments, with the Central Bank taking targeted enforcement action against firms across all impact categories whose poor behaviour risks jeopardising the Bank’s statutory objectives including financial stability and consumer protection.

Another key part of the Central Bank’s change in approach was the introduction of the “fitness and probity” regime⁶⁸ as well as the Enforcement Directorate⁶⁹. Finally, the Central Bank has also published a revised Corporate Governance Code for Credit Institutions and Insurance Undertakings, setting out minimum statutory requirements on how credit institutions and insurance undertakings should organise the governance of their institutions⁷⁰, and a revised Consumer Protection Code⁷¹.

All of these reforms are welcome and necessary changes to the regulatory environment. It is important that on an ongoing basis, Ireland’s regulatory regime remains reflective of and proportionate to the risks posed by international developments, and at the same time avoids the imposition of unnecessary regulatory burdens on firms.

Recommendation: The Central Bank and the Department of Finance should continually review and monitor the adequacy and proportionality of financial services regulation.

Responsibility: Central Bank of Ireland, Department of Finance, Department of the Taoiseach

In this regard, it is important that the upcoming implementation of Solvency II should be consistent with, and not beyond that, of other jurisdictions. In particular, there is concern that some of the Pillar 2 and Pillar 3 requirements could be adopted differently among Member States, particularly in terms of “third country” requirements (i.e. despite the stated goal of harmonising the European insurance industry, some business leaders are concerned that regulatory bodies in some member countries may implement a less onerous

68 Under this new regime, which was fully implemented by 1 December 2012, 47 senior positions are prescribed as Pre-Approval Controlled Functions for regulated financial service providers other than credit unions. The prior approval of the Central Bank of Ireland is required before an individual can be appointed to a Pre-Approval Controlled Function. The individual must complete an online Individual Questionnaire which is endorsed by the proposing entity and then submitted electronically to the Central Bank of Ireland for assessment.

69 The activities of the Enforcement Directorate which includes investigations and enforcement of issues relating to prudential, conduct of business, consumer protection, securities regulations, fitness and probity, enforcement policy, refusal and revocations of authorisations and specialist Anti-Money Laundering/Counter-Terrorist Financing supervisory inspections.

70 Information on the main changes to the Code, which came into effect on 1st January 2015, can be found at <http://www.centralbank.ie/press-area/press-releases/Pages/RevisedCorporateGovernanceCodeforCreditInstitutionsandInsuranceUndertakings.aspx>

71 The Code set out the requirements that regulated firms must comply with when dealing with consumers in order to ensure a similar level of protection for consumers, regardless of the type of financial services provider. The revised Code came into effect from 1st January 2012.

Solvency II process than in other territories). Ultimately, the cost of compliance with unnecessarily onerous regulations can put companies at a competitive disadvantage.

Solvency II

Solvency II is a new European regulatory framework that sets out how insurance companies must calculate their solvency requirements and govern and manage risk. The Solvency II Framework Directive is due to be implemented on 1st January 2016, although interim measures have been in place since 1 January 2014.

Solvency II introduces economic risk-based solvency requirements that promote appropriate risk management and high levels of policyholder protection. One of the key aims of Solvency II is to achieve maximum harmonisation across EU member states and create a level playing field for the European insurance industry.

The Solvency II supervisory regime has been designed as a three pillar framework: Pillar 1 deals with Quantitative Requirements (i.e. the calculation of the capital requirements, and how assets and liabilities must be valued for regulatory purposes); Pillar 2 is concerned with Governance and Supervision (i.e. all companies will be required to demonstrate that they have implemented an adequate and efficient risk management system that captures the right risks and informs appropriate management decision making); and Pillar 3 relates to Disclosure (i.e. providing a greater focus on disclosure and transparency, both to the public and to the relevant supervisors; the aim of which being to harness market discipline and aid in ensuring the stability of insurers and reinsurers).

Under Solvency II, the solvency regimes of non-EU countries (i.e. “third countries”) will be reviewed to assess whether they are “equivalent” to Solvency II. The tests for equivalence aim to ensure that a third country’s supervisory regime provides a similar level of policyholder and beneficiary protection as under Solvency II.

There are concerns that, whilst third countries do have to demonstrate that certain mechanisms are in place, they only have to meet minimum requirements in order to receive the same benefits as EU countries that have implemented full Solvency II programmes. This is a cause for concern among many leading EU insurers that, following the high costs associated with the implementation of Solvency II, they could find themselves at a competitive disadvantage to certain third countries that are in the process of gaining equivalence, and thus are subject to less stringent Solvency II requirements.

Recommendation: In order to minimise unnecessary regulatory burdens which could place Irish based firms at a competitive disadvantage, the upcoming implementation of Solvency II should be consistent with, and not beyond that, of other jurisdictions.

