SIGNIFICANCE OF THE SME SECTOR IN THE IRISH ECONOMY

A Report Prepared for the Local Jobs Alliance

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Contents

EXECUTIVE SUMMARY

- The Local Jobs Alliance was formed over a decade ago to bring together the representatives of local employers and family owned businesses throughout Ireland. It includes RGDATA, CSNA, ISME, VFI, LVA, IHF and RAI. The Alliance was formed to highlight the vital importance and strong economic and social contribution of Irish family-owned and other small businesses to local economies and the national economy.

- The seven members of the Local Jobs Alliance represent around 24,850 businesses in Ireland, employing around 448,000 people. They have a very broad regional footprint and are major employers in the regional and rural economy, as well as the large urban areas.

- The pubs, hotels and restaurants represented by the RAI, the LVA, the VFI and the IHF are the backbone of the very economically significant Irish tourism sector. The retailers and other businesses represented by CSNA and RGDATA account for a very significant component of the grocery and convenience sector. ISME has a footprint across many small businesses across the economy.

- Despite the considerable attention that is directed towards foreign direct investment and the multi-national sector, the SME sector is of substantial significance to the Irish economy. In numerical terms, Ireland has a preponderance of Small and Medium Enterprises (SMEs) spread across Industry, Services & Distribution, and Building & Construction.

- SMEs are firms that employ less than 250 people. Such firms dominate the Irish economic landscape. In overall terms they account for 99.8% of the total number of business enterprises in the private business economy; they employ 1.06 million people, accounting for 68.4% of total employment in the private business economy.

- In recognition of concentration risks in the Irish economy, where a small number of large companies make an inordinate contribution the economy, it is vital that a strong indigenous sector is developed and nurtured and that SMEs in particular can play an increasingly important role in firstly rebuilding the Irish economy post-COVID-19, and secondly in helping to ensure the longer-term sustainability of the Irish economic model.

- Between 2012 and 2017, firms employing over 250 people delivered growth of 26.1% in employment, accounting for 101,835 extra employees; firms employing less than 250 employees, delivered employment growth of 21.6%, accounting for 188,795 extra employees.

- The SME sector played a very important role is pulling the economy out of the labour market crisis in 2012, and with proper support and policy recognition, it will play a very important role in pulling the economy out of the COVID-19 employment crisis.

- The businesses included in the *Local Jobs Alliance* span retail, hospitality and many other areas of SME activity in the Irish economy. Many of these businesses are now shut down as a result of COVID-19, while others are playing a vital role in supporting the economy and society during these difficult times.

- A range of measures is now necessary to ensure that all of these businesses survive the shock posed by COVID-19 as they will play an essential role in re-building the Irish economy once the virus passes and the economy is re-opened. Specific ongoing measures are required to keep those businesses solvent during the crisis, but once the crisis ends, economic recovery will not be possible without those businesses. Longer-term support will be required once COVID-19 passes, because it will take some time for business levels to return to normality.

- The only formal standing engagement forum for industry and the Department of the Taoiseach and the Department of Finance is the LEEF (Labour Employer Economic Forum). If government departments want to fully understand the issues facing the economically significant SME sector, a more formal interaction between Government and SMEs which positions them as equal partners with larger enterprises and labour is essential.

- SMEs will have to be put at the top and centre of the effort to re-boot the economy over the coming months and become a central part of the policy-making agenda. That has not been the case in the past, but that must change with immediate effect. The SME sector is too significant to ignore.

- Specific COVID-19 measures need to be introduced to cover issues such as liquidity and solvency supports, fiscal grants, lower VAT rates, a commercial rates holiday for 12 months, a commercial rent scheme, and insurance cost alleviation measures.

- Significant and unorthodox measures need to be Implemented immediately to prevent viable businesses from becoming vulnerable.

- The measures contained in the May 2nd COVID-19 business rescue package represent another positive step in helping business survive the COVID-19 crisis and successfully re-commence operations once the economy is opened up again. However, the measures cannot be implemented until a new government is in place; the serious liquidity issues for SMEs have still not been adequately addressed; and further measures will be required.

- The Irish Government will have to accept a higher level of government borrowing in the medium-term. There cannot be a return to policies of fiscal austerity. Government spending on public services will have to be maintained and the tax burden cannot be increased.

- The agenda of the incoming government should include a number of priorities to nurture, support and grow the SME sector, which makes such a strong regional and national economic contribution, and which will play an essential role in re-building the economy.

- The SME sector must be mainstreamed into the heart of government policy and it has to become an integral part of economic and business policy formulation. A structure needs to be created at the heart of government policy to include the SME perspective on economic and fiscal policy measures.

- A specific action plan needs to be included in the Programme for Government that gives due recognition to the very significant role the sector plays in Irish economic life at both the national and the local level.

- Given the challenges now facing the economy from COVID-19 and the pressurised FDI model, it is time to create a more formal and professional approach to developing the SME sector. The IDA is a State agency with specific responsibility for attracting FDI into Ireland. Enterprise Ireland is a State agency with responsibility for the development and growth of Irish enterprises in world markets. Both organisations fulfil an important role in achieving their objectives, but there is no such agency for SMEs. Government should set up a State agency with specific responsibility for SMEs. The new body should become an engine to drive urban and rural regeneration, based on an evidenced based strategy; build social capital; deliver a circular economy; and be heavily driven by community aspirations. This is what SMEs are very effective at doing, but the model needs to be developed in a very significant way.

- The Government will need to outline a sector by sector plan to re-open the economy.

LOCAL JOBS ALLIANCE

Seven SME/Irish family business associations representing 24,850 businesses employing 448,000 people in retail, hospitality, manufacturing and services.

SMEs are the backbone of Irish Tourism, Local Community, Retailing, Hospitality, Services and Manufacturing sectors.

SME sector is key to Covid-19 regeneration throughout Ireland.

