Chapter 2

DID YOU KNOW?

Economic threats

- IMF – the external risks to Ireland's economy are high. The factors are Brexit, US tax reform and EU tax proposals, and global protectionism.[1]
- European Commission – Ireland could be subject to external shocks linked to Brexit and the international tax environment, through its impact on multinational location decisions.[2]
- Department of Finance – Brexit's "potential to adversely affect the Irish economy" and "the uncertainty of the policy stance in the US" are among the factors "casting a shadow over future growth prospects".[3]
- Enterprise Ireland – the fact that the growth of exports to the UK has slowed suggests that the impact of Brexit on Irish companies has already started.
- ESRI – a hard Brexit could cost Ireland €200m a year and deprive us of 49,000 jobs over a decade. The country's economic output would be reduced, with exporting companies worst hit.[4]

Dependencies in our economic model

Dependency on multinationals

- Exports by foreign-owned agency-assisted companies account for 89% of total exports in agency-assisted companies.[5]
- US multinationals account for over 70% of employment in IDA Ireland-supported companies.[6]
- 80% of Ireland's corporate tax is paid by multinationals.[7]
- The pharmaceutical sector, which is dominated by multinationals, accounts for 37% of the total value of all industrial production in Ireland.[8]
- Profits in the manufacturing sector account for almost 40% of all trading profits recorded by Revenue – the largest subsectors in corporation tax terms are the manufacture of basic pharmaceutical products, the manufacture of pharmaceutical preparations, and the manufacture of medical and dental instruments/supplies.[9]
- A quarter of all employment in foreign-owned companies is in manufacturing.[10]
- Foreign-owned companies contribute over 50% of gross added value to the overall non-financial business economy in Ireland.[11]
- Ireland's businesses have the highest profitability rate in the EU28, at 15.5%. When foreign-owned enterprises are excluded from the data, Ireland drops 15 places in the rankings, to 8.9%.[12]

Dependency on the UK export market

- In 2015 the UK was our biggest services export market, at 19% of the total.[13]
- In 2016 13% of Ireland's goods exports went to the UK.[14]
- The food sector is particularly dependent on the UK market. The UK remains the biggest export market for Irish food, with 42% of food exports going there in 2016.[15]
- Exports from Enterprise Ireland client companies to the UK totalled €7.5 billion in 2016. However, export growth rates to the UK has slowed from 12% in 2015 to 2% in 2016. The slowdown was largely due to a decline in food exports.
- Such is the dependency on, and impact of, the UK market that global exports growth for Irish-owned food sector companies was only 1% in 2016[16].
- The UK accounts for 35% of net Irish Indigenous exports (€7.5 billion)[17].

Weaknesses in Ireland’s indigenous export model

Weak product diversification in manufacturing

- Most Irish owned manufacturing firms who are exporting are quite small, exporting few products to a small number of destinations[18].
- Exporting is highly skewed, according to research undertaken by the ESRI.
- 20% of Ireland’s smaller firms export just a single product, and close to half export fewer than five products.[19]
- The median number of products exported by Irish firms in 2015 was four, this is one less than the median of five in 2000.[20]
- 9 out of 10 products exported by Irish-owned companies in 2015 were food[21].
- The Number 1 exported product was ‘Meat of Bovine Animals, Fresh or Chilled’ and it accounted for 23% of all exported products by Irish firms in 2015.
- 11% of Irish-owned firms export more than 20 products to over 20 markets and account for over 46% of the total export value.[22]

Weak market diversification in manufacturing

- Almost 27% of Irish firms export to just one market.[23]
- In 2015, the median number of export markets for Irish exporting firms was just three. This was the same number of median export markets that Irish manufacturers were focused on 15 years previously.
- 29% of Irish SMEs consider “finding new markets” their most pressing problem.[24]
- The IMD ranks Ireland’s “export concentration by partner and product” as 52nd and 47th in the world respectively.[25]

Services

- Research on services firms is more narrowly focused on patterns of trade participation and the differences between exporters and non-exporters.
- However, based on research reports on services[26] we know that there are weaknesses in the Irish services model. E.g. The information service activities sector represents almost 14% of total exports by services firms in Ireland but Irish firms in this sector are mainly domestically orientated, exporting less than 2% of their sales and accounting for just 0.5% of total exports.
- Reports also show that large differences in export activity and intensity between Irish-owned and foreign-owned firms suggests that greater international engagement by indigenous firms might be possible[27].