Responsibility: Central Bank of Ireland, Department of Finance, Department of the Taoiseach

Competition

The Irish insurance market is small in international terms, and as such may be viewed as an unattractive market for potential new entrants. It is important, therefore, to minimise any barriers to entry.

As previously noted, the Competition Authority’s non-life insurance market study – which concentrated on motor insurance, employer’s liability insurance, and public liability insurance found that in general Irish non-

life insurance markets were not greatly concentrated – a finding that still applies today⁷². Nevertheless, it was noted that these markets could be improved by lowering barriers to entry, making switching between insurance providers easier, and increasing price transparency. To address these issues, the Competition Authority made 47 recommendations, the majority of which have been implemented or otherwise since addressed. Many of the recommendations implemented to date have focused on providing information to consumers to improve consumer awareness of pricing policies and switching possibilities.

Recommendation: Review the outstanding recommendations from the 2005 Competition Authority report on issues in the non-life assurance market, and implement those that remain relevant.

Responsibility: The Competition and Consumer Protection Commission, Other Relevant Actors

The Personal Injuries Assessment Board

The Personal Injuries Assessment Board (henceforth referred to as the “Injuries Board”) was set up in 2004 by the Irish government as a self-funded statutory body that provides independent assessment of personal injury compensation for victims of workplace, motor and public liability accidents⁷³. All relevant personal injury cases must be submitted to the Injuries Board, unless resolved at an earlier stage. If the compensation award is not accepted by both parties, the case may then proceed into litigation.

The awards include General Damages for pain and suffering caused by the injury and Special Damages for any financial loss both to the current date and into the future (e.g. loss of wages, cost of medical care, etc.).

General Damages are assessed using the Book of Quantum, a guide to compensation levels in Ireland, which was produced in 2004 and has not been updated since then.

Where liability is not contested, the objective of the Injuries Board is to reduce the costs, professional fees and time usually associated with delivering compensation for personal injury claims. Savings are passed onto consumers in the form of lower premiums.

According to the 2013 Annual Report, the Injuries Board has succeeded in removing two-thirds of personal injury cases from unnecessary litigation⁷⁴. In cases where both parties have accepted the Injuries Board assessment, the time taken to settle claims has reduced from an average of three years to nine months, since the establishment of the Board. There has also been significant cost savings that have facilitated a 40 per cent reduction in motor insurance premiums over the past ten years (as per the 2013 Annual Report).

Innovation in the handling of claims could yield potentially significant cost reductions for companies and consumers. For instance, the administrative approach used by the Injuries Board (as opposed to using the Courts as a first port-of-call to resolve a claim) might usefully be replicated across other parts of the commercial insurance sphere – litigation should not be the first option, as it adds to costs for companies and claimants.

In the UK, efforts to reduce premiums payable by policyholders led to the establishment of the Claims Portal. This portal allows efficient transfers of information regarding claims and hence reduces claims costs. The UK

⁷² The Competition Authority, Competition issues in the non-life insurance market, 2005

⁷³ The majority of awards in 2013 were in respect of motor claims (75%) with the remainder relating to PL (17%) and EL (8%) claims. The majority of awards are under €20k, with the largest awards normally in respect of the more complex EL cases.

⁷⁴ There has also been a cultural change within the insurance industry, with almost all insurers targeting early resolution of personal injury claims, either through their own offices or through the services of the Injuries Board. There has been a pattern whereby more respondents/ their insurers are consenting to the Board handling the more complex claims, with the less complex ones being dealt with internally. This pattern is driven mainly by a desire from insurers to reduce the costs associated with handling these more complex claims.

portal, however, does not set clear timelines which can lead to cases stagnating. The UK portal also provides for legal costs, whereas in cases assessed by the Injuries Board, legal costs are generally not awarded. Taking these factors into account, consideration should be given to developing a similar model for Ireland.

Recommendation: The merits of developing an online portal to address all stages on claims being dealt with through the Injuries Board should be considered. It would be important that any procedural changes do not adversely impact on cost or on the time taken to resolve cases.

Responsibility: Injuries Board

The Injuries Board has expressed concern about the impact of unsupervised settlements that occur and the lack of data in respect of these. Since these settlements occur without recourse to the Injuries Board or the Courts, there are concerns that they could negatively impact competitiveness, premiums and potentially result in false or exaggerated claims. Companies in particular, should be aware that such settlements can ultimately have adverse, knock-on consequences for costs. Given the success of the Injuries Board in reducing the costs associated with claims processing, it is in the public interest to promote the use of the Board's services. It is important, therefore, that both parties involved in a claim, participate fully and transparently with the Board's procedures.

