



**IMPROVING
TOURISM
COMPETITIVENESS**

SUBMISSION

to the

MINISTER FOR FINANCE

on

BUDGET 2007

from the

IRISH HOTELS FEDERATION

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Executive Summary

The tourism industry is a large and valuable economic resource. It has doubled in size over the past decade. It attracted 6.8m visitors in 2005, generated €4.3B foreign exchange and generated €2.5B for the Exchequer. It is the most important segment of indigenous international enterprise. It has the potential to generate more economic benefits. The overall hospitality industry provided 246,000 jobs in 2005. The tourism related element accounted for about 140,000 jobs.

Despite excellent long term performance and good overall headline recent performance there are serious concerns. While figures for the number of overseas arrivals in the country are often used as a performance benchmark, the more appropriate measure of performance is the number of holiday and discretionary tourist visits and the length of their stay in the country.

The number of overseas holiday visitors to Ireland in 2005 (3.37 million) was only 1% above the 2000 level and declined slightly compared to 2004. There has been a fundamental change in the composition and pattern of holiday visits to Ireland, which has been masked by the overall total volume of visitors over the past few years. The number of holiday bednights spent outside Dublin is in decline. The information and distribution channels and demands of the tourism market are changing. High labour costs, the strength of the Euro, higher interest rates, domestic inflation and the spiralling cost on the hotel sector of the funding of local authorities are squeezing hotel profitability and long term viability.

The latest performance data for tourism cover the first half of 2006. They show some welcome improvements on medium term trends. Overall visitor numbers are greatly increased (13.2%) and holidaymakers have grown broadly in line with this. Hotel bednights grew very well in this period with an increase of 9.8% but this lagged behind the growth of visitor numbers. This improvement partly reflects the increased marketing efforts of the state agencies and the industry in 2005/2006. This marketing/promotion effort must be maintained into 2007.

The industry is hindered by government imposed VAT penalties relative to other countries, not just in the rate of the tax on the hospitality sector but critically the non reclaimability of VAT on hotel and restaurant costs incurred for conferences, corporate meetings and incentive travel purposes. The high VAT, other high tourism taxes and high local charges greatly reduce the positive impact of the low direct taxes in the economy.

Competitiveness in the marketplace and the effective communication to potential tourists of a compelling reason to visit Ireland have been identified as the main means to sustain the current level of activity and to achieve the growth which is essential for the future. This requires price and cost competitiveness and strong effective marketing.

In this submission the IHF has identified four issues which should receive attention in Budget 07 in order to provide a supportive economic environment for sustainable growth in Irish tourism:-

- The major competitive disadvantage caused by the non recovery by the international conference and corporate meeting sector, of VAT paid on hotel costs should be removed
- The burden of local authority charges and taxes on industry and particularly the hotel and guesthouse sector has to be reduced
- The Exchequer should provide an extra €10 million to Fáilte Ireland and Tourism Ireland to enable them and the industry to effectively market the Irish tourism experience with the aim of returning to growth in the number of holidaymakers and increasing the number of days which overseas tourists spend in the country
- A “hotel energy efficiency programme” should be introduced with financial supports for training and education, awareness and investment requirements for participating hotels.

These measures will improve competitiveness and promote development in tourism and will give a solid return on the money invested. They will support the efforts being undertaken by the hotel sector to develop the industry.

1. Improving Tourism Competitiveness through Fiscal Policy in Budget 2007

The analysis and recommendations of this submission are similar to those in the 2006 submission. Tourism is an international industry competing in the global market for both domestic and overseas tourists. Competitiveness is a critical determinant of Irish tourism performance. Competitiveness, as outlined in the report of the Irish Tourist Industry Confederation, Ireland's Competitive Position in Tourism, is a complex issue and embraces a very wide range of factors. These factors include taxation, cost and prices and marketing. These three areas can be greatly improved by appropriate fiscal measures in both taxation and expenditure policy in Budget 2007.