SMEs DROVE THE RECOVERY IN 2012-2017 DELIVERING 188,795 NEW JOBS. (ENTERPRISES <250 DELIVERED 101,835)

SMEs
(businesses employing <250)
ACCOUNT FOR 99.8% OF PRIVATE BUSINESSES ENTERPRISES AND EMPLOY 1.06 MILLION PEOPLE.

KEY ASKS

1
Specific SME Covid-19 measures are required to cover liquidity; solvency supports, fiscal grants, lower VAT rates, 12 month commercial rates holiday, commercial rent scheme and insurance cost alleviation measures.

2
A new, collaborative Regeneration model at the heart of Government todevelop economic, social and fiscal policies for a recovery based on social capital, vibrant communities, local jobs and enterprises. SMEs should be represented based on equal partnership with other stakeholders.

3
ESTABLISH A STATE AGENCY WITH SPECIFIC RESPONSIBILITY FOR SMEs.

THE LOCAL JOBS ALLIANCE

- **The seven members of the Local Jobs Alliance represent around 24,850 businesses in Ireland, employing around 448,000 people.**
- **The businesses represented by the LJA provide local employment in the cities, towns and villages throughout the country, and they represent the lifeblood of regional economic activity. They receive no direct financial support from the development agencies of the State and get very little recognition in official policy making. This is in marked contrast to the FDI component of the economy.**
- **If government departments want to fully understand the issues facing the economically significant SME sector, a more formal interaction between Government and SMEs, which positions them as equal partners with larger businesses and labour is required.**

The Local Jobs Alliance was formed over a decade ago to bring together the representatives of local employers and family owned businesses throughout Ireland. The Alliance was formed to highlight the vital importance and strong economic and social contribution of Irish family-owned and other small businesses to local economies and the national economy. Its formation was a recognition of the need to create a collective voice on issues relating to local jobs and Irish SME family owned businesses.

The Alliance brings together representatives from retail, hospitality and various other SMEs throughout the economy. There are seven representative bodies involved. These are RGDATA (The Retail Grocery Dairy and Allied Trades Association); the CSNA (Convenience Stores and Newsagents Association); ISME (Irish SME Association); the LVA (Licensed Vintners Association); the VFI (Vintners Federation of Ireland); the IHF (Irish Hotels Federation) and the RAI (Restaurants Association of Ireland).

These seven associations are a subset of the overall SME sector, but they account for a very significant proportion of business and employment in the retail and hospitality sectors in particular, but many facets of the SME economy in general.

RGDATA: Retail Grocery Dairy & Allied Trades Association

RGDATA is the representative body for over 4,000 independent family-owned grocery shops, convenience stores, forecourt stores and supermarkets around Ireland. The independent convenience retail sector employs over 90,000 people in shops, wholesalers and distribution. These businesses are deeply embedded in the communities that they serve – they buy most of their inputs locally; they support local food producers; they provide local full-time and part-time employment; they support local charities and good causes; and they epitomise local community effort.

RGDATA's mission is '*to represent the interests of the independent grocery sector, providing advice and support for independent family grocers and to assist [its] members in providing a high standard of local community retailing*.'

CSNA: Convenience Stores & Newsagents Association

The Convenience Stores and Newsagents Association is the representative group for more than 1,500 retailers. It represents independents, franchisees of all symbol groups, owners and operators of service stations and independent confectionery, tobacconist and newsagents' shops (CTN). Its members employ around 35,000 people around the 26 counties of Ireland.

ISME: Irish Small & Medium Sized Enterprises

ISME is the independent representative association for Small and Medium Enterprises. It has in excess of 10,500 members and accounts for more than 100,000 employees in the Irish economy, spread across many diverse sectors. Its mission includes '*to represent what is best in the SME sector*' and '*to anticipate and decisively articulate the needs of the sector*.'

LVA: Licensed Vintners Association

The Licensed Vintners Association is the trade association and representative body for the publicans of Dublin. The LVA has 550 pub members, who support 12,500 jobs in the Dublin economy. LVA members collectively sell more than 25% of all the alcohol sold through the licensed trade in Ireland and they play a very important role in the business, social and cultural life of Dublin.

VFI: Vintners Federation of Ireland

The Vintners Federation of Ireland is the representative body for pubs for the 25 counties outside of Dublin. It represents 3,800 members and is estimated to employ at least 30,000 people in both alcohol and food services. The VFI works on its members behalf '*to promote and protect their interests and give advice to members on topics such as licensing laws, employment legislation, planning matters and much more*.'

IHF: Irish Hotels Federation

The Irish Hotels Federation is the national organisation representing the hotel and guesthouse industry in Ireland. It represents almost 1,000 hotels and guesthouses nationwide, employing over 60,000 people all over the country. The primary function of the IHF is to promote and defend the interests of its members.

RAI: Restaurants Association of Ireland

The Restaurants Association of Ireland (RAI) is the representative body for restaurants in Ireland. The body was formed in 1970 with the aim of creating a strong lobby group that would represent the restaurant sector on all issues of importance to the Irish restaurant industry. The RAI now represents over 3,500 members in the Republic of Ireland, including full-service restaurants, hotel restaurants, gastro pubs, coffee shops and cafes, industry suppliers, golf clubs and cookery schools. It also has 100 trade partners, businesses that are its approved suppliers of products and services for restaurants. Its membership employs 70,000 restaurant staff and another 50,000 staff in cafes, catering and food service activities. The main aim of the RAI is to develop the restaurant industry in a professional and high-quality manner by providing strong support to its membership.

CONCLUSION

The seven members of the Local Jobs Alliance represent around 24,850 businesses in Ireland, employing around 448,000 people. The businesses that they represent have a very broad regional footprint and they provide significant employment in the regional and rural economy, as well as the large urban areas.

The 448,000 jobs supported by the members of the Local Jobs Alliance account for 30% of total private sector economy. IBEC represents around 70% of private sector workers, but many of these work for banks, insurance companies, large multi-nationals, retail grocery multiples, and many other large firms.