The Book of Quantum

The Book of Quantum is a guide to compensation levels in Ireland. It was compiled in 2004 on behalf of the Personal Injuries Assessment Board (Injuries Board) by independent consultants. It is also used by the Courts for personal injury claims assessment.

Upon its creation in 2004 it was indicated that the Book would be kept under review. Such reviews have not taken place thus far. While a review of the Book is required, it should be noted that the outcome of such a review could result in higher costs, and ultimately higher premiums.

As noted above, the guidance provided by an updated Book – which should provide significantly more granular and detailed data to support the setting of award amounts – should also be complemented by a benchmarking exercise comparing Irish award levels with levels in other EU jurisdictions.

Recommendation: Undertake a review of the book of quantum. In particular, the revised Book should provide a greater degree of granularity in terms of the data (i.e. more specific data broken down by injury type etc.).

Responsibility: Injuries Board

Periodic Payment Orders

There is concern that the introduction of "Period Payment Orders" may result in inflationary pressure⁷⁵. At present, the awarding of compensation for personal injury claims in Irish Courts and via the Injuries Board is by

⁷⁵ PPOs are orders made by a court to pay compensation to the victim of an accident or an act of malpractice in the form of regular payments for the remainder of the insured's lifetime or disability, rather than as a lump sum. At present the Book of Quantum does not contemplate PPO type awards. However, as part of its strategic plan for 2014-2019, the Injuries Board has made a submission to the Department of Justice and Equality confirming the requirement for provisions in the legislation for the making of PPOs by the Board.

way of a single lump sum payment. In January 2012 the Government approved proposals to prepare legislation which empowers the Courts to make periodic payment orders (PPOs) in cases where persons are catastrophically injured through the negligence of others.

An inter-departmental working group has been established by Department of Justice and Equality to deal with PPOs in Irish legislation and has made recommendations in relation to the introduction of earnings and costs related indices which would allow periodic payments to be index-linked⁷⁶. This would allow payments to be linked to levels of earnings or treatment and to changes in costs of medical aids and appliances.

The introduction of PPOs has the potential to increase the costs of catastrophic injury claims for Irish insurers. The impact of this change, however, is difficult to estimate since it is dependent on the propensity of claimants to take the PPO rather than a lump sum, and the eventual cost of the PPO will be linked to actual inflation and the interest rate environment at the time of the award. PPOs are expected to significantly increase the reserves that non-life insurance companies will be required to hold. General insurers will be required to hold reserves for liabilities that may remain in place for several decades.

Recommendation: Once introduced, the impact of PPOs on insurance premiums should be monitored.

Responsibility: Department of Justice and Equality

Uninsured Drivers

The Motor Insurance Bureau of Ireland (MIBI) provides compensation for claimants whose claim arises because of the actions of uninsured and unidentified drivers and vehicles. MIBI only steps in if no other insurer has even partial liability (i.e. if a claimant has fully-comprehensive insurance, they would be compensated by their insurer, rather than the MIBI, in respect of property damage claims only)⁷⁷.

There have been concerns that this practice, by which motor insurers underwriting business in Ireland are required to fund claims arising from uninsured and unidentified drivers, may act as a deterrent for new entrants to the market. About 5 per cent of all claims in Ireland are paid by the MIBI, a much higher percentage than elsewhere in Europe. This reflects the comparatively high levels of uninsured drivers in Ireland relative to other EU countries. According to the MIBI, uninsured drivers have historically cost the Irish insurance industry around €58 million per year. This is equivalent to a levy on each individual policy of about €30 per year.

Other competition concerns persist as a result of the MIBI model – MIBI claims are currently handled by six insurers (AXA, Allianz, Zurich, FBD, Aviva and RSA). There is a concern that since these companies are reimbursed by contributions from all insurers, there may be a lack of incentive among them to keep the costs down or settle claims quickly. Those insurers who do not handle the MIBI claims have expressed a concern that they could be at a competitive disadvantage, through effectively subsidising their rivals. These companies also have access to data and claims costs incurred by other insurers.

⁷⁶ The Government, in 2013, approved the drafting of the Heads of a Civil Liability (Amendment) Bill to implement the recommendations contained in the High Court Working Group Report on Periodic Payments Orders in catastrophic personal injury cases with respect to awards made against the State and agreed that the extension of any such scheme to non-State defendants would be examined further in consultation with the Department of Finance. Subsequent to that Government decision, the Department of Finance, through the State Claims Agency, commissioned an actuarial study of this issue. Following receipt of the actuarial study, in April, 2014, the Department of Justice and Equality established an inter-departmental working group to work through the technical aspects of this issue and to devise the elements of the periodic payment scheme for the proposed legislation.