Challenges with the key enablers to grow our exports

Talent

- High effective personal tax rates are a barrier to attracting talent.
- 81% of Irish CEOs say the lack of available talent is a key threat to business growth.[28]
- The services sector is key to exports, yet there are over 2,800 ICT-related vacancies on TechLifeIreland.com,[29] a national website to attract technology talent.

- The big growth in jobs is in the services area. 40% of EU companies recruiting ICT specialists reported problems finding candidates with the required skills[30]. Advanced ICT specialists are the fastest-growing large jobs category in the EU and are also among the best-paid 20% of jobs[31].
- Knowledge-intensive modern manufacturing is key for exports, yet skills shortages exist across a wide range of roles, e.g. chemical engineers, biochemists, biotechnology technicians and scientists.[32] Highly skilled employees are critical in key growth areas such as medical devices.
- A global talent shortage is impacting all EU countries.
- Young Irish SMEs competing for global talent need to offer share awards to attract employees, but Ireland has no workable share option regime for Irish businesses.
- The UK share regime specifically targets SMEs and is employee-friendly from a tax perspective.
- Ireland's employee tax regime to attract overseas talent is the Special Assignee Relief Programme (SARP).[33]
- SARP cannot be used by most Irish businesses as the relief applies only to staff assigned to Ireland from another group company outside the country.
- 67% of Irish HR management say that there are delays or cancellations of strategic activity because of a skills shortage.[34]

R&D and innovation

- Only 1% of all small companies consider themselves to be R&D active and 16% of medium companies consider themselves to be R&D active.[35]
- The largest 100 enterprises in terms of R&D spend account for 70% of the total R&D expenditure.[36]
- R&D expenditure in Ireland (1.51% of GDP) falls short of the EU average of 2.03%.[37]
- It also falls well short of some of the leading performers in the EU, such as Sweden, Germany and France.[38]
- R&D is largely carried out by foreign multinational companies.[39] Without the innovation spend of this sector, Ireland would have been one of the lowest performers in the EU.[40]
- R&D in Ireland leans heavily on companies that are foreign owned, large and long established (over 16 years of age). Innovation in younger companies (less than 3 years of age) has flatlined.[41]
- Outsourcing and collaboration are restricted in the R&D tax credit, at odds with international standards and especially worrying as an R&D environment that supports further collaboration with the university sector is regarded as the best-practice model internationally.
- A critical factor for Ireland's modern manufacturing companies is the importance of R&D and collaboration with third-level institutes.
- The R&D tax credit claims process and the uncertainty surrounding the qualifying criteria are daunting, and some SMEs do not venture to use the R&D tax credit as a result.
- The UK has an extensive range of measures that encourage all companies to make full use of the R&D tax regime.

Irish Tax Institute/B&A Research[42]

- 75% of companies surveyed were aware of the R&D tax credit and 20% had claimed it.
- Of those who availed of the R&D tax credit, almost half found it difficult to prepare for and administer.
- Only 35% of companies surveyed intend to avail of the R&D tax credit in the next 18 months.
- Over 60% would consider using the R&D tax credit if there was more clarity around the criteria for qualification.

The real-life importance of R&D and innovation in Irish enterprise

- Innovation is key to ensuring the long-term growth and increased competitiveness of medical device companies and many others in the modern manufacturing sector.
- There is growing pressure on manufacturing companies to conserve energy and reduce their carbon footprint, and innovation will be key to this.
- The pace of change in the fintech sector necessitates high levels of innovation – Enterprise Ireland's fintech portfolio employs more than 8,000 people, of which 40% are located outside Dublin.
- Enterprise Ireland – "the need for greater levels of innovation among Irish companies as part of their response to Brexit is crucial".