The Irish Hotels Federation (IHF) acknowledges and welcomes Government's commitment to the marketing budget and recommends that it be continued and enhanced through Budget 2007. IHF also welcomes the Government's efforts to revive regional tourism. However, as argued in this submission and the IHF submission on last year's budget, taxation policy continues to impose severe penalties on this internationally competing industry. Local authority charges and taxes continue to rise generating a negative competitiveness impact. This taxation situation arises at a time when competitiveness of Irish hotels and tourism is being attacked by a range of factors over which hotels and guesthouses have no control. These include rising interest rates, a continuing strong exchange rate of the Euro against the Dollar and Sterling, growing domestic inflation, increased labour costs, rising local authority charges and accelerating energy costs.

The IHF accepts that the industry must play its part in responding to the competitiveness challenge through effective management, operating efficiency, investment, innovation and providing value-for-money high quality services. The Government should play its part in Budget 2007 by;

- Increasing the Fáilte Ireland and Tourism Ireland marketing budget by €10M
- Allowing the recoverability of VAT paid on hotel costs in the international conference incentive travel and corporate meetings sector
- Control the growth of local authority charges and taxes
- Introduce an energy efficiency programme for hotels and guesthouses with increased resources to promote and implement energy efficiency and alternative energy usage.

The IHF welcomes and recognises the support given to marketing in Budget 2006 and previous budgets. It is disappointed in Government's failure to deal with the taxation and local authority charges issues. The Government's finances are strong and capable of reducing the taxation burden in Budget 2007. The large increases in energy prices and forthcoming increase have highlighted the need to devote additional efforts to find long term sustainable solutions.

In addition to specifically Budget matters the planned programme of improvements in the national and regional transport infrastructure, including the Western Corridor should be implemented within tight schedules.

The proposed four measures will ameliorate some of the negative competitiveness pressures on tourism and will generate a strong return on the money invested.

2. The Economic and Business Environment for Tourism in 2007

2.1 Irish and International Economic Growth

Despite the effects of international political uncertainty, increasing interest rates and higher energy costs the domestic and international economies are expected to perform well in 2007.

Based on ESRI forecasts Irish GDP volume growth will be 5.6% in 2006 and 5.2% in 2007. Employment levels will rise from 2.037M persons to 2.111M and the unemployment rate will stay at a low 4.4%. Government finances will remain strong. Although 2007 growth will be slightly below 2006, the overall 2007 position is of a strong buoyant economy. A concern for domestic tourism is that higher interest rates could reduce discretionary consumer expenditure but on the positive side SSIA monies will increase consumer resources.

Table 2.1 Irish Economy in 2006 and 2007

	2006	2007
GDP increase %	5.6	5.2
Employment (000s)	2037	2111
General Govt Balance % of GDP	1.2	0.9

Source: ESRI QEC Summary 2006

As outlined in Table 2.2 the international growth forecast for 2007 is good. The USA will grow by 3.1%, although this is lower than the 3.6% in 2006. The UK growth rate will increase in 2007 compared with 2006, 2.9% versus 2.4%. The overall OECD growth rate in 2007 (2.9%) is almost the same as the 2006 performance (3.1%). The same is true for the Euro area growth (2.1% in 2007 and 2.2% in 2006). Within the Euro area the two main economies Germany and France will have similar growth rates in 2007 to those experienced in 2006.

Table 2.2 International GDP growth (real)%

	2006	2007
USA	3.6	3.1
Euro Area	2.2	2.1
OECD	3.1	2.9
UK	2.4	2.9
Germany	1.8	1.6
France	2.1	2.2

Source: OECD Economic Outlook

As is the case for recent years the international political situation could rapidly worsen and reduce economic performance. It is necessary to support the favourable international demand situation with the budgetary measures identified in this submission for marketing and improved competitiveness.

International economic growth in 2007 will be broadly comparable to the good 2006 performance. The two main tourism markets of the USA and the UK will fare slightly differently with the USA's growth rate declining and the UK's rate increasing. The public finances are in relatively good shape. The Irish growth rate will be high in 2007.

2.2 Domestic Inflation and the Hotel Industry

Ireland's inflation rate has accelerated in recent months. In the year to August 2006 it was 4.5% compared with 3.9% to June, and 4.2% to July 2006.

Ireland's inflation rate has again moved ahead of the EU and Euro area rates. High domestic inflation translates into increased operating costs for hotels and guesthouses

resulting in lower margins and / or higher prices. High inflation reduces both tourism operators' competitiveness and the attractiveness of Ireland as a holiday location.

