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ANALYSIS OF GOVERNMENT INDUCED COSTS ON TOURISM & HOSPITALITY ENTERPRISES

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A REPORT PREPARED FOR
THE IRISH TOURISM INDUSTRY CONFEDERATION
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Contents

KEY POINTS

- Coming into 2024, the tourism and hospitality sector has been characterised by a significant degree of apprehension about prospects for the sector. The global economic background is uncertain and risky; domestic consumer spending is under some pressure; there is a shortage of accommodation due to beds being removed from the system to facilitate Ukrainian refugees and international asylum seekers; the costs of doing business have increased significantly over the past couple of years, particularly labour costs and energy; labour shortages are very obvious; and the cost base is being damaged by a number of State-induced upward pressure on labour costs, which are set to be rolled out this year and in the coming years.

- The introduction of several labour-market measures is imposing considerable pressure on many businesses, and these pressures are set to intensify. The State-induced measures include the increase in the national minimum wage; statutory sick pay changes; the move towards a living wage by 2026; parental leave changes; the extra bank holiday; higher PRSI; and auto-enrolment for pensions. The measures are combining to increase costs significantly for businesses across the tourism and hospitality sector. These businesses were already under significant pressure due to higher energy costs, higher food prices, labour shortages, the increase in the VAT rate, and other input costs.

- Based on employment levels in the tourism sector at the end of 2023 and the March 2024 Irish Government Economic and Evaluation Service (IGEES) calculation that the State-induced measures would add 6.6 per cent in payroll costs in the hospitality sector in 2024, a conservative estimated is that the measures would increase the payroll costs by €456 million in 2024 and €1.4 billion by 2026. Such an increase in payroll costs, above and beyond regular wage trends, for an industry that is facing so many challenges would be very damaging to the industry in the absence of mitigating measures.

- These additional cost burdens are in the context of the tourism and hospitality VAT increase last year from 9% to 13.5% which is estimated by the Department of Finance to be quantified at €750m annually, as well as a cost of €1.1 billion as estimated by Fáilte Ireland to the wider tourism industry of hotels and guesthouses being used by the State for emergency accommodation, The net result is that the operating environment for many businesses in the tourism and hospitality sector is becoming very challenging; margins are being squeezed; and the viability of many businesses is being threatened.

- Government acknowledges in the March 2024 IGEES report that the most affected industries *"will be labour-intensive and low-margin sectors"* such as tourism and hospitality. Thus it is imperative for the tourism and hospitality sector that Government moves as quickly as possible to mitigate the costs imposed by the raft of state-induced labour-market measures that are being imposed on business now.

- The Government is providing short-term support for economy-wide SMEs through schemes such as energy supports and rebate of commercial rates. However these are modest by nature and the certainty is that these supports will be overwhelmed by the State-induced increases in the cost-of-doing business. Given the short to medium-term impact that the package of State-induced cost measures will have, it is important that longer-term relief is provided to the businesses and the sectors most adversely affected by the increase in costs.

- This report outlines a number of mitigation proposals for Government to adopt to support Ireland's tourism and hospitality industry. The overall objective of any Government support measures should be to alleviate the cost-of-doing business pressures; support the competitiveness of the offering of the tourism & hospitality sector; preserve margins; help business viability; and ensure that regional economic activity and employment is sustained. All these objectives are inter-connected.

PROPOSED MEASURES TO SUPPORT TOURISM & HOSPITALITY

- Return the tourism & hospitality VAT rate to 9 per cent on an ongoing basis
- Reform Employer PRSI for SMEs: apply 8.8 per cent rate to entirety of the National Minimum Wage or PRSI rate rebate for most vulnerable sectors such as tourism and hospitality
- An Enterprise Support Package for those sectors such as tourism and hospitality most adversely affected by state-induced labour market measures every year out to 2026