⁷⁷ The MIBI is a private, non-profit organisation, established in Ireland in 1955, under an Agreement between the Government and the Irish motor insurance industry. Further agreements were signed in 1964, 1988, 2004 and 2009. All insurance companies underwriting motor insurance business in Ireland must legally be members of the MIBI. The membership currently consists of 32 insurers and 7 Lloyds syndicates, who contribute to funding for claims in proportion to their share of the Irish market.

Recommendation: A continued focus on law enforcement is critical to managing the level of uninsured driving.

Responsibility: An Garda Síochána

Ancillary Income

Insurance companies can generate ancillary income which can be used to generate a return on capital and therefore to help reduce the costs of insurance protection for policyholders. On the other hand, some activities can also incentivise adverse behaviour. In this respect, the UK Office of Fair Trading has noted that “insurers of at-fault drivers appear to have little control over the bills they must pay, and this may be leading to higher costs for them and ultimately higher premiums for motorists”. There was particular concern around the unnecessarily high costs associated with both vehicle repair and the provision of replacement vehicles, with such vehicles being provided for longer than necessary. This was due to the lucrative fees, payable to the opposing insurers, from the car hire firms or garages involved. Such “dysfunctional” practices have increased total premiums by about £225m a year in the UK; potentially about £10 per policy. Although no data is available, it seems likely that such practices also exist in Ireland.

Claims Farming

Concerns also exist in relation to the practice of “claims-farming” activity⁷⁸. While solicitors are banned from promoting their services in Ireland, claims handling firms can operate freely. The practice was blamed for massive increases in the incidence and cost of whiplash claims in the UK where it is thought that fraudulent whiplash claims now amount to more than £1bn annually. There is concern that claims farming may emerge as a practice in Ireland. Comments in the 2012 Injuries Board Annual Report partly attributed the increases in claims volumes to increased claims promotion by claims farming⁷⁹. Ultimately, the use of claims management firms by companies pushes up the price of insurance products for all.

As a consequence, there is a need to ensure greater oversight and regulation of the activities of claims farming companies in Ireland who continue to advertise and promote their services. In the first instance, it is important that responsibility for regulation/oversight of claims management sector activity be clearly assigned – at present it does not appear to be the responsibility of either the Central Bank or the proposed Legal Services Regulatory Authority.

Regulation of Intermediaries

From a competition perspective, the dominance of insurance intermediaries/ brokers in the Irish commercial insurance sector has historically caused concerns about the level of, and opportunities for, competition in the market. Whilst brokers can and do help to facilitate competition through reducing the search and switching costs for consumers; helping alert new underwriters to profitable opportunities in the Irish market; and offering a distribution channel for new entrants, a 2005 Competition Authority report, “*Competition Issues in the Non-Life Insurance Market*”, identified a range of reasons suggesting why the role of brokers in the non-life market “may not be entirely pro-competitive”. For commercial clients, in particular, competition may be hindered due to certain insurer’s unwillingness to transact business with more than one broker. Consumers

⁷⁸ “Claims farming” is a practice where claims handling intermediaries hunt for potential cases involving accidents or other damages. Details are then sold on to law firms, personal injury lawyers, credit hire firms and vehicle repair firms for a “referral fee”.

⁷⁹ The issue was raised again in a statement in April 2014 by Patricia Byron, Injuries Board Chief Executive; “It is clear that the aggressive promotion of personal injury services in other jurisdictions is a key factor in driving personal injury claims.

may also not be aware of the remuneration structure applying to brokers that may incentivise them to place their client's business with particular underwriters. This may also limit competition if it prevents new insurers from selling via the intermediary market. In addition, current regulations governing intermediaries can sometimes be viewed as confusing and anticompetitive. There may, therefore, be merit in undertaking a review of current regulations.

Special Article: Waste Management Costs

Introduction

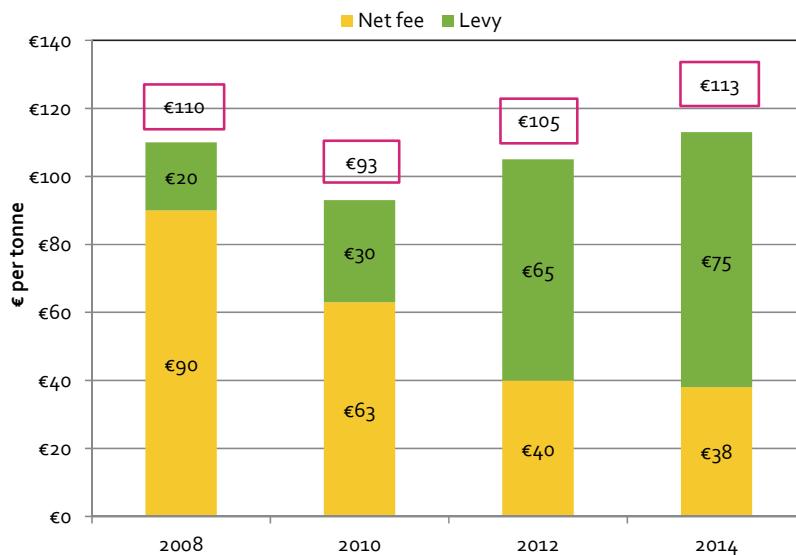
The availability of waste management services and the associated costs continue to be important competitiveness issues for enterprise in Ireland. The Irish waste market has undergone significant change in recent years, in particular the move away from landfill towards a more environmentally sustainable approach to waste management and the increasing role of the private sector in waste collection and waste infrastructure provision.