Table 2-3 Ireland and EU Inflation Rates Yr to July 06

	%
Ireland	2.9
Eurozone	2.4
EU	2.4
UK	2.4
France	2.2
Germany	2.1

(Based on EU Harmonised Index; this is equivalent to 4.2% on the CPI measure)

Some illustrative recent price increases are shown below. While the overall inflation rate was 4.5% in the year to August 2006 many tourism related items increased by much higher rates.

Table 2-4 Price Increases: Year to August 06

CPI	4.5%
Water Supply, Refuse and Misc. Services	6.9%
Energy Products	10.8%
Hospital Services	5.0%
All Services	7.0%
Doctor fees	6.8%
Petrol	13.1%
Postal	6.7%
Newspapers	7.0%
Hairdressing	6.3%

The hotel industry is particularly burdened by local authority charges. Between December 2001 and August 2006 the CPI has risen by 16.8% but water supply, refuse and miscellaneous charges have grown by 118.7%

Table 2.5 Annual Rate Valuation Multiplier 2002 – 2006, cities

	2002	2006	% increase
Cork	57.56	68.22	18.5
Dublin	46.86	57.41	22.5
Galway	48.70	60.76	24.8
Limerick	65.46	75.31	15.0
Waterford	48.69	60.86	25.0

Source: Dept of Environment

Over the period 2002 to 2006 the annual rate valuation multiplier for the five city councils increased by between 15% and 25% while the CPI increase measured as the change between the annual average CPI in 2002 compared with the estimated annual average CPI in 2006 was just over 12%.

2.3 Labour Costs

Over the past decade as economic growth accelerated Irish labour costs grew to the levels of the advanced industrial economies. Over the past several years Irish labour cost growth has exceeded other relevant countries. More recently the gap has narrowed but even now Irish labour cost increases are currently over twice those of the Euro area and similar to the UK and USA.

Table 2.6 Compensation per Employee (in Private Sector) % change

	2006	2007 (forecast)
OECD	3.3	3.7
Euro	1.6	2.0
USA	4.5	5.0
UK	5.0	4.7
Ireland	4.6	4.9

Source: OECD

The hotel industry is particularly vulnerable to labour cost increases. The industry is very labour intensive and as a services industry there is limited scope for productivity improvements. In addition it is an exposed sector competing in competitive international markets. Its domestic and international customers have a wide variety of alternative holiday destinations and experiences, often in low cost locations.

Based on CSO data the labour cost share of turnover in hotels is almost four times that of manufacturing (31.5% relative to 8.1%). The Hotel Industry Survey shows that payroll costs relative to turnover grew from 32.2% in 1999 to 37.6% in 2005.

Table 2-7 Payroll Cost Relative to Turnover (Hotels)

1999	2000	2001	2002	2003	2004	2005
32.2	33.3	32.4	34.2	35.6	35.4	37.6

2.4 Exchange Rates and Interest Rates

Because of the appreciation of the Euro against the Dollar and Sterling since 2002 and the subsequent maintenance of the higher level the Irish hotel industry has been operating for the past few years in a fundamentally more difficult price environment in the US and UK markets. These two markets are also more attractive than domestic breaks to Irish holiday makers because of the exchange rate appreciation. This situation will not change in the near future. The Euro will remain strong against other currencies.

Interest rates have risen substantially in the past year. This has increased pressure on costs in the hotel industry. Further interest rate increases are expected in 2007.

Table 2.8 Exchange Rates and Interest Rates

	2004	2005	2006	2007
US\$/€ Exchange Rate (Annual Average)	1.24	1.24	1.30	1.32
STG £/€ Exchange Rate (Annual Average)	0.69	0.68	0.68	0.68
Main ECB Interest Rate (%) (year end)	2.00	2.25	3.50	4.00

Source: ERSI Quarterly Economic Commentary Summer, 2006

2.5 VAT

Much of the operating environment (interest rates, exchange rates, international growth, political instability, oil prices) is outside the control of the Irish government. However, its domestic fiscal policy is within its control. The low profits tax level and low income tax levels are very welcome aspects of the government's fiscal policy. However, other aspects of fiscal policy are very much against the interests of the tourism industry and the hotel sector. Ireland has among the highest alcohol excise taxes in the EU and has one of the worst VAT regimes for hotel tourism. In addition there are high and continually growing local government taxes and charges.