The Local Jobs alliance represents many of the small businesses around the country. These businesses are involved in a diverse range of activities across the economy and make a very strong contribution to villages and towns throughout the country. It is imperative that these small businesses have a strong voice at the table and get their due recognition and voice in the programme for government that will be prepared by the incoming government.

The pubs, hotels and restaurants represented by the RAI, the LVA, the VFI and the IHF are the backbone of the very economically significant Irish tourism sector. The retailers and other businesses represented by CSNA and RGDATA account for a very significant component of the grocery and convenience sector. ISME has a footprint across many small businesses and many diverse business activities across the economy.

The one thing all of these businesses have in common is that they provide local employment in the cities, towns and villages throughout the country, and they represent the lifeblood of regional economic activity. They receive no support from agencies of the state and get very little recognition in official policy making. This is in marked contrast to the FDI component of the economy.

In 2018, the Industrial Development Authority (IDA) received Oireachtas Grants of €160.8 million, and it paid out grants of €96 million and spent a further €50.9 million on Promotion, Administration and General Expenses. Between 2012 and 2018, the average cost per job sustained by the IDA was €6,583.

FDI is clearly of great importance to the Irish economy, and this is reflected in the level of financial and other support provided to the IDA. However, the thousands of SMEs who provide thousands of jobs throughout the economy are largely ignored in official policy making and get little or no financial support or real recognition. This needs to change.

The only formal standing engagement forum for industry and the Department of the Taoiseach and the Department of Finance is the LEEF (Labour Employer Economic Forum). The Enterprise Forum in the Department of Business, Enterprise and Innovation (DBEI) is a useful but insufficient engagement forum. If government departments want to fully understand the issues facing the economically significant SME sector, a more formal interaction between Government and SMEs is essential.

In March 2019, Minister Pat Breen launched an SME and Entrepreneurship Consultation Group, whose stated function is to draw together the range of policy and other supports available across Government for SME/Entrepreneurship development and to ensure that they contribute to an enterprise culture that allows SMEs and entrepreneurship to develop and flourish. This group was established on the back of recommendations contained in a draft OECD Review of SME and Entrepreneurship Policies in Ireland. The OECD[i] published the final report in October 2019. One of its recommendations is to develop a national strategic document for SME and entrepreneurship policy, outlining all planned policy interventions in this field in the medium term. The OECD suggested that this strategy should set out the policy vision, objectives, targets, lines of action and performance indicators specific to SMEs and entrepreneurship.

All of these developments are helpful, but it is time to move away from a talking-shop approach and put SME development on a much more formal and professional footing.

THE SIGNIFICANCE OF THE SME SECTOR IN IRELAND

- **The Irish economic landscape is dominated by Small and Medium Enterprises (SME's). They are predominantly Irish owned.**
- **SMEs account for 99.8% of private business enterprises in the economy, spread across Industry, Services & Distribution, and Building & Construction.**
- **There are 270,557 SME enterprises in the economy, employing 1.063 million people, which is equivalent to 68.4% of private business employment.**
- **SMEs account for 41.7% of gross valued added in the Irish economy.**
- **The majority of SMEs are small in employment terms. 92.3% of SMEs employ less than 10 people and employ 411,8923 workers in total. 4.1% employ between 10 and 19; 2.4% employ between 20 and 49; and just 1.2% employ between 40 and 249 workers.**
- **SMEs account for more than 70% of employment in every county in Ireland, with the exception of Dublin.**

THE BUSINESS LANDSCAPE IN IRELAND

Despite the very significant support and attention that is directed towards foreign direct investment and the multi-national sector, the SME sector is of substantial significance to the Irish economy. In numerical terms, Ireland has a preponderance of SMEs spread across Industry, Services & Distribution, and Building & Construction.

In 2017, there were 271,166 business enterprises engaged in Industry, Services & Distribution, and Building & Construction activities in Ireland in total. These business enterprises in total employed 1.55 million workers. Of these, SMEs make up 99.8%.

THE SME LANDSCAPE

A business employing less than 250 people is officially categorised as an SME. They account for 99.8% of total business enterprises or 270,557 businesses in the overall economy. Just 609 enterprises employ more than 250 employees. SMEs employ 1.063 million people.

Of the 270,557 SMEs:

- In 2016, SMEs generated turnover of €323.8 billion, accounting for 50.2% of total turnover;
- In 2016, SMEs contributed €79.6 billion in gross value added, accounting for 41.7% of total gross value added;
- 92.3% of SMEs employ less than 10 people and account for 38.7% of total employment in the SME private business sector;
- 4.1% employ between 10 and 19 people and account for 14.1% of total employment in the SME business sector;

- 2.4% employ between 20 and 49 people and account for 18.3% of total employment in the SME business sector; and
- 1.2% employ between 50 and 249 people and account for 28.9% of total employment in the SME business sector.

Table 1: Breakdown of SME Employment

EMPLOYEE RANGE	NO. FIRMS	%	NO. EMPLOYED	%
<10 People	249,690	92.3%	411,923	38.7%
10-19 People	11,167	4.1%	149,356	14.1%
20-49 People	6,546	2.4%	194,575	18.3%
50-249 People	3,154	1.2%	307,759	28.9%
Total	270,557		1,063,613	

Source: CSO Statbank, Business Demography

INDUSTRY

The CSO estimated that in 2017, there were 18,817 Industrial business enterprises in Ireland.[ii] Of this total, 18,639 or 99.1% were categorised as SME.

In 2017, these 18,639 SMEs:

- Employed 125,596 employees, accounting for 51.7% of total industrial employment.
- Generated €44.3 billion in turnover, accounting for 18.6% of total industrial turnover; and
- Accounted for €15.04 billion or 14.6% of total gross value added in Industry.

