

Invitation to Submit to the Joint Committee on Jobs, Enterprise, and Innovation on the Costs of Doing Business

ISME thanks the Joint Committee for this opportunity to address the issue of business costs.

While we accept the Committee's invitation to highlight our issues of greatest concern in *order of priority*, we must emphasise that this is a difficult thing to do for an Association with as diverse a membership base as ISME. Services businesses (which make up the majority of ISME membership) have a different cost base to our members in distribution, construction, and financial services businesses. Their prioritisation of cost issues will therefore differ. However, in order to comply with your invitation, the order of priority expressed below reflects the consensus view among our membership sectors. Their most significant business cost drivers are:

- Commercial Insurance
- Labour Costs
- Public Service Costs
- Commercial Property Costs
- Energy Costs

Though we have highlighted five areas of business costs, we wish at the outset to express our frustration that the Committee has asked us to identify 'priority' areas. This is symptomatic of the different approaches the public and commercial sectors take to cost problems. Most businesses now adopt 'Six-Sigma,' 'Lean,' or 'Lean-Sigma' approaches to the containment and reduction of cost (waste). Anything which is not value-additive *from the customer's point of view*¹ is regarded as waste. This concept is alien to the public sector mind-set. A small business adopting lean practices will not reduce its focus to four or five large items (as we do below). Rather it will plan to tackle 10, 20, 30, or more issues, each of which might save only 0.3% of enterprise cost, but which can, collectively, reduce a material amount of *waste*. We commend this approach to the members of the Committee.

While not the largest cost driver for all businesses, **Commercial Insurance Costs** frustrate SMEs more than any other because they reflect political and judicial inaction on an issue which has distanced Ireland from peer economies for a long time. Insurance costs are not merely high, but are enterprise-threatening, in areas such as hospitality, distribution, and retail. The inconvenient truth is that our personal injuries environment is driven by a highly profitable costs regime, which exists independently of, and frequently trumps, the compensation to plaintiffs. The solutions to our insurance cost problem are remarkably simple, but politically challenging. They require facing down vested interests, who view

¹ <http://www.sixsigmaonline.org/six-sigma-training-certification-information/lean-six-sigma-wastes-and-principles/>

insurance reform as hostile to their livelihoods. Within our own membership, we have SMEs in the insurance brokerage sector. Their profitability would be reduced by proposals ISME has made to the Joint Oireachtas Finance Committee and the Cost of Insurance Working Group. Nonetheless, as ISME members, they acknowledge that the greater good is served by reducing what is an unjustifiable and unsustainable cost on business. To summarise our prescription for lower insurance costs:

1. Rehabilitation, if not the sole means of recompense by a defendant, must be given a far higher ranking in the hierarchy of compensation. This issue will not deter genuine claimants.
2. Our general damages regime is an outlier internationally, and bears no objective relationship to the special damages regime. The Book of Quantum must be benchmarked against its equivalent in peer economies. The revised Book of Quantum must be prescriptive in nature, with very limited, and legislatively defined exceptions. There is no constitutional impediment to so doing.
3. There must be a statutory offence of perjury², based along the similar, simple lines of those of the other common law jurisdictions which have long ago codified perjury. Statements of claim to the Injuries Board must be made under an affidavit of verification.
4. There must be a meaningful moral hazard for those who wish to appeal an Injuries Board recommendation to the courts. Appellants of IB assessments to the courts must better those assessments in court by at least 50% (to reflect the cost implications) if they are to be awarded their costs. They must in all cases be required to provide security for costs.
5. The Statute of Limitations for the submission of personal injuries actions must be curtailed.
6. Implement the overhauls to the legal profession required under the EU/IMF program.
7. Submit certain contentious diagnoses, such as whiplash, to an impartial expert medical body for certification, prior to the initiation of a statement of claim.
8. Full transparency on all settlements data, made available to, and for publication by, a state agency such as the Central Bank or the CSO.