There are two major VAT related issues adversely affecting tourism, the VAT rate applied to accommodation and meals and the fact that the Irish tax code does not allow the refunding of VAT paid on corporate hotel and restaurant expenditure. The latter has a major negative impact on the conference, incentive travel and corporate meetings sector, which is a strongly growing sector internationally.

Ireland is in a relatively weak position in terms of tourism VAT.

Table 2-9 Ireland relative to the EU (of 25) in VAT

	Ireland	Ranking (of 25)	2 Lowest
Standard Rate	21	6 th Highest	15,16
Hotel Accom.	13.5	6 th Highest	3, 5
Restaurants	13.5	15 th Highest	3, 6

Source: HOTREC

Ireland has the sixth highest hotel VAT rate of 13.5%. Denmark (25%), Germany (16%), the UK (17.5%), Slovakia (19%) and Hungary (15%) are higher. Ireland is middle ranked on the restaurant VAT rate. Ten countries have a higher restaurant than hotel VAT rate and the other 15 have similar rates for both sectors.

Within the Eurozone, Ireland has the second highest VAT rate on hotel accommodation next only to Germany (16%).

The already weak competitive position on hotel VAT rates is substantially worsened by the fact that all higher VAT rate countries allow VAT on hotel expenditure as a business input.

The effective VAT rate on legitimate hotel expenses for corporate customers is therefore zero in Germany, the UK, Hungary and Slovakia compared to the 13.5% in Ireland.

EU countries (of the EU 25) which allow VAT on hotels/restaurants as business inputs fully or partly are Austria, Denmark, Finland, Netherlands, Spain, Sweden, Germany, the UK, Lithuania, Slovenia and Hungary. Because of the allowability issues Ireland's VAT rate of 13.5% significantly reduces its competitiveness relative to the above seven countries.

The countries which do not allow VAT on accommodation as an input have lower VAT rates than Ireland. The VAT rates in these countries range between 10% and 5%.

Excluding Ireland, of the non deductible countries only Italy has a hotel VAT rate of 10% or higher. Relative to the EU, the Irish tourism sector for corporate business is substantially disadvantaged because of the high VAT rate and non deductibility. The VAT rates comparison understates the weak competitive position because all the higher VAT rate countries allow VAT on business hotel accommodation as an input. Visit Britain make a substantial play of the fact that VAT is refunded on corporate hospitality expenditure in targeting the Irish and other markets.

Irish Tourism is greatly disadvantaged by the VAT regime

3. Performance of Tourism and the Hotel Sector

The most usually discussed tourism performance indicator is number of overseas visitors. In 2005 this was 6.76M persons, compared with 6.18M in 2000, an increase of 9.4%. In 2005 the increase was 5.9%, 6.76M compared to 6.38M. However, this measure includes business trips and those visiting family and friends. A more correct measure of tourism's competitive performance is the number of holidaymakers, the promotable or discretionary segment of overseas visitors. This indicator illustrates a

substantially weaker tourism performance (Table 3.1) and, by implication, identifies the need to improve competitiveness.

Table 3.1 Overseas Visitors and Holidaymakers 2000-2005(m)

	Overseas Visitors	Holidaymakers
2000	6.181	3.320
2001	5.840	3.140
2002	5919	3.216
2003	6.178	3.291
2004	6.384	3.367
2005	6.763	3.365
% increase		
00/05	9.4	1.4
04/05	5.9	-0.1

Source: Fáilte Ireland

The number of holidaymakers declined slightly in 2005 compared with 2004 while overall visitor numbers increased by 5.9%. The 2005 holidaymaker level is only very slightly above the 2000 level. In short we have a holidaymaker crisis and this is masked by the overall visitor trends. Previous IHF submissions have referred to this and to the decline in Ireland's share of traditional markets such as the UK.