SERVICES AND DISTRIBUTION

The CSO estimated that in 2017, there were 207,172 Services & Distribution business enterprises in Ireland. Of this total, 206,809 or 99.8% were categorised as SME.

In 2017, these 206,809 SMEs:

- Employed 833,843 employees, accounting for 73% of total employment in Services & Distribution.
- Generated €268.3 billion in turnover, accounting for 66.4% of total turnover in the Services & Distribution sector; and
- Accounted for €57.9 billion or 59.1% of total gross value added in Services & Distribution.

BUILDING AND CONSTRUCTION

The CSO estimated that in 2017, there were 57,255 Building & Construction business enterprises in Ireland. Of this total, 57,238 or 99.9% were categorised as SME.

In 2017, these 57,688 SMEs:

- Employed 128,303 employees, or 93.5% of total employment in the Building & Construction sector.

- Generated €17.4 billion in turnover, accounting for 89.5% of total turnover in the Building & Construction sector (2016); and
- Accounted for €6.3 billion or 90.5% of total gross value added in the Building & Construction sector (2016).

IRISH-OWNED v FOREIGN-OWNED BUSINESS ENTERPRISES

- SMEs accounted for 66.7% of total employment in Irish-owned Industrial enterprises;
- In foreign-owned Industrial enterprises, 73.2% of all persons engaged were employed in large enterprises;
- SMEs accounted for 82.4% of all employment in Irish-owned Services & Distribution enterprises;
- 50.8% of gross value added in Irish-owned Industrial enterprises was contributed by SMEs;
- 94.4% of gross value added in Irish-owned Building & Construction enterprises was contributed by SMEs; and
- 74.8% of gross value added in Irish-owned Services & Distribution enterprises was contributed by SMEs; and
- 65% of gross value added in foreign-owned Services & Distribution enterprises was contributed by large enterprises.

Table 2 provides a county-by-county breakdown of employment in SMEs as a percentage of total business employment. Dublin has the lowest SME penetration at 52.5%, but is as high as 100% in a number of counties. SMEs support a very significant level of employment around the country.

Table 2: SME Employment by County

	SME EMPLOYMENT	% TOTAL EMPLOYMENT		SME EMPLOYMENT	% TOTAL EMPLOYMENT
All Counties	1,063,613	68.4%	**Longford**	6,345	100.0%
Carlow	10,626	100.0%	**Louth**	26,238	87.0%
Cavan	15,731	88.6%	**Mayo**	25,446	82.5%
Clare	24,451	82.5%	**Meath**	37,106	90.7%
Cork	116,652	74.7%	**Monaghan**	14,829	92.5%
Donegal	31,650	92.0%	**Offaly**	12,385	85.9%
Dublin	381,110	52.5%	**Roscommon**	9,193	100.0%
Galway	55,788	81.4%	**Sligo**	11,935	73.6%
Kerry	31,925	86.4%	**Tipperary**	27,624	81.5%
Kildare	42,354	76.6%	**Waterford**	22,464	70.2%
Kilkenny	17,354	88.1%	**Westmeath**	16,905	84.7%
Laois	9,768	100.0%	**Wexford**	29,400	81.8%
Leitrim	5,238	100.0%	**Wicklow**	26,256	85.9%
Limerick	38,788	78.2%			

Source: CSO Statbank, Business Demography

THE IRISH ECONOMIC CONTEXT

- **The global economy was in a very fragile state coming in to 2020 and this has been exacerbated by the COVID-19 crisis. This uncertain global backdrop will create a more challenging environment for the tourism and merchandise export sector in particular.**
- **Global policy makers are reacting in an aggressive way to the crisis, but more will be needed.**
- **The Irish economy has had a very good five years, but it is important to recognise and adjust for the exaggerated nature of Irish GDP. It distorts the real health of the economy and does not reflect the challenges facing the SME sector.**
- **The early impact of COVID-19 on the Irish economy looks very dramatic.**
- **COVID-19 is the immediate challenge for the Irish economy on a range of different fronts. However, there are other risks and challenges, including Brexit, international corporation tax reform, housing, pressure to increase government spending on public services, insurance costs and political stability. These have been totally overshadowed by the unprecedented COVID-19 crisis.**

THE INTERNATIONAL BACKGROUND

As a small open economy with a heavy reliance on external trade and foreign direct investment (FDI), Ireland is very exposed to global economic and financial developments.

2019 was a challenging year for the global economy. Global growth slowed consistently as the year progressed and the estimated growth rate of 2.9% was the lowest in a decade. Outright economic recession was not experienced, but it was a year of modest growth, muted inflationary pressures and considerable uncertainty emanating from the US/China trade dispute, Brexit, and a generally more uncertain and fractious global geo-political environment.

Growth in the Euro Zone was the biggest disappointment in 2019. Germany and Italy moved close to technical recession and inflation remained well below the European Central Bank's target of '*2% or slightly lower*'. There was no surprise in the fact that the UK economy was undermined by Brexit uncertainty and business investment in particular was in a state of uncertainty-driven paralysis. Chinese growth slowed due to the trade dispute with the US, and ongoing domestic economic and financial restructuring. The Japanese economy weakened significantly and moved to the brink of recession.

Coming into 2020, there was an expectation that growth would improve. This was based on a belief that President Trump would reach agreement with China due to the fact that he faces an election in November and would not want to go into that election against a background of global and US economic difficulties as a result of a trade dispute between the US and China. This is exactly how the situation was evolving in the early weeks of the year.

However, the COVID-19 crisis has thrown the global economy into an unprecedented slump over the past couple of months. The International Monetary Fund (IMF) has warned that this could be the most significant global economic slowdown since the Great Depression. However, the IMF is expecting recovery in 2021, but to get there, it will be essential to prioritise virus containment and strengthen health systems everywhere. What differentiates this recession from previous ones is that recovery will be guided by health developments, rather than by normal economic factors. It is somewhat re-assuring that global policy makers, including the Irish authorities, are reacting aggressively on the economic policy front. This did not happen back in 2008.