Ireland's Comparative Performance

Waste management costs across the main treatment options in Ireland – landfill, thermal and biological – are among the most expensive of the benchmarked countries/regions. Under the Waste Framework Directive, Ireland is obliged to meet landfill diversion targets and to apply the waste hierarchy⁸⁰. Like almost all EU Member States, Ireland uses a landfill levy as an economic instrument to achieve this.

Landfill costs (gate fees) in Ireland, therefore, comprise the net fee (charged by the service provider) and the Government levy (Figure 63). The landfill levy has been increased significantly since 2008 to divert waste away from landfill to other waste treatment options further up the waste hierarchy such as recovery and recycling. The landfill levy has increased from €20 per tonne in 2008 to €75 in 2014.

Figure 63: Landfill cost trends in Ireland (including levy), 2008-2014



The net fee charged at the gate, however, has declined considerably since 2009 and has remained relatively stable in recent years. Overall, the cost to business users has increased however from €93 per tonne in 2010 to €113 in 2014 because of the increase in the landfill levy.

Source: RPS Research

⁸⁰ The waste hierarchy refers to the 5 steps included in the article 4 of the Waste Framework Directive: prevention; reuse and preparation for reuse; recycle; recovery; and disposal.

Figure 64: Landfill Costs in Comparator Countries/Regions⁸¹, 2008-2014

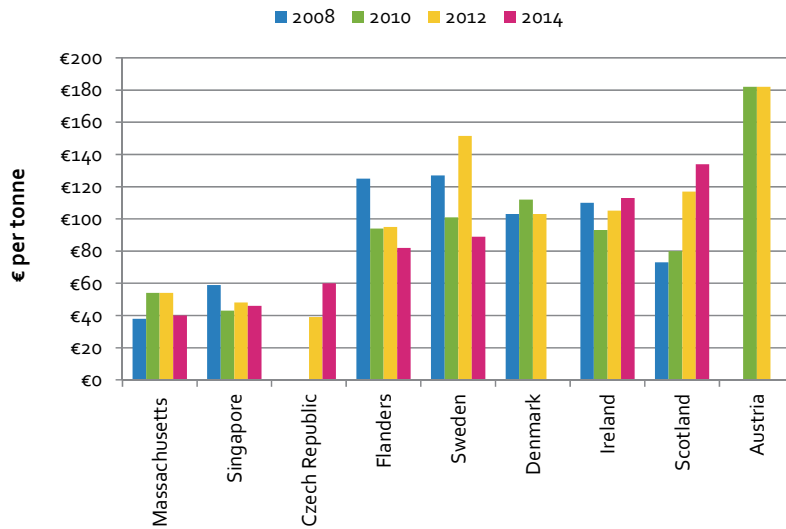
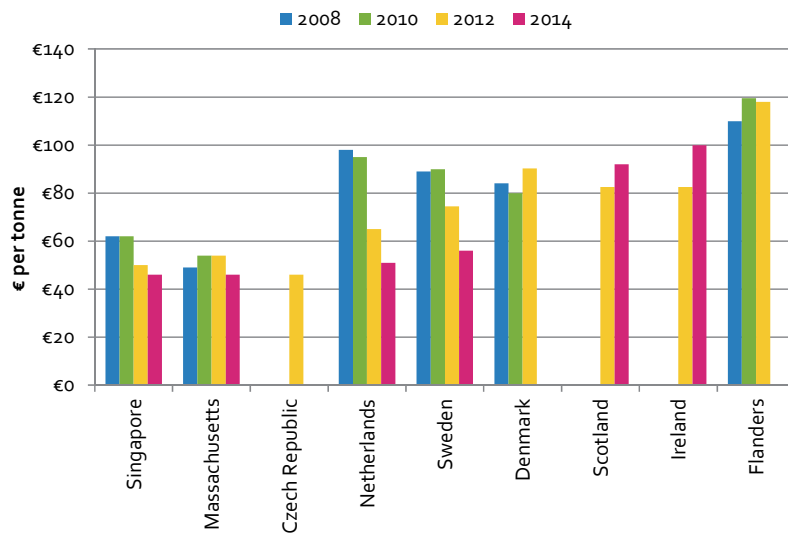


Figure 64 places Irish landfill costs into an international context. Although landfill costs in Ireland declined in 2010, they are once again among the most expensive of the benchmarked competitor and comparator countries/regions for which data is available⁸².