The above are a summary only of the longer submissions ISME has made to the Joint Oireachtas Finance Committee and the Cost of Insurance Working Group. We would ask the Committee to bear in mind that the cost of insurance is not merely a fiscal issue. It erodes trust between businesses and customer, between employers and employees, between parents and schools; it is contributing directly to a decline in the health of our children³. It is a national scandal, which you, the members of the Oireachtas, have the power to redress.

The **Cost of Labour** in Ireland is high relative to peer economies, and is regulated to an inappropriately high degree. We have the second highest national minimum wage (NMW) in

² <https://isme.ie/assets/The-Case-for-a-Perjury-Act.pdf>

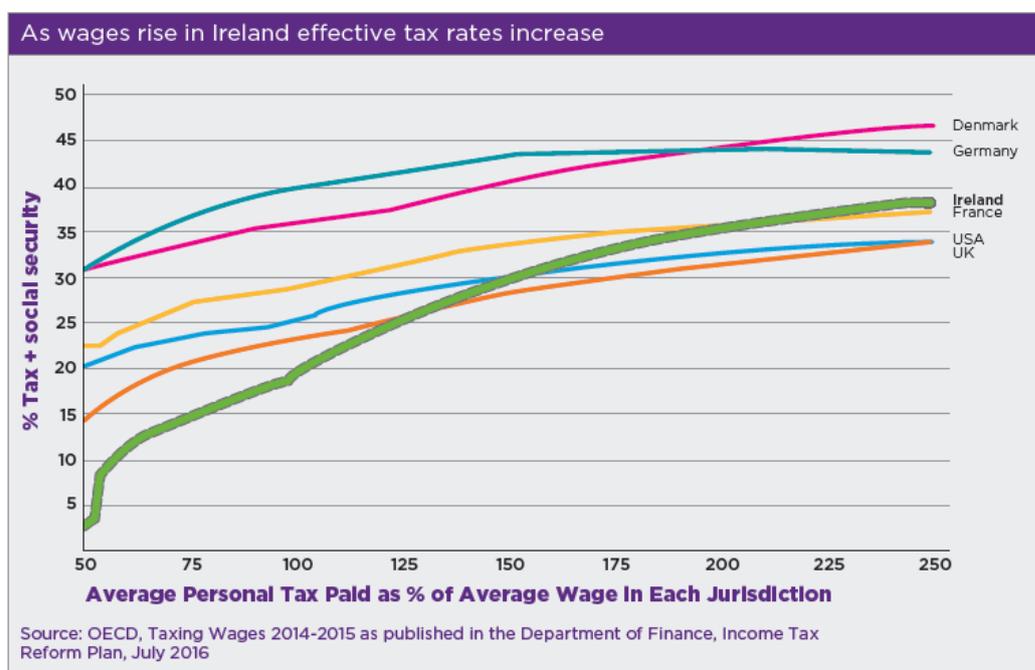
³ <http://www.independent.ie/irish-news/health/revealed-irish-kids-aged-12-cannot-run-jump-catch-or-even-hit-a-ball-36043842.html>

Europe⁴ despite the fact that the Low Pay Commission (LPC) was unable to adhere to its terms of reference by citing any objective reasoning behind its latest increase. This non-compliance has earned the LPC a rebuke from the Department of Finance⁵ and a dissenting opinion from some of its own members⁶. This is also despite evidence suggesting that increasing hourly minimum pay rates does not assure workers of increasing levels of income (i.e. 'P60' income)⁷, and in any case is at the expense of a small rise in unemployment levels.

The one area where ISME is *ad idem* with the LPC is the fact that property and rental prices are too high (see below). Yet a 3% increase in the NMW will do nothing to help the low paid with finding rental accommodation. It is political gesturing, and a worthless sop to the low paid, while doing nothing to tackle the underlying issue of excessive housing cost.

The extreme rate at which the personal tax wedge rises from a very low base represents a significant disincentive for workers to upskill, gain promotion, or do overtime. It also presents a significant barrier to employers seeking to meaningfully increase a worker's take-home pay without very substantial increases in gross-pay. Ireland is second only to Israel in the OECD⁸ in income tax progressivity (see Fig 1. below). This is potentially a significant detractor from Ireland's ability to attract talent in a post-Brexit environment.