Financing

- More businesses in Ireland rated access to finance as their number one problem than in most other EU countries.[43]
- By European standards, Irish SMEs are considered among the most reliant on banks.[44]
- Almost 42% of Irish SMEs that were unsuccessful in a bank financing application did not seek alternative sources of funding.[45]
- Business angels provide equity investment and industry know-how to early-stage companies. Business angels invested €13.6m in 50 Irish start-ups in 2016.[46]
- Business angel investment in Ireland is low compared with other countries, such as the UK, Spain, France, Germany and Sweden.
- Ireland is also behind economies of a similar size such as Denmark and Finland.[47]
- Revised entrepreneur relief is restricted to owner-managers and locks out much-needed external investors.
- Ireland's 33% CGT rate is the fourth-highest rate in the OECD and is having a negative impact on investment in Irish business. The median rate in the OECD is 23%.
- High CGT rates are not generating high receipts for the Exchequer – CGT represented only 1.7% of the total tax yield in 2016.[48]
- Countries with targeted tax strategies for investors have seen results:
    - Venture capital investments in Israel were 14 times the level of those in Ireland in 2014.[49]
    - The UK had the highest level of venture capital investment in Europe in 2015.[50]

Low level of take-up of tax incentives

- The Foreign Earnings Deduction (FED) encourages businesses to send employees into emerging markets – only 144 FED claims were made in 2014.[51]
- The Employment and Investment Incentive (EII) is an income tax relief to encourage early-stage investment in scaling companies. In 2016, 1768 claimed it[52] – just over half the number are using it compared to the BES when it was at its most successful.
- Start-Up Refunds for Entrepreneurs (SURE) is a measure to encourage employees to start a business – only 59 people claimed it in 2014.[53]
- Income tax relief is available for key employees engaged in R&D[54] – only 25 people claimed it in 2014.[55]

Future opportunities and potential

The services economy

- Globally, trade in services has been the fastest-growing component of international trade.[56]
- Annual growth rates in recent years have been 10%.[57]
- Ireland has gained relative comparative advantage in high-tech knowledge-intensive services, one of the most dynamic export sectors worldwide.
- Irish-owned services agency-assisted companies recorded 97% exports growth in the seven-year period between 2008 and 2015.[58]
- Exports in ICT alone grew 114% in that period, but this was from a low base, and they accounted for just 9% of exports among Irish-owned companies in 2015.[59]
- Last year the trend continued. The strongest export growth sector among Irish companies in 2016 was software and internationally traded services. It grew by 16%.[60]
- Services account for 35% of total employment in Irish-owned companies, compared to 20% in 2000.[61]
- The presence of leading global IT and computer companies in Ireland is creating a dynamism that encourages Irish-owned start-ups, innovators and creatives in the services sector.
- Growth in areas such as fintech highlights the fast-paced nature of the services sector and the potential that exists for Irish companies. In Enterprise Ireland's fintech portfolio, 220 companies represent a wide range of subsectors from financial software to supply chain finance. Fintech employs more than 8,000 people, of which 40% are located outside Dublin.[62]
- Ireland is a hub for Fintech innovation and a key focus on Enterprise Ireland is to encourage and support more entrepreneurs through the Fintech Competitive Start Fund (CSF).

Modern manufacturing

- Modern manufacturing sectors that have significant growth potential include chemical products; computer, electronic and optical products, and medical devices.[63]
- Irish-owned modern manufacturing is intensely export driven, with an export intensity of 72%.[64]

- Irish-owned modern manufacturing exports grew by 85% in the seven years between 2008 and 2015 – and grew faster than traditional manufacturing exports in that period.[65]
- Last year Enterprise Ireland clients in “lifesciences, engineering, paper print & packaging, electronics, and cleantech” grew their exports by 10%, a reflection of the future importance of growth in modern manufacturing.[66]
- Modern manufacturing is experiencing high levels of growth but accounts for just 5% of exports by Irish-owned companies in value terms.[67]