THE ECONOMIC SIGNIFICANCE OF TOURISM & HOSPITALITY

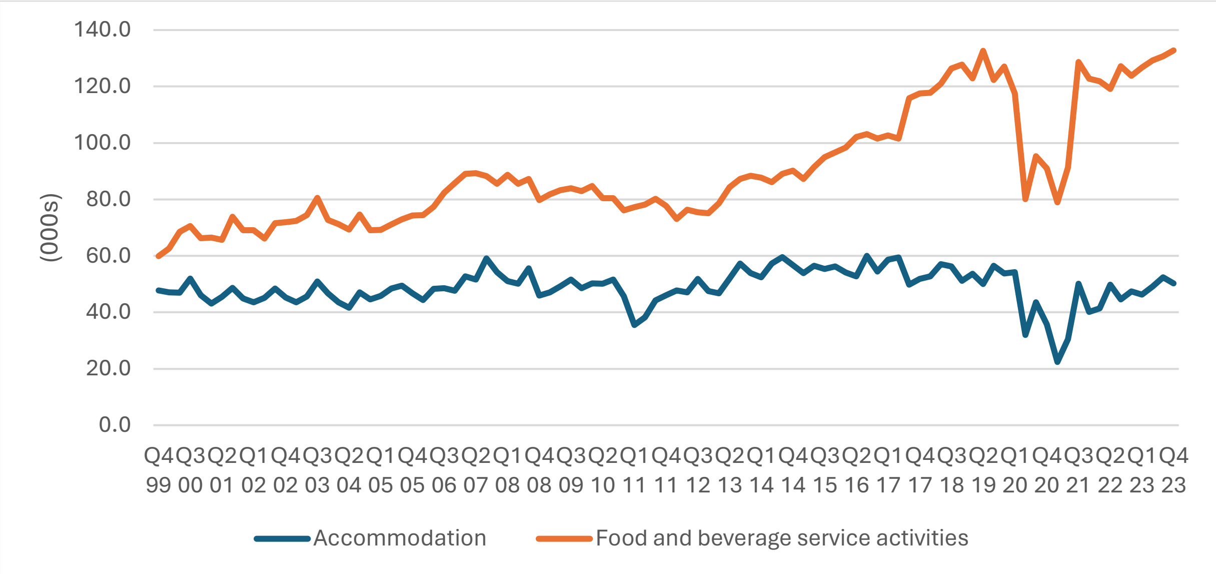
Tourism is a very important component and driver of economic activity in Ireland. Its real significance is that it is a major engine of employment at a regional level and is consequently an important driver of the balanced regional economic growth agenda.

Tourism helps to drive employment in several sectors such as hospitality and food, particularly in the locations and visitor attractions that are very popular with tourists. The revenue generated by both domestic and foreign visitors during their trip contributes to both the balance of payments and national accounts data.

In 2019, the CSO Tourism Satellite Account estimated that there were 284,800 full-time equivalent jobs directly involved in tourism in Ireland, which represents a tourism share of more than 13 per cent of total full-time equivalent jobs in the overall Irish economy. This compares with an approximate 4 per cent share of all employment involved in Agriculture, a 6 per cent share of employment in Construction, and 12 per cent share of employment in the industry sector. When all full-time equivalent jobs in the tourism characteristic industries are included (adding those not directly involved in tourism), the employment figure rose to 351,700.

Direct employment in the tourism sector derives from activities such as cultural and recreational; transport, rental, and leasing; passenger transport; and accommodation and food beverage services. In the final quarter of 2023, CSO data show that accommodation supported 50,300 jobs directly, and food and beverage service activities supported 132,800 jobs.

Figure 1: Employment in Accommodation & Food and Beverage Service Activities



Source: CSO PxStat

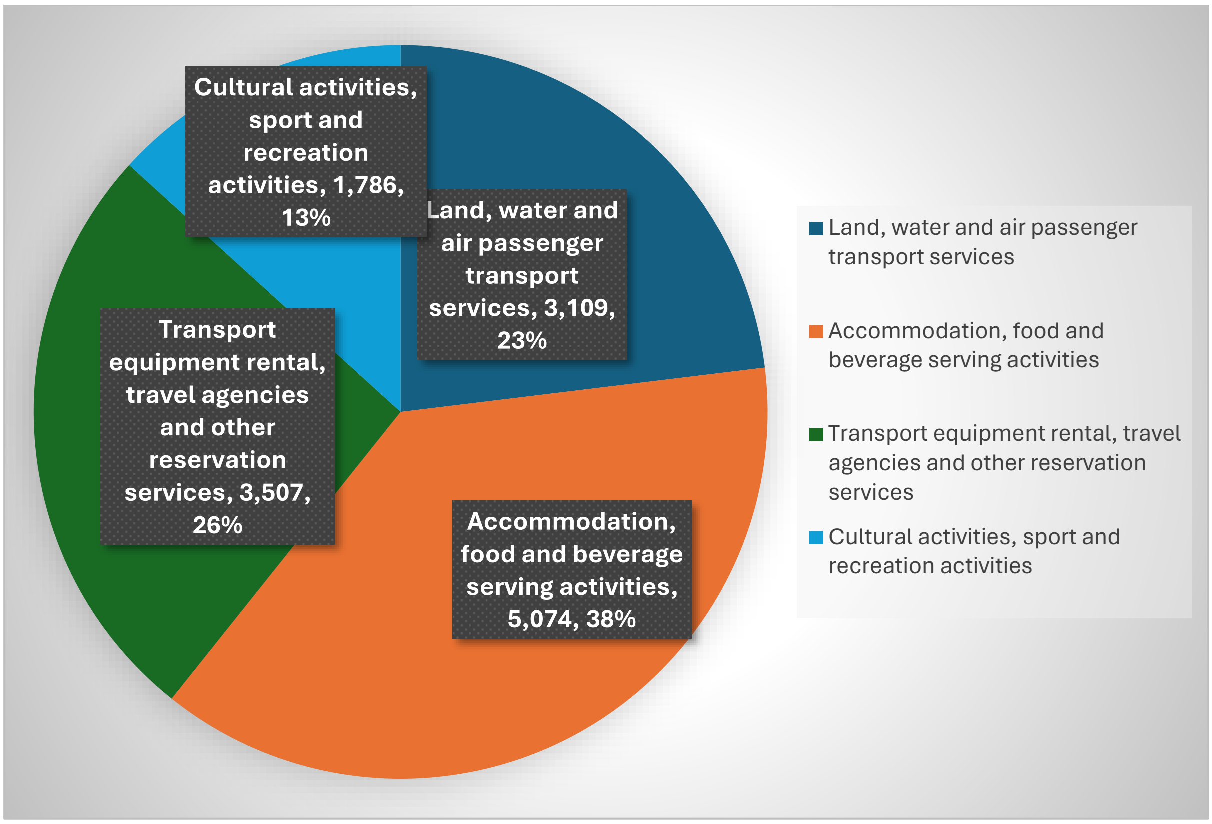
In terms of tourism businesses an estimated 45,700 enterprises were involved in providing goods and services directly to tourism in 2019.