In terms of economic data releases, we are now starting to see the first indications of the impact to date.

- The Purchasing Mangers' Index (PMI) is a monthly survey of business confidence in both manufacturing and services. A reading above 50 means that more businesses expect growth than contraction, and vice-versa for a reading below 50.
- In March, the composite PMI in the US fell from 49.6 to 40.9; the UK index fell from 53 to 36; and the Euro Zone index fell from 51.6 to 29.7. These declines are without precedent and are truly dramatic. Within the composite indices, services are taking the biggest hit as many service activities are shut down.
- The German Ifo survey of business confidence in March fell from 96 to 85.9 and to 74.3 in April.
- Initial jobless claims in the US increased by 26.6 million in the five-week period to 17th April. These are the largest weekly increases ever recorded.
- US employment declined by 701,000 in March, which brought an end to 113 consecutive months of employment increases.
- Chinese GDP fell by 6.8% in the first quarter of the year. The Chinese only began recording quarterly economic growth in 1992, but the last time it officially acknowledged a year-on-year decline in economic output was in 1976.

The official policy response around the world to the crisis has been strong. There will be more required over the coming months. The following is a sample of the official actions already taken or being considered:

- The Bank of England has cut interest rates from 0.75% to 0.1% and has committed to a further £250 billion of official bond purchases;
- The UK government has introduced a fiscal stimulus package of around £75 billion;
- The US administration has got approval for the largest ever fiscal stimulus package seen anywhere, totalling $2 trillion;
- The Federal Reserve has cut interests to zero in two emergency moves. The last time there was an emergency rate cut in the US was in the immediate aftermath of the collapse of Lehman Brothers in September 2008. The US central bank is also supplying massive liquidity to the markets;
- The German government has announced a fiscal stimulus package of €156 billion (equivalent €10% of GDP);

- The Japanese have introduced a fiscal stimulus package of JPY 108 billion;
- The EU has relaxed the EU fiscal rules;
- The EU is giving consideration to the issuance of an EU-backed ‘Corona Bond’. This would help control sovereign risk, which is very important in the context of countries like Italy and Greece, but the Germans are opposed; and
- The EU is utilising the precautionary credit line available under the European Stability Mechanism (ESM). This credit line is intended to help countries with sound economic fundamentals, which are affected by an adverse shock beyond their control. This mechanism would be equivalent to around 3% of GDP, but this could be increased.

This is a sample of the monetary and fiscal policy response seen to date. The key problem is that the global economy was already quite vulnerable before the COVID-19 crisis, so the impact of the crisis is proving very significant.

The official policy response to date is impressive and does suggest that policy makers stand ready to do whatever is necessary to support global banks, households and businesses. It is imperative that what is currently an economic shock and crisis, is not allowed morph into a banking crisis, which was the distinguishing feature of the 2007/2008 crisis. That is why it is essential that central banks pump liquidity into the banking system and that loan default rates are controlled through government support for businesses and households.

The global economy will see a massive contraction in activity in the second quarter, but the timing of recovery will depend on how quickly the virus is brought under control. This is a medical uncertainty, rather than an economic one. It will be important for policy makers to do whatever is necessary until a vaccine is developed. Meanwhile, the problems in the global economy will set a challenging backdrop for Ireland.

THE DOMESTIC IRISH ECONOMIC BACKGROUND

The Irish economy experienced a very deep and damaging recession in 2008, but experienced a strong and sustained economic recovery from 2013 onwards. Data from the Central Statistics Office (CSO) show that by 2019, the size of the economy, as measured by gross domestic product (GDP), had increased by an estimated 74% since 2013.

The strong recovery in the Irish economy over recent years has been helped considerably by the reasonably benign global economic backdrop and by the European Central Bank’s (ECB) historically low interest rate policy. However, domestic policy making has also been supportive of growth.

In any discussion of the Irish economy, it is important to understand the vagaries of the Irish economic model and the extent to which the official growth statistics, as measured by GDP, are distorted by the activities of the multi-national sector and Ireland’s strong aircraft leasing sector

The published growth rates in GDP are suggestive of an economy experiencing very rapid economic growth, but that is not quite the reality on the ground in the real economy. GDP as a measure of economic activity has become particularly distorted since 2015. As a consequence, the Central Statistics Office (CSO) has developed an alternative measure of economic activity, which excludes globalisation effects such as trade in intellectual property assets, imports of R&D services, and trade in aircraft by leasing companies. This measure is called gross national income* (GNI*) and is a more realistic indicator of the underling level of activity in the economy. In 2018, GDP was measured at €324 billion in current price terms and GNI* was measured at €197 billion. GNI* has no international resonance, but it helps with analysis of the real health of the Irish economy.

The Irish economy delivered another year of solid growth in 2019. Data show that GDP expanded by 5.5%. Consumer expenditure increased by 2.8% and exports of goods and services expanded by 11.1%. However, the modified and more realistic measure of economic growth – modified final domestic demand - expanded by 3%. These data describe an economy that was growing at a steady and sustainable pace, rather than at an overheated pace.

In the early days of January, the Department of Finance updated its Irish growth forecast for 2020 reflecting the lessened risk of the potential for a disorderly Brexit in 2020. The revised forecasts were predicated on a free-trade agreement between the EU and UK that mirrors existing arrangements or the agreement of an extension to the transition period.

GDP was forecast to expand by 3.9% in 2020 and growth was projected to average 2.9% between 2020 and 2025. These forecasts looked realistic based on the facts available at the time. However, all has subsequently changed due the COVID-19 crisis.

RISKS AND CHALLENGES

Prior to COVID-19, there were a number of external and domestic risks and challenges facing Ireland. They remain relevant, but have been compounded and in many ways overshadowed by the potential economic impact of the global health crisis.