The digitised economy

- A new global report, *Digitizing Europe*,[68] has named Ireland as one of nine European frontrunner countries that could see the largest benefits from a more digitised European economy.
- This is because we are geographically small and have limited domestic markets but are well digitised.
- The nine frontrunners are even more sensitive than other EU countries to a lost digital opportunity, because a larger share of their economies is digitized and the majority of their future growth is digitally enabled.[69]
- In Ireland e-commerce sales account for 46% of total sales of enterprises that have an online platform (52%).[70] This includes the influence of multinational companies.
- However, over 66% of SMEs in Ireland are not capable of processing e-commerce, and almost 25% have no website at all.[71]
- The digital economy offers plenty of opportunities for SMEs, traditional industries and for disadvantaged regions.[72]
- Digitisation is no longer a choice businesses can ignore – it is a necessity: any business missing out on the opportunities of digital will not be able to sustain the competitive pressure from more digitised rivals[73].
- Digitisation creates opportunities for small companies to innovate and grow faster by making it easier to distribute products, market services and reach a global audience.[74]
- The World Economic Forum ranks Ireland 25th out of 139 countries in its Networked Readiness Index. This measures how well countries are using information and communication technologies to boost competitiveness and well-being.[75]
- The potential export market that the digitised economy provides is huge, but if we fail to grasp it fully, the opportunity lost would be equally great.[76]
- 90% of existing jobs in the EU require some level of digital skills.[77]
- 37% of the European labour force does not have basic digital skills[78]

Eurozone Growth

- Growth in the Eurozone grew by 0.5% in the first quarter of 2017, an annualised rate of around 2%[79].
- The Eurozone is picking up speed and is growing at a faster rate than the US economy.

- The European Commission's economic-sentiment index rose to its highest level for a decade in April.
- The index is based on surveys of services industries, manufacturers, builders and consumers in the eurozone.
- Growth across the economies is becoming more broad-based[80].
- The Eurozone is now Ireland's second largest market for Irish indigenous exporters and accounts for €4.2 billion of sales[81]. Enterprise Ireland launched a new Eurozone Market Strategy in May. Innovation and diversification are two of the pillars in the strategy.

SMEs using FDI knowledge and collaboration as a springboard for global growth

- The IMF Ireland Report says that continued efforts to support SME collaboration with multinational companies and research centres can help to overcome knowledge barriers and increase linkages to foreign markets.[82]
- An important factor in developing globally focused SMEs in Ireland is the presence and influence of multinationals in Ireland's ecosystem. Innovators and creatives are attracted to FDI companies, with spill-over effects for Irish SMEs that are collaborating with or learning from the global companies.[83]
- The IDA Ireland/Enterprise Ireland Global Outsourcing Initiative is bringing Irish companies in contact with multinationals, with the aim of developing supplier contracts that allow Irish companies to gain global experience and global standards.[84]
- Foreign multinationals have played an important and valued role in Ireland's export growth and made a vast contribution to our tax base, employment growth, the development of talent and innovation, and the encouragement of Irish SMEs that are working closely with them.[85]
- Clusterings of Irish indigenous tech companies in the east, medical device companies in the west and pharma-related companies in the south-west have been the result of collaboration, partnerships and interaction, across a range of levels, with FDI companies.