Figure 1.



⁴ http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Minimum_wages,_January_2008_and_2017_YB17_1.png

⁵ <http://www.lowpaycommission.ie/consultations/department-of-finance.rtf>

⁶ <http://www.lowpaycommission.ie/publications/national%20minimum%20wage%202017/national%20minimum%20wage%202017%20report.pdf>

⁷ https://evans.uw.edu/sites/default/files/MinWageReport-July2016_Final.pdf

⁸ <https://taxinstitute.ie/Portals/0/The%20Budget%20Book%202017%20-%20Final%2016%20Sept.pdf>

In virtually every commentary on prices, ISME points out that affordability and wealth cannot be improved by increasing wages. We must recognise that we are a high-cost economy, in many ways unjustifiably so. Instead of inducing a wage-price spiral with pay increases for the few, which will not increase net wealth in an environment where there are supply restrictions, the Government must focus remedial actions on reducing the costs of living (and working) for everyone.

To our frustration, these facts are well-known and independently established via the National Competitiveness Council's Competitiveness Scorecard,⁹ yet Government does not appear to be under any obligation to implement its recommendations. ISME believes Government should implement NCC recommendations, or disband that body and save the money.

Most nations and societies employ and engage a **Public Service** to enact their will, and to provide for social goods and amenities to their citizens. One could be forgiven for thinking it was the other way round in Ireland; that our public service has captured and engaged the services of an independent state in the furtherance of their own interests and personal amenity. While not overwhelming in size by comparison with neighbouring countries (approximately 15% of the total workforce), the preservation of its employment levels, and the continuation of its pay premium over the rest of the workforce appear to have been prioritised. Despite the tsunami of unemployment which hit the private sector in the Great Recession, and despite the fact that we have as yet to regain 125,000 of the jobs lost during it; the gap between public and private sector pay remains stubbornly high, and as of Q1 2017 is 37%.¹⁰

At the same time, the taxation system adopts a whole series of arbitrary distinctions between income in the public and private sectors which favour the former in ways which are not objectively just. The tax status of business expenses is governed by the rates agreed from time to time between the Department of Finance and the IMPACT trade union¹¹. The Revenue applies a 'Personal Fund Threshold' to private pensions calculated to be worth more than €2m, and apply a tax surcharge on the pension pot in excess of that. However the open market annuity cost of the pension for most TDs, Gardai above the rank of sergeant, judges, hospital consultants would exceed this threshold if calculated in the same way, yet are not subject to such a surcharge. 'Gratuities' paid to public service employees on retirement are not taxable. Any such payment to a non-state employee would be deemed as taxable income. These all have real costs in terms of taxation policy, and long-term pensions sustainability.

⁹ <http://www.competitiveness.ie/Publications/2017/Ireland%20s%20Competitiveness%20Scorecard%202017.html>

¹⁰ <http://cso.ie/en/releasesandpublications/er/elcg/earningsandlabourcostsq42016finalq12017preliminaryestimates/>

¹¹ <http://www.revenue.ie/en/tax-professionals/tm/income-tax-capital-gains-tax-corporation-tax/part-05/05-01-06.pdf>

The continuation of this public service income premium is divisive and socially corrosive. It is one of the largest income gaps in existence outside of Mediterranean countries (which have lower income levels across their economies in any case). The equivalent public/private sector pay gap in the UK is just over 3%¹². In our Pre-Budget Submission¹³ ISME sought a commitment from Government to reduce this gap to 10% not later than 2025. This is achievable within an eight-year time frame if Government can moderate the expectations of public service unions on the one hand, while private sector wages can catch up on the other. In the longer term, Government should commit to its elimination.