Source: RPS Research

Figure 65: Thermal treatment costs in comparator countries/regions⁸³, 2008-2014



As previously noted in the main report, thermal treatment costs (gate fees) in Ireland, although lower than landfill costs, are also among the most expensive in the benchmarked countries/regions⁸⁴.

Source: RPS research

⁸¹ Where relevant, data is based on a simple average of a range of waste charges available. For Singapore, 2013 data is used instead of 2014; for Sweden, 2007 data is used for 2008 and 2013 data for 2014; for Denmark, 2007 data is used for 2008.

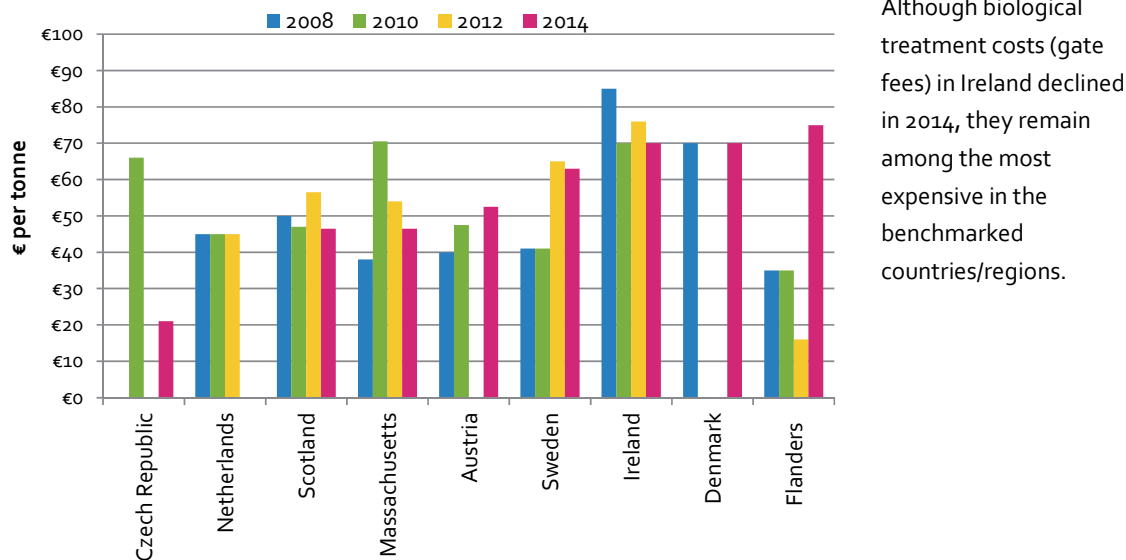
⁸² It should be borne in mind, however, that disposal at landfill represents not only the least desirable environmental outcome - it very often represents a failure to capture the resource value in various waste streams and is resource inefficient. No Member State wants to reduce the cost of landfilling.

⁸³ Where relevant, data is based on a simple average of a range of waste charges available. For Singapore, 2013 data is used instead of 2014; for Netherlands, 2013 data is used instead of 2014 data; data for 2012 and 2014 was not available for Sweden so 2011 and 2013 data is used instead; for Denmark, 2009 data is used instead of 2010 data. Note also, the thermal treatment fee for Sweden for 2008 and 2010 includes the maximum levy of €44 per tonne - the levy varies depending on the level of heat and energy recovery available; the fee for Denmark includes a levy of €44 per tonne; the fee for Flanders includes a levy of €7 in 2008/2010 and €8 in 2012.

⁸⁴ In this context it should be noted that Ireland has only one thermal treatment facility at Carranstown, County Meath. A second and considerably larger facility is expected to come on stream by end 2017/beginning 2018 at Poolbeg, Dublin - introducing competition into the thermal treatment market in Ireland.

It is also important to note that declines in gate fees in other Member States are largely attributed to overcapacity arising from the economic downturn in those countries. Gate fees are expected to increase both as a result of market forces and as a number of Member States are now introducing incineration levies to drive recycling and reduce reliance on recovery.