The CSO has developed a Tourism Satellite Account (TSA) methodology to measure the total contribution of tourism. The TSA methodology compiles data from both the supply side and the demand side of tourism within the overall system of National Accounts. This allows a country to determine a measure of Tourism Direct Gross Value Added (TDGVA), which is the component of output from the Irish tourism industries that is driven directly by tourism spend. Essentially it involves estimating all tourist related spending by domestic and foreign visitors within Ireland. TDGVA is calculated by reconciling the supply (the output of tourism industries) with the use (tourist consumption) side of tourism, so that the proportion of the output of the tourism industries that is accounted for by tourism expenditure can be estimated.

The CSO generated an initial estimate for the TDGVA which calculates that tourism contributed €13.5 billion to the Irish economy in 2019, and this gives a ratio of TDGVA to total Gross Value Added (GVA) in the economy of 4.4 per cent.

The main tourism industry contributors to TDGVA in 2019 in Ireland were accommodation services for visitors and food and beverage serving activities (€5.1 billion).

Figure 2: Tourism Direct Gross Value added by Industry (2019 €m)



Source: CSO

The Department of Tourism, Culture, Arts, Gaeltacht, Sport and Media has high-level goals in relation to tourism. These goals are:

- To support the sustainable growth of a competitive Tourism sector with a particular emphasis on supporting economic development in communities throughout the country, whilst protecting our environment and natural resources
- To promote North-South co-operation, within the context of the Good Friday Agreement and the Government's Shared Island Initiative, particularly in the context of the work of Tourism Ireland

The Government has an ambition to have a vibrant and competitive tourism sector that makes a significant contribution across the country, is economically, socially, and environmentally sustainable, helps promote a positive image of Ireland overseas, and enables local communities to prosper.

Tourism Ireland[i] plans to grow overseas tourism industry revenues by 5.6 per cent on average annually out to 2030. If this growth does not materialize it could prevent close to €15 billion in economic activity out to 2030 from being realised.

Last September the ITIC (Irish Tourism Industry Confederation) published an ambitious but realistic growth strategy for Irish tourism, which if delivered would make a very significant positive contribution to the Irish economy and Irish society over the coming years.[ii]

The vision for Irish tourism set out by ITIC is that '*2030 will see Ireland as a leader in sustainable tourism growth, delivering a unique business experience which delivers regional economic growth based on value over volume, while respecting environmental, social and community values.*'

Specifically, ITIC believes that the value of tourism earnings could grow by 50 per cent by 2030; employing up to 350,000 workers, and delivering €3.5 billion annually to the Exchequer in taxes, compared to €2.3 billion now.

Coming into 2024, the tourism sector has been characterised by a significant degree of apprehension about prospects for the sector due to demand uncertainties, capacity constraints and cost of business pressures.