- The UK eventually left the EU on January 31st and the trade negotiations commenced in early March. These negotiations were always destined to be extremely difficult and the risks of a significant trade disruption in January 2021 cannot be ruled out. The UK Prime Minister has been adamant that his government would not seek an extension to the Brexit transition mechanism, regardless of whether agreement ion the future trading relationship with the EU had been reached or not. Logic suggests that as a result of COVID-19 an extension will have to be sought, but this cannot be taken for granted as the UK remains adamant that it will exit the transition mechanism at the end of 2020. Brexit still represents a serious threat to Ireland and ultimately will cause a considerable deterioration in the ability of Ireland to trade with the UK. It is just a question of how damaging it will be.

- The International Monetary Fund (IMF) published its latest official global economic outlook in January. Global growth was estimated at 2.9% in 2019 and was forecast to increase to 3.3% in 2020 and 3.4% in 2021. This pointed to a continuation of sluggish growth, with downside risks. The downside risks identified included rising geopolitical tensions, particularly between the US and Iran; intensifying social unrest; a further worsening of relations between the US and its trading partners; and deepening economic frictions between other countries. COVID-19 has altered this benign outlook and the global economy is now experiencing a serious and unprecedented shock to growth. The IMF is now expecting the worst global economic recession since the 1920s.
- While the moderation in Irish house price inflation in 2019 was very welcome, rents continued rising and housing affordability remained a big issue. The Central Bank is not likely to ease the mortgage lending rules, and the imperative to increase housing supply should remain the key focus of policy makers. COVID-19 brought most construction activity to a standstill, so the delivery of sufficient housing supply will become more difficult.
- The pressure to increase expenditure on public services has been intensifying in recent years. This was particularly highlighted during the February 2020 general election campaign. Ireland still had a high level of debt prior to the crisis and fiscal prudence looked essential, regardless of who formed the government. The whole fiscal situation has been thrown into total turmoil by the COVID-19 crisis.
- General Election 2020 marked a significant shift in the Irish political system. Formation of a stable government has proven problematical, but the COVID-19 crisis has accelerated the impetus to form a stable government that will last a full term and that is empowered to address the COVID-19 impact and the other pre-existing challenges that Ireland is facing.
- In an economy that was approaching full employment, the recruitment and retention of workers was set to prove a significant challenge for all employers in 2020 and beyond. COVID-19 has obviously changed the labour market landscape in dramatic fashion.
- For small businesses in particular, the cost and availability of affordable insurance is a major problem. It must be properly addressed and solved by the incoming government.
- Ireland’s corporate tax model will come under increasing pressure and will threaten the overall FDI model in the longer term, and corporate tax revenues in the more immediate future.

All of these risks and challenges are still very real, but have been totally overshadowed by the unprecedented COVID-19 crisis.

COVID-19 AND THE IRISH ECONOMY

- **The impact of COVID-19 on the Irish economy is proving very dramatic. Due to officially mandated restrictions, large swathes of the economy have been effectively shut down.**
- **It is clear that the COVID-19 crisis is hitting service sector activities very significantly, while manufacturing is less affected.**
- **COVID-19 represents the biggest shock to hit the economy since 2007/2008, but depending on how long it continues, it could ultimately prove more damaging.**
- **The real pain in the economy is being felt by the service sector, with tourism-related businesses and those depending on discretionary consumer spending particularly badly hit; as are non-grocery retailers, including new car sales.**
- **The sectors most adversely affected by COVID-19 tend to be dominated by SMEs and small family-owned businesses.**
- **It is essential that those businesses that were viable before the COVID-19 shock should be fully supported to ensure that they can re-commence business once the lockdown ends and normality returns.**

THE ECONOMIC IMPACT

COVID-19 has effectively brough global economic activity to a standstill. The tourism and airline industries are being particularly badly affected, but very few sectors are immune. It represents the biggest shock to the global economy since the great financial crash (GFC) of 2007/2008. However, in some ways it is more serious, because human health is at stake; intense fear defines every country in the world at the moment; and we still have no idea how bad it is going to get or how long it will last. A vaccine is still likely to be some time away. Social distancing cannot end until a vaccine is widely available.

Meanwhile most countries are in a state of forced or voluntary lockdown and economic activity has collapsed. The world economy has been particularly vulnerable prior to COVID-19, as it was already struggling, with the Euro Zone particularly weak. COVID-19 has exacerbated the problems in a very dramatic way.

The Irish economy is also experiencing immense difficulties. Large swathes of the non-grocery retail sector have been shut down; hotels and restaurants are mostly shut down; and business continuity and productivity has been severely impacted. Over the coming weeks/ months economic growth will slow sharply and many thousands of jobs are being lost.

The risks and challenges confronting the Irish economy coming in to 2020 have been totally overshadowed by the global health crisis. The impact of COVID-19 on the Irish economy is proving very dramatic. It represents the biggest shock to hit the economy since 2007/2008, but depending on how long it continues, it could ultimately prove more damaging.

The first official COVID-19 economic projections were published by the Department of Finance as part of the EU Stability Programme Update on 21st April. It lays out in stark terms the economic impact and fiscal implications of COVID-19. It is couching its projections as scenarios rather than forecasts - such is the level of uncertainty at the moment.

The key elements of the economic update are:

- Economic landscape fundamentally changed in Ireland and across the globe;
- Irish GDP to fall by 10.5% in 2020;
- Labour market bears the brunt of the economic shock, going from full employment to a peak unemployment rate of 22% in the current quarter;
- Recovery over the second half of 2020 is dependent on successful virus containment;
- General government deficit of €23 billion (7.4% of GDP) projected in 2020;
- Modified Domestic Demand, perhaps the best indicator of domestic economic conditions, is projected to fall by 15% in 2020;
- Recovery in second half of 2020 projected to gain momentum in 2021 with economic growth of 6% projected;
- Employment to grow in 2021, with numbers out of work to fall below 10%;
- Debt-to-GDP ratio projected to rise to 69% in 2020.