References

1 IMF, "Staff Concluding Statement of the 2017 Article IV Consultation" (May 2017), http://www.imf.org/en/News/Articles/2017/05/12/ms051217-ireland-staff-concluding-statement-of-the-2017-article-iv-consultation.
2 European Commission, 2017 European Semester: Country Report – Ireland (February 2017), https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-ireland-en.pdf.
3 Department of Finance, "Ireland's Stability Programme, April 2017 Update" (April 2017).
4 ESRI, Quarterly Economic Commentary, 22 June 2017.
5 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015* (2017).
6 IDA Ireland, Annual Report and Accounts 2015 (2016).
7 Revenue, *An Analysis of 2015 Corporate Tax Returns and 2016 Payments* (April 2017).
8 CSO, Irish Industrial Production by Sector 2015 (28 July 2016).
9 Revenue, *An Analysis of 2015 Corporate Tax Returns and 2016 Payments* (April 2017).
10 CSO, Foreign Direct Investment in Ireland, 2015, http://www.cso.ie/en/releasesandpublications/ep/p-fdi/fdi2015/ae/
11 CSO, Business in Ireland Report 2014, Multinationals – An Irish Perspective.
12 CSO, Business in Ireland Report 2014, Multinationals – An Irish Perspective.
13 CSO, International Trade in Services 2015 (November 2016), http://www.cso.ie/en/releasesandpublications/er/its/internationaltradeinservices2015/.
14 CSO, Goods Exports and Imports December 2016 (February 2017), http://www.cso.ie/en/releasesandpublications/er/gei/goodsexportsandimportsdecember2016/.
15 CSO, Goods Exports and Imports December 2016 (February 2017), http://www.cso.ie/en/releasesandpublications/er/gei/goodsexportsandimportsdecember2016/.
16 Enterprise Ireland: Export performance in Global Markets 2016, May 2017
17 Enterprise Ireland: Export performance in Global Markets 2016, May 2017
18 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises* (April 2017).
19 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises* (April 2017).
20 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*.
21 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*.
22 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*.