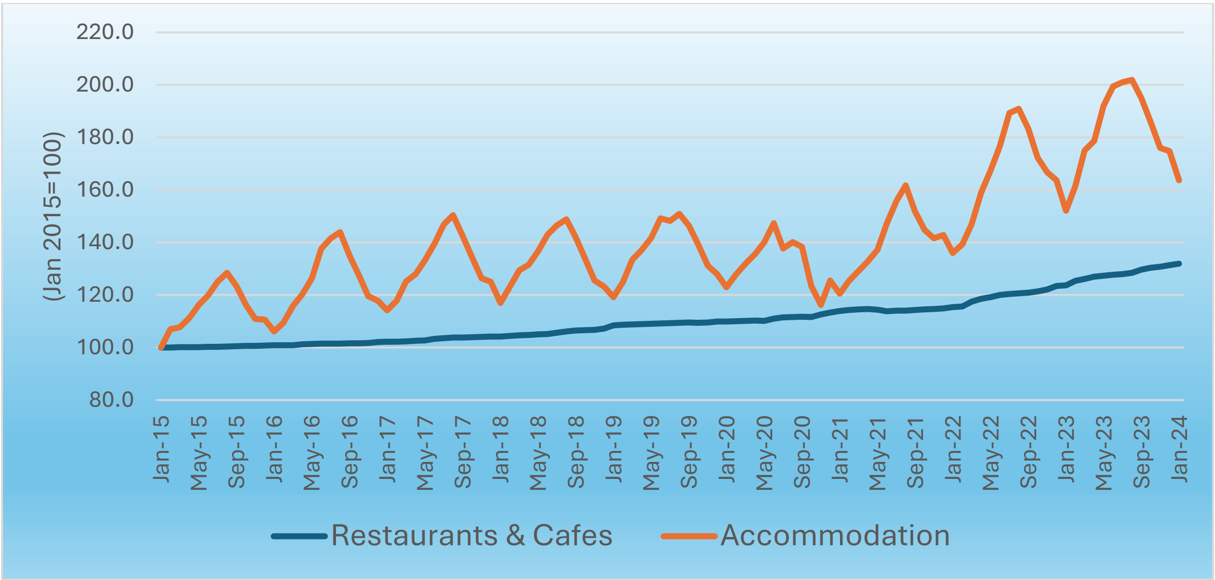
IMPACT OF GOVERNMENT MEASURES ON TOURISM & HOSPITALITY SECTOR

COST PRESSURES IN THE TOURISM & HOSPITALITY SECTOR

The Irish economy is now operating very close to full employment. At the end of 2023 employment reached a new record high of 2.7 million, and in February 2024 the unemployment rate stood at 4.2 per cent of the labour force. From a social and economic perspective these labour market conditions are very positive, but the tightness of the labour market poses a significant challenge for many businesses across the economy in terms of pressure on wage costs, recruitment, and retention of employees. This is a particular issue for the retail and hospitality sectors.

The general costs of doing business have increased significantly since the end of the Covid-19 pandemic and the advent of the war in Ukraine. Higher energy costs; higher wage costs; and higher interest rates are all pressuring businesses, but the tourism and hospitality sector are particularly exposed, given the labour-intensive nature of the sector. In addition, the escalation in the cost of living and higher interest rates have pressurised consumer spending.

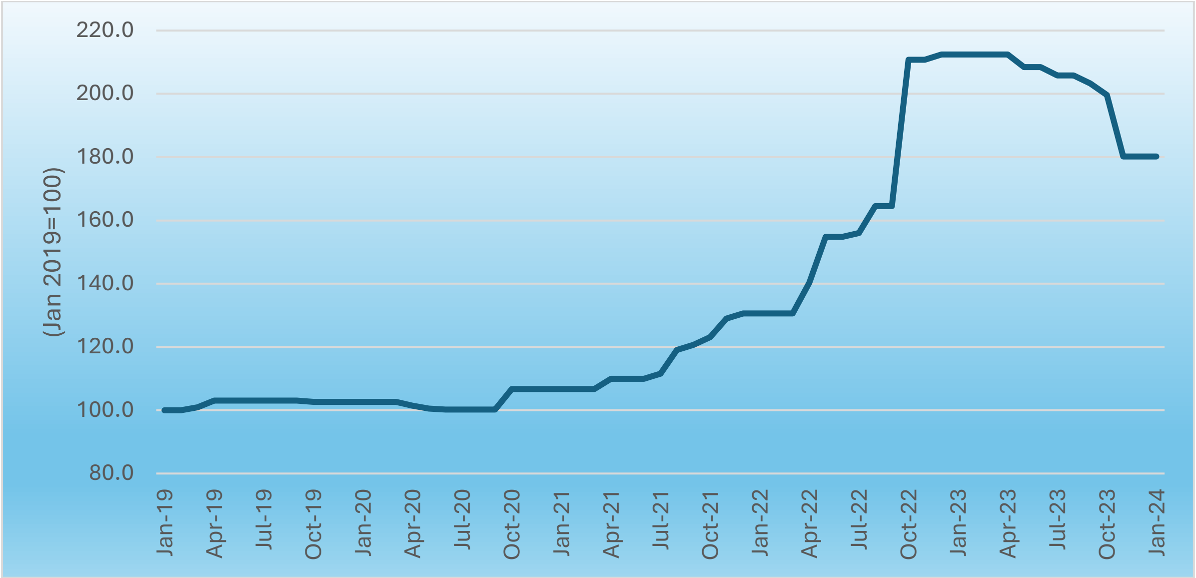
Figure 3: Consumer Price Trends in Hospitality Sector



Source: CSO

Between January 2020 and January 2024, the average price of accommodation has increased by 33.1 per cent and the average price charged by restaurants and cafes has increased by 20 per cent. These price rises are reflecting significant increases in the cost of doing business, and in the case of accommodation, there is the additional pressure caused by hotel accommodation being withdrawn to accommodate asylum seekers.