A breakdown of the origin of holidaymakers is shown below (Table 3.2)

Table 3.2 Overseas Holidaymakers to Ireland 2000 – 2005 (,000s)

	Total	Britain	M.Eur	N.Amer	Other
2000	3,320	1,644	803	722	151
2001	3,140	1,623	743	626	148
2002	3,216	1,751	757	579	130
2003	3,291	1,779	775	616	124
2004	3,367	1,718	825	656	167
2005	3,365	1,662	950	614	139
±% change 2005 vs. 2000	+1.4%	+1.1%	+18.3%	-15.0%	-7.9%

Source: Fáilte Ireland

The number of holidaymakers from both Britain and from North America declined in 2005 relative to 2004. The British 2005 level is slightly above the 2000 level. The North American level in 2005 is well below the 2000 level. In 2005 visitors from mainland Europe increased greatly but the 2004 level was only slightly above the 2000 level. Fáilte Ireland has embarked on a marketing/promotion effort to recover market share in the British market. It is essential that this marketing drive should continue and be well resourced.

The detailed analysis of the tourism data shows that the ongoing erosion of cost competitiveness is having a negative impact. Domestic inflation, high tourism related taxes, high labour costs and appreciation of the Euro have contributed to a weak performance in attracting holidaymakers. This situation must be reversed. Budget 2007 is an opportunity to deal with some of the taxation problems. The need to do so is becoming more urgent as successive recent budgets have not dealt with the issue.

There have been significant changes in the structure of tourism and the tourism market which Government has recognised. These include;

- Decline in regional tourism. Dublin had about one third of all overseas holidaymakers bednights in 2005 compared with 20% in 1999
- Over the past five years the Western seaboard has lost 3M bednights
- Decline in internal tourist mobility due to the decline in British tourists bringing their own cars

While the number of overseas visitors increased by 6.1% (CSO statistics) in 2005 and the number of bednights also increased by 6.1% this improvement was not reflected in hotel/guesthouse activity. In 2005 the number of hotel bednights taken by overseas visitors declined slightly from 10.663M to 10.615M. Guesthouse and B&B bednights declined by 8.2% in 2005. This weak performance reflected the holidaymaker numbers situation.

The most recent data from the CSO which deal with the first half of 2006 indicate some welcome improvements.

Table 3-4 Tourism performance Jan-June 05 to 06

	Jan/June 05 (M)	Jan/June 06 (M)	% change
Total Overseas Visits	3.093	3.502	13.2
Holidaymakers	1.504	1.715	14.0
Bednights	20.048	23.638	17.9
Hotel bednights	4.833	5.307	9.8
Guesthouse/BB's	2.484	2.778	11.8

Source: CSO

In the first half of 2006 compared with 2005 total visitors increased by 13.2% and holidaymakers grew by 14.0%. This is very welcome relative to the medium term trends. Bednights grew by 17.9% in this period. Hotel bednights grew by 9.8% compared to the total visitor increase of 13.2%. Guesthouses and bed and breakfast bednights recovered somewhat in this period with a growth of 11.8%. It is essential that the marketing/promotional effort be maintained to sustain these welcome short-term improvements.

4. Adapting to New Market Forces

Previous IHF submissions and ITIC reports such as those on competitiveness and regional tourism have identified that the marketplace in which Ireland competes for tourists is undergoing significant changes:

- consumers are taking more frequent and shorter holiday trips, where choices are increasingly being determined by motivators or 'reasons to visit' as experiential and urban tourism grow in popularity
- the internet has revolutionised the way in which consumers obtain information and purchase travel and holidays
- low cost carriers have established themselves as the preferred mode of travel for an increasing share of the intra-European tourism travel market and in many instances are opening up new destination options; and
- the traveller is becoming more demanding in securing value for money.

Ireland's marketing approach and tourism product must respond to this more demanding environment and develop and sustain compelling reasons to visit Ireland.

The Irish tourist industry must use the new communication and distribution channels in reaching its target markets.

Fáilte Ireland and Tourism Ireland and the new regional boards are important elements in using the new technologies, promoting Ireland and in responding to the market. The marketing effort must be well resourced. It is also important that value for money is a feature of the tourist experience. The budget can assist in both tasks by allocating adequate marketing resources and by removing tax penalties.