Table 3: Economic Projections Department of Finance (April 2020)

	2019	2020f	2021f
GDP	5.5%	-10.5%	6.0%
GNP	3.3%	-11.7%	7.1%
Personal Consumption	2.8%	-14.2%	8.7%
Government Consumption	5.6%	9.1%	-3.2%
Modified Investment	1.3%	-37.3%	22.5%
Exports	11.1%	-7.7%	7.5%
Modified Imports	11.9%	-9.3%	9.7%
Modified Domestic Demand	3.0%	-15.1%	8.2%
GNI*	4.1%	-15.5%	9.6%
Inflation (HICP)	0.9%	-0.6%	0.4%
Employment	2.9%	-9.3%	5.5%
Employment (000s)	2,323	2,106	2,221
General Government Balance (% GDP)	0.4%	-7.4%	-4.1%
Government Debt Ratio (% GDP Year End)	58.8%	69.1%	68.4%
Government Debt Ratio (% GNI* Year End)	99.2%	125.1%	121.6%

Source: Department of Finance, Draft Stability Programme Update, 21st April 2020

Economic Data Update

There is a limited amount of economic data available that relates to the period since the stringent COVID-19 measures were taken. However, that which is available, highlights clearly the dramatic economic impact.

- In early May, data from the Department of Employment Affairs and Social Protection show that 598,000 people were in receipt of the COVID-19 Pandemic Unemployment Payment; over 52,000 employers had registered for the Temporary COVID-19 Wage Subsidy Scheme; and 39,100 people were in receipt of the COVID-19 enhanced Illness Benefit. This is in addition to the 214,741 people who were on the Live Register at the end of April.
- The Exchequer returns for the first 4 months of the year were only affected towards the end of the March. Overall tax revenues were 0.6% lower than the same period last year. The real impact will be felt over the coming months. Current government expenditure was 23.9% higher than the first 4 months of last year, with COVID-19 related spending pressures evident in Social Protection and Health.
- The Purchasing Managers Index (PMI) for manufacturing declined from 51.2 in February to 45.1 in March and to 36 in April.
- The PMI for services declined from a two-year high of 59.9 in February to 32.5 in March to just 13.9 in April.
- The PMI for construction fell from 50.6 in February to 28.9 in March and to just 4.5 in April. This is the lowest level since the series commenced in June 2000.
- New car sales in the year to May 12th were 32.3% down on the same period in 2019. Sales of Light Commercial Vehicles declined by 27.8%.
- Consumer confidence in April declined from 77.3 to 42.6. This is the largest monthly drop in confidence in the survey's 24-year history.
- Merchandise exports in the first 2 months of the year increased by 1.7%. However, February exports were 6.5% lower than a year earlier. This decline occurred when China was really the only country affected by COVID-19, so the situation looks set to become considerably more difficult over the coming months.

It is clear that the COVID-19 crisis is hitting service sector activities very significantly, while manufacturing is less affected.

Manufacturing is dominated by Chemicals & Related Products, which in turn is dominated by multi-national companies. Exports of Chemicals & Related Products (which includes Pharmaceutical & Medical Products) totalled €93.1 billion in 2019, and accounted for 61% of total merchandise exports and 27% of GDP. Food and Live Animals represent another important export category and accounted for 7.7% of total merchandise exports in 2019. Both of these sectors will not be affected as significantly by COVID-19 as others, particularly those where SMEs dominate.

Pain felt most acutely in Services Sector

The real pain in the economy is being felt by the service sector, with tourism-related businesses and those depending on discretionary consumer spending particularly badly hit; as are non essential retailers, including new car sales. While the immediate hit for construction activity is very severe, construction activity will re-commence immediately once the restrictions are eased. For many service-sector businesses, it will take considerably longer for activity to recover.

2020 will now be a complete write-off for international tourism and 2021 is likely to be extremely challenging. In addition, 'social distancing' will remain a feature of life for the next year at least and that will impose extra costs on business and will damage trade.

The reality for many businesses is that cashflow has collapsed, but many costs are still there. This is not a sustainable situation.

The banks will need to support businesses through this; the Revenue Commissioners will have to give breaks on VAT and other tax payments; commercial rates will have to be frozen and central government will instead have to provide funding to local authorities; rents will have to be frozen; and businesses will have to be subsidised directly to keep cashflow alive.

It is vital to recognise that while households will have to be supported, without viable businesses it will not be possible to rebuild the economy.

It is impossible to predict at this juncture how bad it will get or how long it will last. However, this will inevitably end and then the challenge will be to re-create a functioning economy. To restore a functioning economy, it is necessary to have functioning businesses. Without significant and ongoing government intervention, this will be difficult to achieve.

THE HOSPITALITY SECTOR

- **The Accommodation and Food Services Sector is a very important component of the Irish economy. It employs 179,800 people and has a very strong regional and rural employment footprint. It is crucial for tourism.**
- **SMEs and family owned businesses dominate the hospitality sector.**
- **Many of the jobs in the hospitality sector will be temporarily lost during the COVID-19 crisis. It is imperative that measures are put in place to ensure that all of those jobs can be re-created once the health crisis ends.**
- **Without an adequate supply of high-quality food service businesses, the ability of tourism in particular and the economy in general to recover will be seriously curtailed. This will be a particular challenge for the rural economy.**