Figure 4: Average Consumer Electricity Prices

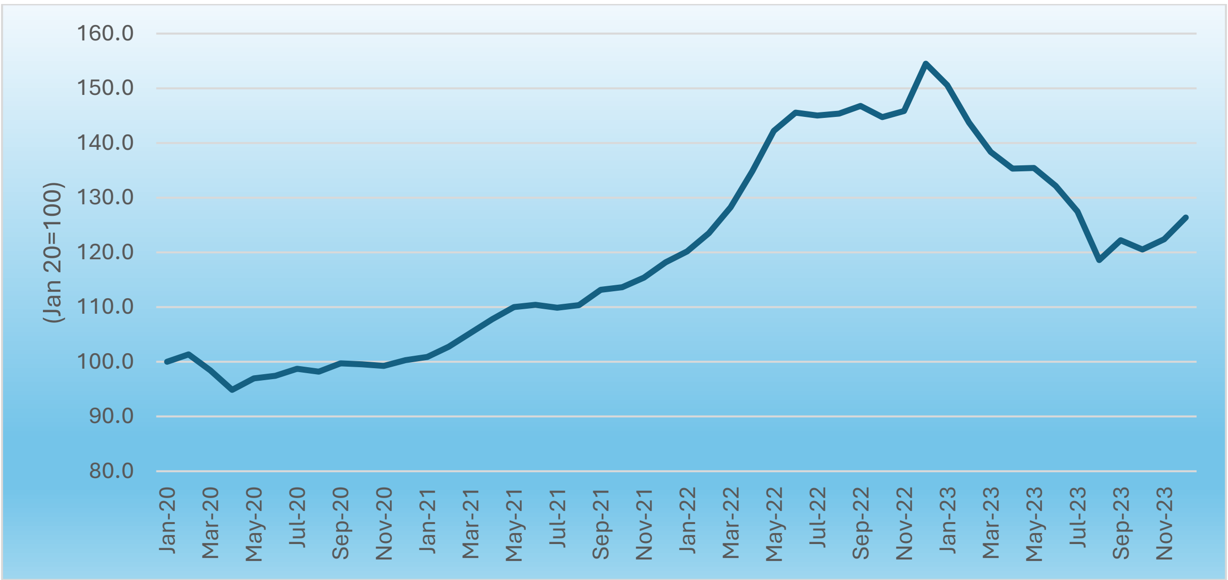


Source: CSO

Electricity provides a compelling picture of the increased costs in the economy for consumers and businesses. Between September 2020 and April 2023, the average cost of electricity for consumers increased by 112 per cent. Although prices have subsequently started to moderate, average electricity prices in January 2024 were still 79.8 per cent higher than in September 2020.

Input costs such as food has also increased significantly for the hospitality sector. Between April 2020 and December 2022, agricultural output prices increased by 82 per cent. Output prices have subsequently eased, but in December 2023, prices were still 49 per cent higher than in April 2020.