The relative cost of the Public Service would be tolerable if society and business felt they were getting good service, value for money, and accountability. Sadly this is not the case. Our health services remain a constant area of underperformance, despite the very high levels of public spending¹⁴ on a relatively young population. Our education system seems immune to modernisation. We are unable to provide accommodation to substantial numbers of citizens at an affordable sum. Our policing service is beset by scandals. Our justice system takes an inordinate time to process criminal wrongdoing, and appears blind to white-collar crime. This level of mismanagement and incompetence would never be tolerated, nor could it persist, in a commercial entity. Yet in none of these areas are the numbers of public servants employed materially below international norms; nor (with the exception of restricted areas in health and defence) are public service rates of pay deterrent to recruitment or retention. The fact that Ireland, as one of the most heavily indebted countries in the world¹⁵, continues to borrow money to inflate this already-generous pay bill adds ignorance to injury.

The costs of **Commercial Property** are very high for a small economy, in a country with a low-density population. The rate of increase of prime office rents in Dublin, and the fact that Dublin prime rents now exceed those in cities like Singapore, Los Angeles, Frankfurt, Manchester, Munich, Rome, and Seattle¹⁶ should give the members pause for thought. The planning laws, rent laws, and commercial rates laws conspire to make the commercial property in Ireland a poor value for money proposition by comparison with our neighbours. These shortcomings also spill over into private property and private renting, which have a knock-on impact in the cost of living, and the expectation among employees that it is the duty of employers to fund the cost of housing. ISME has long held as a principle that upward only rent reviews (UORR) were an outdated and unacceptable practice, and should be outlawed. We were continually advised that interference in rental contracts was unconstitutional, despite advices we had received to the contrary. Yet in 2016, the Government enacted the

¹² <https://www.ifs.org.uk/uploads/publications/bns/BN210.pdf>

¹³ <https://isme.ie/assets/ISME-Pre-Budget-Submission-2018.pdf>

¹⁴ <https://data.oecd.org/healthres/health-spending.htm>

¹⁵ <http://www.nationaldebtclocks.org/debtclock/ireland>

¹⁶ <https://www.cbre.com/about/media-center/global-prime-office-rents>

Planning and Development (Housing) and Residential Tenancies Act 2016¹⁷, which interfered with private rents via ‘Rent Pressure Zones.’ There is clearly no longer any justification for tolerating UORR.

When ISME met with the Valuations Office in early 2017 about the Commercial Rates Revaluation Program,¹⁸ we understood that a low-level rebalancing of rates, together with an increased effort on collections, would be the result. Within months, we received numerous complaints from members about exorbitant increases in rates¹⁹. The current rates system is obsolete, and ISME does not believe that tinkering with it is justifiable. It should be replaced with a modern, fit-for-purpose calculation mechanism, which reflects site value (rather than commercial value), and is sensitive to the profitability of a business. Rates should be a known quantity, and independently calculable by reference to objective criteria. Since businesses now pay separately for utilities, this element of what was once paid for via commercial rates must be discounted.

While the inputs to **Energy Costs** have been falling for several years, muddled Government policies have meant that medium and large users have been hit with large increases in the PSO levy. The theory of the PSO levy is good- it supports the generation of electricity from sustainable, renewable, and indigenous sources. But by tying its calculation exclusively to wholesale energy prices, the levy increases as energy prices fall. It therefore reduces savings to end users. We have member companies who have seen a 277% increase in the cost of the PSO levy over the last four years, even as they have invested heavily in energy efficient technologies to reduce their energy consumption. This is nonsensical, and contrary to the policy objectives intended.

Bizarrely, the very high taxes we have traditionally attached to energy (and transport- via private motor vehicle taxes and commercial vehicle taxes) now make it very difficult to encourage the use of more energy efficient alternatives. The high capex costs that will be incurred to reengineer our energy supply chain mean businesses and consumers will need some form of financial inducement to wean themselves off older, more CO₂-intensive technologies. Yet these technologies have generated massive incomes for the state via excise, VRT and VAT charges. The state must develop an ability to think longer than a single budgetary cycle to address this, and similar, issues.

¹⁷ <http://www.irishstatutebook.ie/eli/2016/act/17/enacted/en/html>

¹⁸ http://www.valoff.ie/en/Latest_News/Next_Phase_of_National_Revaluation_Programme_Now_Under_Way.html

¹⁹ <https://www.isme.ie/ismes-local-authority-commercial-rates-survey-results>