5. The Strategic Economic Role of Tourism

Unlike many other developed economies Ireland depends on foreign direct investment for its export performance. Internationally competitive indigenous manufacturing is limited. Consequently the export earning capacity of tourism which is a mainly indigenous industry is of strategic importance to the Irish economy.

Over the longer term the tourism and hotel industries have achieved substantial growth. The weaker performance of recent years can be reversed through appropriate inputs by all the stakeholders. Budget 2007 can reduce tourism taxation and support marketing.

The tourism industry;

- Generated €4.3B in foreign exchange earnings in 2005 compared to €2.1B in 1995
- There are 6.8M visitors
- Domestic tourism expenditure in 2005 was €1.2B
- The Exchequer received €2.5B in taxation from tourism
- Allowing for indirect and induced effects tourism accounted for 3.8% of GNP in 2005
- According to Fáilte Ireland data the hospitality industry accounts for 246,000 jobs. Tourism accounts for 140,000 jobs.

Tourism is a large, strategically important industry which has great potential but is currently delivering an unsatisfactory performance in some areas of activity. Measures are needed to realise the industry's full potential.

6 Budget Policy to Improve Competitiveness of Tourism

6.1 Context

The IHF Budget proposals are based on the objective analysis of the previous sections. They are designed to enhance competitiveness as part of a co-operative effort to deal with the identified worrying features of weak performance and a changing market. The proposals take into account;

- The forecast domestic and international economic situation
- The major competitiveness impact of the strength of the Euro
- The strategic economic role of tourism
- The worrying indicators of a reduction in holiday bednights spent outside Dublin
- The weak performance in attracting holidaymakers
- The strength of the public finances
- The value for money return on investment in tourism
- The competitiveness reducing impact of labour costs inflation, taxes, interest rates and exchange rates
- The self imposed penalty of internationally high tourism VAT rates
- The prohibition on reclaiming VAT on corporate hotel expenditure
- The self imposed penalty of high local taxes and charges

6.2 The Budget Proposals

The IHF proposes four measures to enhance competitiveness and to promote development. These complement the efforts being undertaken by the tourism and hotel industries.

1. VAT on corporate expenditure in hotels and restaurants for conferences, incentive travel and corporate meetings should be refundable. This will remove a self imposed competitiveness penalty and will greatly assist in developing this sector the allowance of VAT on hotel and restaurant costs, as an input in respect of conferences, incentive travel and corporate meetings allied to an increased marketing performance will present a strong and positive position for Ireland in world tourism markets. These proposals continue the strategy presented in previous IHF submissions but it is essential that action be taken now.

2. A new model must be put in place to ensure that the funding of local authorities is fair. Seeking excessive revenue from business cannot be sustained. The IHF suggested in its submission to the consultants acting on behalf of the Minister for the Environment and Local Government that:-
 - a. the present Local Authority Rates system be abolished and replaced with a local income tax based on profitability as opposed to property valuations to pay for the provision of community based services such as parks, libraries, street cleaning, local contribution to road maintenance;
 - b. user charges be introduced for services for both businesses and households where the levels of use can be determined such as water provision, waste collection, planning fees;
 - c. central government funds social services specifically social housing, assistance to elderly and disabled people to adapt their houses. Pending the introduction of this system increases in any LA charge be capped at 2% for 2007.
3. The marketing budget for tourism should be increased by €10M in 2007 to ensure a significant real increase in resources to deal with the changing tourism market and to deal with weaknesses in the holidaymaker market.
4. An “Efficient Energy in Hotels Programme” should be introduced. The Government and the relevant agencies have greatly improved their activity in this area in recent times but this must be enhanced for the hotel sector. The cost and availability of energy is an important issue for hotels. The task of reducing costs while still meeting customer requirements and expectations is difficult. Sustainable Energy Ireland (SEI) has recognised the particular needs of hotels and has developed strategic guidelines for hotels. Many Irish hotels both independently and with SEI have introduced energy efficiency and/or green energy programmes. Both in terms of cost competitiveness, energy efficiency and environment enhancement the IHF recommends a hotel specific programme to be rolled out on a general basis. This would include;
 - advice and education on energy efficiency and alternative energy
 - financial support for investment costs to adjust to more efficient and /or more sustainable methods