Figure 66: Biological treatment (food waste) costs in comparator countries/regions⁸⁵, 2008-2014



Source: RPS research

Waste Management Treatment

Ireland's approach to waste management is based on the internationally adopted hierarchy of options that has been embraced by the European Union since 1989 as the cornerstone of its waste management policy. The waste management hierarchy states that the most preferred option is prevention and minimisation, followed by re-use and recycling, energy recovery and, least favoured of all, disposal (landfill).

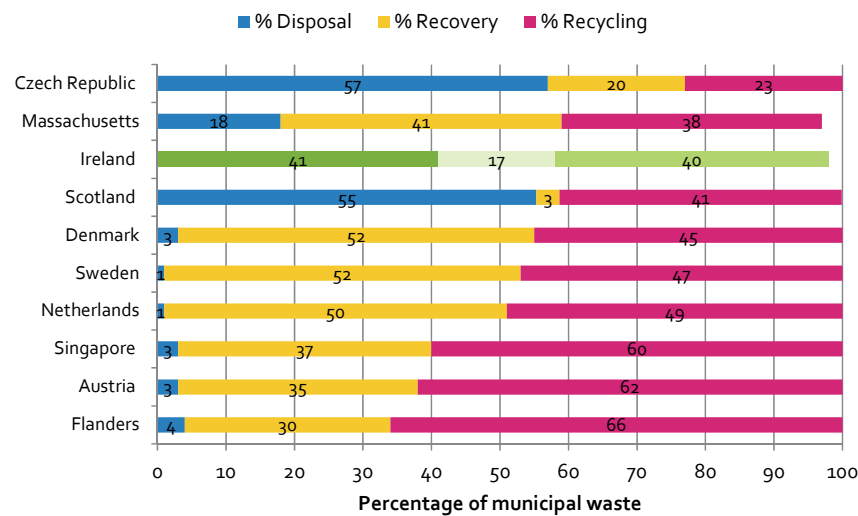
Until very recently, landfill had dominated waste treatment in Ireland, unlike in many competitor and comparator countries/regions. However, our reliance on landfill is at its lowest rate in the history of the State. In 2012 (latest data available), 41 per cent of municipal (household and commercial) waste went to landfill while 40 per cent was recycled and 17 per cent was thermally treated (incineration). In 2008, 62 per cent of municipal waste was landfilled and 35 per cent was recycled; 2012 was the first year that the percentage tonnage of municipal waste managed for recovery (59%) exceeded the percentage tonnage managed for disposal (41%).

A range of regulatory and market based instruments have been used to achieve more sustainable waste management practices. These include increases in the landfill levy, source separated collection of bio-waste,

⁸⁵ Where relevant, data is based on a simple average of a range of waste charges available. For Denmark, data for 2007 is used instead of 2008 data.

pre-treatment and restriction of particular waste streams to landfill and producer responsibility initiatives for waste streams (e.g. packaging, waste electrical and electronic equipment).

Figure 67: Municipal waste management treatment⁸⁶, 2012



Although, Ireland's reliance on landfill is declining and the recycling performance is improving, we rank 8th of the ten benchmarked countries in terms of the proportion of municipal waste recycled.

Source: RPS research

Drivers of Costs

This section examines some of the principal drivers of waste costs in Ireland. As is the case for other business inputs, some of the non-controllable drivers are determined by EU legislation and others by geographical circumstances.

Non-controllable Drivers

- In Ireland, as in other member states, the polluter pays principle is at the centre of waste management policy. This means that the generator of the waste is obliged to ensure that the waste is properly managed. In its application of the polluter pays principle, Ireland has imposed producer responsibility obligations on several sectors and waste streams, most notably packaging, waste electrical and electronic equipment and end-of-life vehicles. However, member states do have some discretion in terms of how they implement producer responsibility obligations;
- Ireland's small size and dispersed population have an adverse impact on waste costs (e.g. waste collection routes are longer with higher unit costs); and
- Competitive waste management costs in other EU countries influences both landfill and thermal treatment costs in Ireland. Since 2010, Irish operators are exporting an increasing amount of residual waste (both processed and unprocessed) due to a number of factors including the increases in the Irish

⁸⁶ Approximately, 3% of municipal Irish waste is treated through Waste-to-Energy (WtE). This waste is collected and transported overseas to receive this treatment; as a result, the Irish data in the chart does not equal 100%.

landfill levy and competitive waste treatment costs in overseas markets due to over capacity. In 2013, around 20 per cent of residual waste was exported.