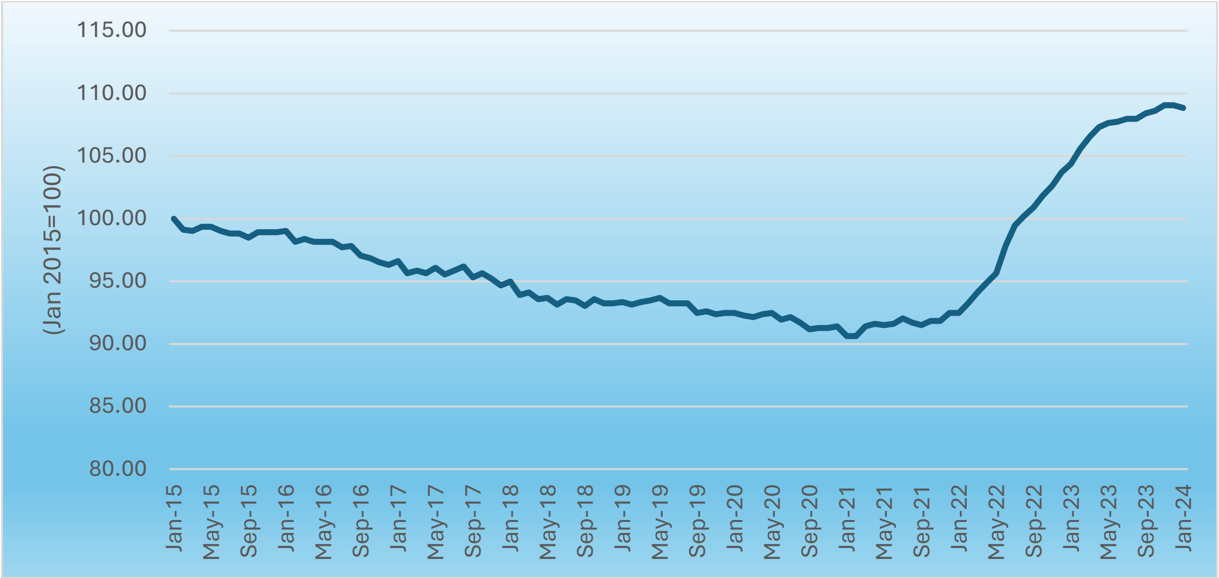
Figure 5: Agricultural Output Prices



Source: CSO

These forces have combined to push food prices up for the consumer also. Between January 2021 and January 2024, the average price of food increased by 20.1 per cent.

Figure 6: Average Consumer Price for Food



Source: CSO

COST PRESSURES IN THE TOURISM & HOSPITALITY SECTOR DRIVEN BY GOVERNMENT POLICY

On September 1st, 2023, the Government increased the VAT rate from 9 per cent to 13.5 per cent, arguing that the reduction was a temporary measure. The timing of this increase was unfortunate, as it occurred at a time when trading conditions were starting to become much more challenging for many businesses in the sector.

In addition to this Government measure on VAT, several other government measures are already impacting or will impact on businesses in the tourism and hospitality sector over the next couple of years. These Government measures include:

- The minimum wage was increased by 12.4 per cent on 1st January 2024.
- The progression towards a living wage.
- Statutory sick pay.
- Parent's Leave and Parent's Benefit.
- The addition of an extra public holiday.
- The auto enrolment savings system.
- PRSI increases.

The National Minimum Wage

The National Minimum Wage was introduced in Ireland under the National Minimum Wage Act 2000. It was initially introduced at a rate of €5.58 per hour on 1st April 2000. Between April 2000 and January 2024, the minimum wage was increased by 127.6 per cent. Over the same period, the consumer price index increased by 61.4 per cent.

On January 1st 2024, the statutory minimum wage was increased by 12.4 per cent to €12.70 per hour. Average consumer prices in January 2024 were 4.1 per cent higher than a year earlier. Ireland now has the second highest statutory minimum wage in the EU.

Data from the CSO[iii] show that in Q4 2019, 6.4 per cent of employees for whom earnings data was reported, earned the National Minimum Wage or less. This works out at 122,800 employees. 54.7 per cent of those earning the minimum wage or less were in the 15-24 age group.

In the Accommodation and Food services sector, 36,800 workers reported earning the National Minimum Wage or less, equivalent to 30 per cent of the total number of employees across the economy earning the minimum wage or less; and 22.7 per cent of total employment in the sector. The Wholesale and Retail trade accounted for 35,200 or 28.7 per cent of the total. Data for 2023 are not available.

The Living Wage

The living wage is targeted to reach 60 per cent of hourly median earnings in 2026. Once this is achieved, the living wage will replace the national minimum wage. It is estimated that increase of more than €1 per hour will be needed over the next three years to reach an estimate living wage of €15 per hour by 2026.

Statutory Sick Pay

The statutory right to sick pay is equivalent to 70 per cent of normal pay. In 2024, statutory sick pay was increased from 3 days to 5 days. This is set to increase to 7 days in 2025 and to 10 days in 2026.

Parent's Leave and Parent's Benefit

In 2022 an additional two week's parental leave was introduced.

An Extra Public Holiday

An extra public holiday in February was introduced in 2023. This brings the number of public holidays to 10.

The Auto Enrolment Savings System

It is planned to introduce the auto-enrolment retirement savings scheme in the second half of 2024. An employee aged between 23 and 60, earning at least €20,000 per annum, will be enrolled into the new retirement savings system, whereby they and their employer will pay a set rate of earnings into the fund. Employers and the State will not make contributions on annual earnings above €80,000. It is envisaged that the employer contribution will be equivalent to 1.5 per cent of salary per annum between 2024 and 2026; 3 per cent per annum between 2027 and 2029; 4.5 per cent per annum between 2030 and 2032; and 6 per cent in 2033, when the scheme is fully implemented. The scheme is not relevant for those employees already in occupational schemes, or in PRSAs, or who do not otherwise meet eligibility criteria.

PRSI Increases

PRSI rates will increase by 0.1 per cent on 1st October 2024. A further increase of 0.1 per cent is scheduled in 2025; 0.15 per cent in 2026 and 2027; and 0.2 per cent in 2028.