23 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*.
24 European Commission, Survey on the Access to Finance of Enterprises (SAFE) (May 2017).
25 Institute for Management Development, World Competitiveness Yearbook, 2016, https://worldcompetitiveness.imd.org/.
26 ESRI, Services exports and exporters of services, April 2017
27 ESRI, Services exports and exporters of services, April 2017
28 PwC, "Shaping Ireland's Future Talent Landscape: 2017", PwC HRD Pulse Survey.
29 Figure taken on 26 June 2017.
30 Eurostat – survey of ICT use by enterprises, 2016
31 Eurofound: European Jobs Monitor 2016, p. 14
32 Department of Jobs, Enterprise and Innovation, Enterprise 2025 Background Report.
33 Revenue, Analysis of Special Assignee Relief Programme 2015, p. 5; http://www.finance.gov.ie/sites/default/files/SARP%20Analysis%202015.pdf.
34 PwC, "Shaping Ireland's Future Talent Landscape: 2017".
35 CSO, Business Expenditure on Research and Development 2013–2014 (June 2015), p. 9, http://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2013-2014/.
36 CSO, Business Expenditure on Research and Development 2013–2014, p. 3, http://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2013-2014.
37 Eurostat, R & D Expenditure (February 2017), http://ec.europa.eu/eurostat/statistics-explained/index.php/R_%26_D_expenditure.
38 Eurostat, R & D Expenditure (February 2017), http://ec.europa.eu/eurostat/statistics-explained/index.php/R_%26_D_expenditure.
39 T. Martin and P. Fákó, *RIO Country Report 2016: Ireland*; 28493 EN; doi: 10.2760/8608 (Chapter 5), https://rio.jrc.ec.europa.eu/en/country-analysis/Ireland/country-report.
40 Department of Finance, "Economic Impact of Foreign-Owned Sector – Economic Impact Assessment of Ireland's Corporation Tax Policy" (October 2014), http://finance.gov.ie/sites/default/files/Economic%20Impact%20of%20the%20FDI%20sector.pdf.
41 Department of Finance, "Report on Tax Expenditures", p. 43, http://www.budget.gov.ie/Budgets/2017/Documents/Tax_Expenditures_Report%202016_final.pdf.
42 Irish Tax Institute and B&A Irish Indigenous Companies Survey (May 2017).
43 European Commission, Survey on the Access to Finance of Enterprises (SAFE) – Analytical Report 2016 (November 2016).
44 OECD, "Financing SMEs and Entrepreneurs 2016 – An OECD Scoreboard" (2016), https://www.oecd.org/cfe/smes/SME-Scoreboard-2016-Highlights.pdf.
45 CSO, Access to Finance 2014 (March 2016), http://www.cso.ie/en/releasesandpublications/er/atf/accesstofinance2014/.
46 Halo Business Angel Network, "HBAN Angels Invested €13.6m in 50 Irish Start-ups in 2016" (9 March 2017), http://www.hban.org/News/HBAN-angels-invested-%25E2%2582%25AC136m-in-50-Irish-start-ups-in-2016.1004.html#sthash.CxISURwt.dpuf.
47 EBAN, "European Early Stage Market Statistics 2015" (May 2016), http://www.eban.org/wp-content/uploads/2016/06/Early-Stage-Market-Statistics-2015.pdf.
48 Revenue, Annual Report 2016 (April 2017).
49 OECD, *Entrepreneurship at a Glance 2016* (Paris: OECD Publishing, 2016).
50 OECD, *Entrepreneurship at a Glance 2016*.
51 Revenue, Costs of Tax Expenditures (Credits, Allowances and Reliefs). Most recent data available.
52 Revenue, Costs of Tax Expenditures (Credits, Allowances and Reliefs). Most recent data available.
53 Revenue, Costs of Tax Expenditures (Credits, Allowances and Reliefs). Most recent data available.
54 Section 472D Taxes Consolidation Act 1997.
55 Revenue data given on 12 May 2017.
56 World Trade Organisation, *'The most dynamic segment of international trade: Trade in services'*, 2015.
57 World Trade Organisation, *'The most dynamic segment of international trade: Trade in services'*, 2015.
58 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015* (January 2017).
59 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015*.
60 Enterprise Ireland, "Export Performance in Global Markets 2016" (May 2017), https://www.enterprise-ireland.com/en/Publications/Reports-Published-Strategies/ABR-2017.PDF.
61 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015*.
62 Comments made by Enterprise Ireland, 21 June 2017.
63 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015*.
64 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015*.
65 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015*.
66 Enterprise Ireland, "Export Performance in Global Markets 2016".
67 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015*.
68 Boston Consulting Group, "Digitizing Europe: Why Northern European Frontrunners Must Drive Digitization of the EU Economy" (May 2016).
69 Boston Consulting Group, "Digitizing Europe: Why Northern European Frontrunners Must Drive Digitization of the EU Economy".
70 CSO, Information Society Statistics – Enterprises 2016 (Summary) (December 2016), http://pdf.cso.ie/www/pdf/20170615114232_Information_Society_Statistics__Enterprises_2016_summary.pdf.
71 J. Kennedy, "Heads in the Sand: Almost 25pc of Irish SME Businesses Are Offline", Silicon Republic (9 June 2017).
72 European Commission Concept paper on digitisation, employability and inclusiveness the role of Europe DG Communications Networks, Content &Technology (CONNECT), May 2017
73 European Commission Concept paper on digitisation, employability and inclusiveness the role of Europe DG Communications Networks, Content &Technology (CONNECT), May 2017
74 European Commission Concept paper on digitisation, employability and inclusiveness the role of Europe DG Communications Networks, Content &Technology (CONNECT), May 2017
75 World Economic Forum 2016 Networked Readiness Index, http://reports.weforum.org/global-information-technology-report-2016/.
76 Boston Consulting Group, "Digitizing Europe: Why Northern European Frontrunners Must Drive Digitization of the EU Economy".
77 European Commission Mid-term review of Digital Single Market http://europa.eu/rapid/press-release_MEMO-17-1233_en.htm
78 Eurostat
79 IDA Ireland, June 2017.
80 The Economist: http://www.economist.com/news/finance-and-economics/21721557-first-quarter-figures-probably-overstate-gap-between-two.
81 Focus Economics: http://www.focus-economics.com/regions/euro-area.
82 Enterprise Ireland: Export performance in Global Markets 2016, May 2017.
83 IMF, "Ireland: Staff Concluding Statement of the 2017 Article IV Consultation".
84 IDA Ireland, June 2017.
85 Enterprise Ireland, "Enterprise Ireland and IDA Joint Trade Mission in Ireland Opens Doors for Irish SMEs with Irish Based Multinationals' (18 May 2016).