Controllable Drivers

- *The balance between economic and environmental goals:* Ireland needs to ensure that national waste policy supports national competitiveness as well as environmental sustainability policy objectives.
- *Regulatory and policy uncertainty:* Prior to the new national waste policy (2012), the waste policy agenda had been highly uncertain in Ireland for a number of years which ultimately resulted in higher costs for consumers (business and residential). The uncertainty created higher risks for investors and higher cost of capital investment for those building new infrastructure;
- *Fragmented waste sector:* Up until 2014, the regional approach to waste planning and implementation involved ten somewhat arbitrarily decided regions which contributed to a very fragmented waste market and resulted in smaller scale facilities than would have been the case if infrastructure planning was done at a national or more aggregated regional level. The recent move to three regional waste management plans is a welcome development⁸⁷;
- *Company cost structures:* The cost structures of the waste collection and infrastructure companies also influence the costs of the services provided. Waste companies need to ensure that they are taking all necessary steps to improve efficiencies and reduce costs;
- *Planning delays:* Lengthy delays in the planning process have had a negative impact on the timely delivery of cost competitive waste management infrastructure;
- *Resource efficiency:* In line with the “user pays” principles, the more waste a company produces the more waste management costs. Reducing the amount of waste generated, therefore, is one of the most effective ways for companies to cut waste management costs.

Policy Priorities

The availability of a choice of competitively priced, sophisticated waste management services is critical to support economic growth and job creation. It is particularly important in key internationally trading sectors (e.g. food, pharma, ICT) and in domestic sectors (e.g. hospitality and retail) of the economy. The main policy priorities to improve waste management cost competitiveness are set out below.

Delivering sufficient cost effective waste infrastructure to meet business needs

Historically, Ireland has performed poorly relative to competitor countries in the provision and cost of waste management treatment options to business. Currently, Ireland is exporting increasing amounts of waste as there is an excess of low cost waste infrastructure capacity available in other EU markets. This is unlikely to continue in the longer term, which will leave Irish businesses vulnerable to price increases if a sufficient stock of new cost effective domestic treatment capacity along the waste hierarchy does not come on stream on time. Like most infrastructure, it will take time to deliver new waste facilities. The new regional waste plans

⁸⁷ The three new waste regions are Southern (Carlow, Clare, Cork City, Cork County, Kerry, Kilkenny, Limerick, Tipperary, Waterford, Wexford), Eastern-Midland (Dublin City, Dun Laoghaire/Rathdown, Fingal, Kildare, Laois, Longford, Louth, Meath, Offaly, South Dublin, Wicklow, Westmeath) and Connaught-Ulster (Cavan, Donegal, Galway City, Galway County, Leitrim, Mayo, Monaghan, Roscommon, Sligo). The draft regional waste plans are available at: <http://www.environ.ie/en/Environment/Waste/WasteManagementPlans/#draft>

currently under development have a critical role to play in facilitating timely investment in the required waste infrastructure. The reduction in the number of waste management plans will create larger waste markets which should facilitate the delivery of cost effective, commercially viable, sophisticated waste treatment options along the waste hierarchy – in particular for thermal and biological facilities. The success of the plans will depend on close and constructive engagement between public authorities and the waste industry.

Recommendation: The new regional waste management plans should facilitate private investment in cost effective, integrated and diversified waste treatment options across the waste management spectrum.

Responsibility: Department of Environment, Community and Local Government, Local Authorities

Balancing competitiveness and environmental goals

While improving Ireland’s environmental sustainability is important, it must be done at least cost to Irish businesses. Ireland needs to ensure that national waste policy supports national competitiveness as well as environmental sustainability policy objectives. There are two important elements to this.

Recommendation: Ireland needs to implement EU environmental obligations in the most cost effective manner.

Responsibility: Department of Environment, Community and Local Government

Recommendation: When the EC is reviewing waste policy and setting new waste targets, Ireland’s negotiating position must be informed by national competitiveness as well as environmental considerations. New EU-wide waste targets are to be negotiated during 2015⁸⁸. These targets should not hinder the development of a diverse, integrated and cost-effective waste infrastructure.

Responsibility: Department of Environment, Community and Local Government

Reducing waste generation

The most effective way for businesses to cut their waste management costs is by reducing the amount of waste they generate. The prioritisation of waste prevention in the 2012 waste policy is welcome. However, continued and enhanced efforts are required by Government departments, agencies, business representative associations and businesses themselves to ensure that businesses are fully aware of how best to exploit waste management reduction processes and technologies⁸⁹.

88 In December 2014, the new European Commission withdrew proposals adopted by the previous commission in June and announced that it plans to put forward new more ambitious plans during the 2015. The original plans included targets to recycle 70 per cent of municipal waste and 80 per cent of packaging waste by 2030, and ban burying recyclable waste in landfill as of 2025. For details see: <http://ec.europa.eu/environment/circular-economy/>

89 The Green Business programme, which is funded by the Environmental Protection Agency (EPA) under the National Waste Prevention Programme, works with business to help them become more resource efficient and save money through waste prevention and reductions in water and energy consumption. For details, see: <http://greenbusiness.ie/>