THE IMPACT OF THE VARIOUS STATE MEASURES

The Minister for Enterprise Trade and Employment directed the **Irish Government Economic and Evaluation Service (IGEES)** to carry out an assessment of the combined impact of the various measures to capture the costs and benefits that might arise from the measures being implemented. This assessment was published in March 2024.[iv]

The assessment suggests that the overall payroll cost impact could range from 1.8 per cent to 2.2 per cent by 2026, with the largest costs arising from the introduction of a Living Wage and the auto-enrolment retirement savings scheme. IGEES points out that wage levels across the various sectors of the economy would not have remained unchanged in the absence of this transition. Furthermore, the impact will vary significantly by sector. IGEES acknowledge that the most affected will be labour-intensive and low-margin sectors including hospitality and retail.

For a small hospitality business, the analysis suggests that there would be a policy-driven annual increase in its payroll costs of 6.6 per cent in 2024; and the projected increase is expected to be closer to 19.6 per cent in 2026.

IGEES points out that both the hospitality and retail sectors are important sources of employment for Ireland, particularly in more rural areas, and are a fundamental component of Ireland's tourist offering.

Recent research from **Fáilte Ireland**[v] suggests that rising costs (to businesses or consumers) occupy the top spots of concern in the tourism sector. In its survey of stakeholders, 49 per cent of businesses employing staff say the minimum wage increase will have a 'significant' impact on their payroll costs, with the impact being higher in the food & drink sector. The increase in the minimum wage will increase prices, with 59 per cent of respondents suggesting that they would have to increase prices to compensate for the impact of the increase in the minimum wage.

IBEC conducted its own analysis of the impact of the proposed changes.[vi] described the measures as the 'biggest change in labour market policy in decades.' The cumulative cost and lack of coordination are also building into serious concern amongst many employers about their ongoing competitiveness. The direct 'bite' of many of these costs will be felt greatest in SMEs where the new 'living wage' will be worth over 70 per cent of their current median wages and in sectors such as accommodation, food service, personal services, the cultural sector, childcare, residential care, retail and in low margin parts of the manufacturing sector. The step-change for the 330,000 or so employees earning less than the 2026 target will cost employers around €1.3 billion per year. What is more challenging is the knock-on costs which will arrive as other workers understandably look for their relative pay to keep ahead of the new wage floor.

In total, IBEC concludes that the raft of labour market measures will add more than €4 billion annually to employment costs, over and above normal wage trends. This is before knock-on relativity pay claims or administrative costs are included.

The Fáilte Ireland analysis suggests that the increase in the minimum wage, the changes to statutory sick pay, the additional bank holiday, the increase in employer PRSI, and the increase in pension contributions will increase employment costs in 2024 by 5.9 per cent in the hotel sector; by 10.1 per cent in restaurants and bars; and by 10.3 per cent in visitor attractions. The medium-term impacts of the government measures are projected to increase employment costs by 21.2 per cent in the hotel sector; by 31.3 per cent in restaurants and bars; and by 31.7 per cent in visitor attractions by 2026.

Such employment cost increases will push up consumer prices, squeeze margins, threaten the viability of many businesses, and undermine the competitiveness and quality of the Irish tourism product. This is not consistent with official targets to grow Irish tourism in the medium-term.

Based on employment levels in the tourism sector at the end of 2023 and the IGEES calculation that the State-induced measures would add 6.6 per cent in payroll costs in the tourism and hospitality sector in 2024, a conservative estimated is that the measures would increase the payroll costs by €456 million in 2024 and €1.4 billion by 2026. Such an increase in payroll costs, above and beyond regular wage trends, for an industry that is facing so many challenges, would be very damaging to the industry in the absence of mitigating measures.

ADDRESSING THE COST PRESSURES ON THE TOURISM AND HOSPITALITY SECTOR

The increase in the national minimum wage; statutory sick pay changes; the move towards a living wage; parental leave changes; the extra bank holiday; higher PRSI; and auto-enrolment for pensions will all combine to increase costs significantly for businesses across the tourism and hospitality sector. These businesses were already under significant pressure due to higher energy costs, higher food prices, labour shortages, the increase in the VAT rate, and other input costs. The tight labour market was already resulting in wage pressures, but the total cost of employment is set to rise significantly for business over the next couple of years due to Government measures.

The net result is that the operating environment for many businesses in the tourism and hospitality sector is becoming very challenging; margins are being squeezed; and the viability of many businesses is being threatened.

There has been a recent escalation in the closure of restaurants, with the Restaurants Association of Ireland (RAI) estimating that 280 restaurants have closed over the past six months. These closures are resulting in workers being laid off; a loss of tax revenues and commercial rates for central and local government; a loss of business for suppliers; damage to the integrity and appeal of streetscapes in villages, towns, and cities around the country; and most worryingly in the context of the vital tourism industry, the loss of these businesses will serve to undermine the overall offering for tourists.

While the afore-mentioned measures will improve working conditions significantly, they will all add to the costs of doing business. In a labour-intensive sector like hospitality, the impact will be more severe, as is demonstrated clearly from IGEES and Failte Ireland.

It is vital that Government provides adequate supports to businesses in the tourism and hospitality sector to counteract the State measures being implemented.

The Government has stated that some of these measures, such as the expansion of Statutory Sick Pay, will proceed 'having regard to the state of the economy generally, the business environment, and national competitiveness.' This commitment needs to be taken seriously and delivered upon.

The business environment for many small businesses in the tourism & hospitality sector is now very challenging, and the risk is that many more businesses will not survive if all the measures are followed through and implemented, and if adequate government support is not provided. It is also clear that many of the measures and their potential impact on the product offering, will damage the competitiveness of Irish tourism.

To help support those businesses and preserve employment around the regions, significant support will be required. The argument for such support is that the situation for many businesses in the tourism & hospitality sector has been seriously exacerbated by State initiatives. It is also important to bear in mind that many such businesses are by their very nature, labour intensive and low margin.

The Government is providing short-term support for economy-wide SMEs through schemes such as energy supports and rebate of commercial rates. However, the certainty is that these supports will be overwhelmed by the State-induced increases in the cost-of-doing business. Given the short to medium-term impact that the package of State-induced measures will have, it is important that longer-term supports are provided to the businesses and the sectors most adversely affected by the increase in costs.

The business reality is that Government has committed enterprises to significantly increased costs through entitlements and regulations over the coming years without any overarching strategy. While individual measures may make sense, like pension auto-enrollment or pay-linked unemployment benefits, the timing is not good and the apparent lack of coordination across Government has meant a series of new measures hitting business at the same time.

The following proposed mitigation measures are made. The overall objective should be to alleviate the cost-of-doing business pressures; support the competitiveness of the offering of the tourism & hospitality sector; preserve margins; help business viability; and ensure that regional economic activity and employment is sustained.

- **RETURN THE TOURISM & HOSPITALITY VAT RATE TO 9% ON AN ONGOING BASIS**

The VAT rate for the tourism & hospitality sector should be reduced to 9 per cent and remain at that level on an ongoing basis. This reduction would take pressure off prices; help business margins; and stimulate consumer demand; and provide certainty for business. The balance between those objectives would be determined by the incidence of the VAT reduction. In other words, some of the reduction may be passed on to consumer and some may be absorbed into margins, depending on the financial strength of the business. Either way, the VAT reduction would help sustain valuable businesses.

The 9 per cent VAT rate was introduced in July 2011 and persisted until 2018, at which stage it reverted to 13.5 per cent. It was reduced to 9 per cent again from 1st November 2020 but reverted to 13.5 per cent on 1st September 2023 against industry objections and without a cost-benefit analysis. The reduced rate was used to help improve the competitiveness of the Irish tourism product; alleviate pressure on consumer prices; and support businesses in the sector.

- **REFORM EMPLOYER PRSI FOR SMEs: APPLY 8.8% TO ENTIRETY OF NATIONAL MINIMUM WAGE OR PRSI RATE REBATE FOR MOST VULNERABLE SECTORS**

The 8.8 per cent rate of PRSI should apply to the entirety of the National Minimum Wage. The 8.8 per cent rate currently applies if income is less than €410 per week. As the minimum wage progresses towards the living wage, this threshold should be increased gradually to ensure that the 8.8 per cent PRSI rate applies to that income.

Alternatively, as the labour market is steadily moved towards the living wage target, which is estimated at €15 per hour by 2026, those sectors most adversely affected should be given a rebate on PRSI. IBEC has suggested that a PRSI rebate scheme would be based on a rebate for each worker below 60 per cent of median weekly wages in the years 2024, 2025 and 2026. In 2023 prices, IBEC estimates that this would equal a level of around €410 in weekly earnings.

A total of 482,240 employments would therefore be eligible for the scheme (based on CSO EHECS Q2 2023). The PRSI rebate would be for €13.46 weekly (equivalent to €700 annually) per worker on a weekly wage of under €410 per week and a pro-rata subsidy for those beneath that level. This €410 level would be indexed to the living wage increases in 2025 and 2026. Based on 2021 weekly earnings distributions the average rebate would stand at around €463 annually per worker in the scheme. IBEC estimates that this would cost around €223 million per annum in 2024, with similar increases for 2025 and 2026.

- **ANNUAL ENTERPRISE SUPPORT PACKAGE**

For those sectors most adversely affected, such as tourism and hospitality, by the State measures that are being introduced, a package of enterprise supports should be put in place every year out to 2026. The nature of the scheme should be determined by business conditions, the trajectory of business costs, and other economic and business realities. Such a support package would be consistent with the Low Pay Commission report of 2022 which stated that "*consideration should be given to the introduction of an economy-wide enterprise support scheme to support eligible businesses in the transition to a living wage*".

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