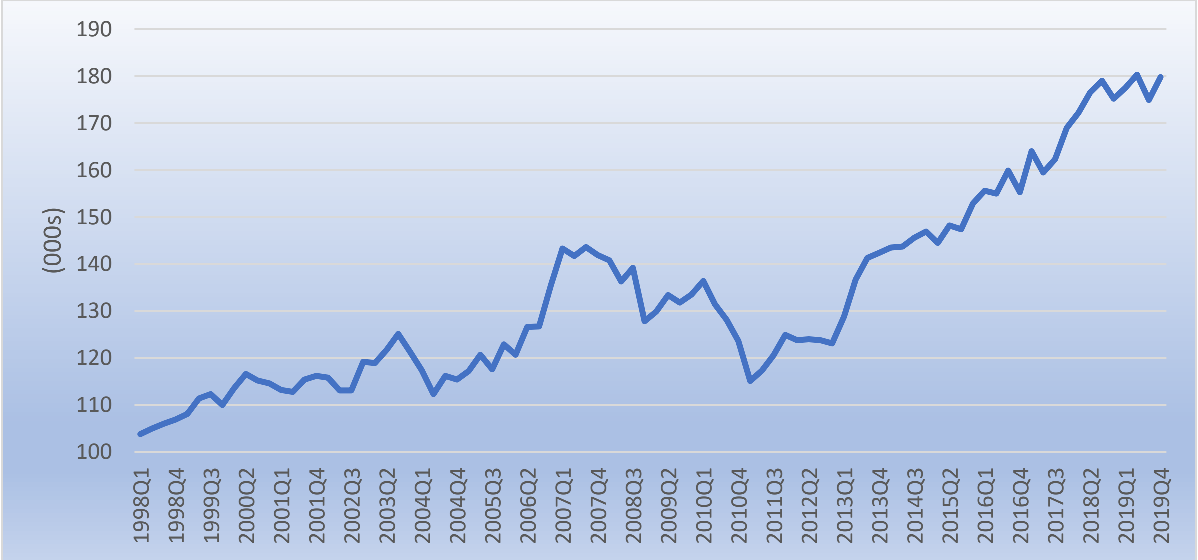
THE HOSPITALITY SECTOR IN IRELAND

The Accommodation and Food Services Sector is a very important component of the Irish economy. The latest labour force survey from the Central Statistics Office (CSO) estimated that employment in the sector stood at 179,800 on a seasonally adjusted basis in the final quarter of 2019 (179,100 on a non-seasonally adjusted basis) which is equivalent to 7.6% of total employment in the economy.

Since the second quarter of 2011, just before the special VAT rate of 9% was introduced in July 2011 in order to boost employment in the sector, employment increased by 62,500 or 53.3%. The reversal of the VAT reduction in Budget 2019 has been a significant concern for the sector and its timing was totally inopportune, as it coincided with slower global growth and intense Brexit-related problems.

The CSO estimates that at the end of 2019, 53,300 workers were employed in the Accommodation sector and 125,800 were employed in Food and Beverage Service activities (non-seasonally adjusted)

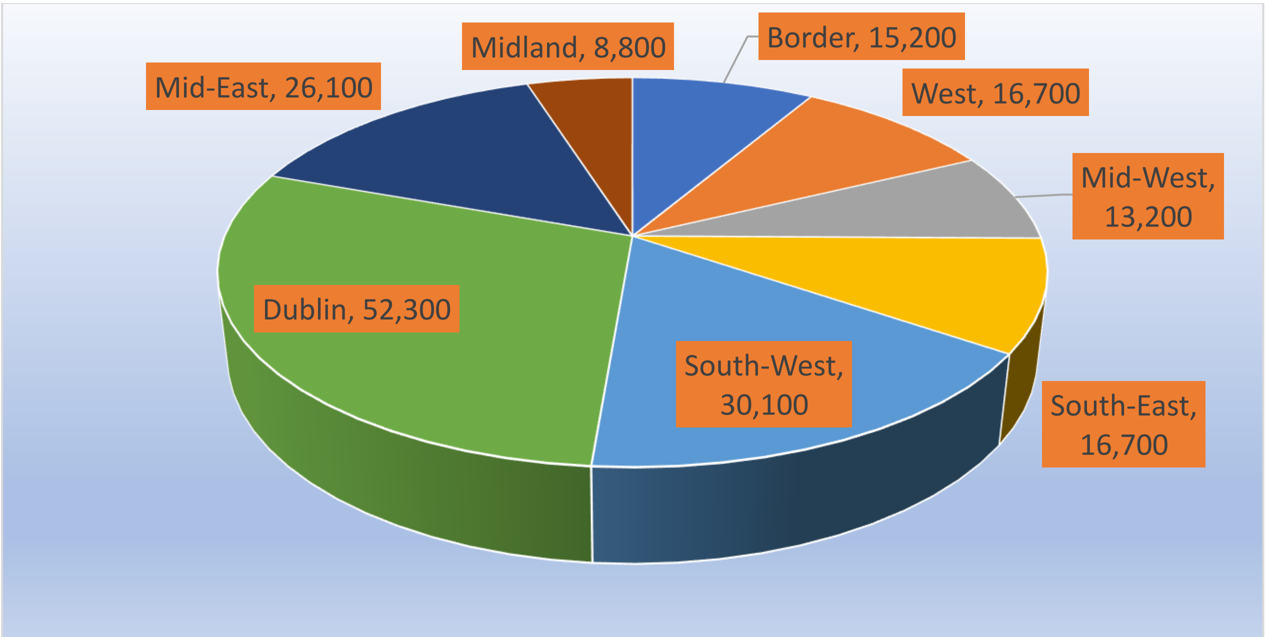
Figure 1: Employment in the Accommodation and Food Services Sector



Source: CSO, Labour Force Survey Quarter 4 2019, 18th February 2020.

The Accommodation and Food Services sector has a broad regional footprint. The figure below shows the breakdown of employment in the sector by region in the final quarter of 2019. Dublin accounted for 29.2% of total employment in the sector, but employment is spread across the regions and makes a very strong economic and social contribution to rural and regional economies. In the context of the priority that is being given to achieving more balanced regional economic and social development in official government policy, the strong regional employment and general economic contribution from the sector is very important.

Figure 2: Employment in Accommodation & Food Services Sector by Region (Q4 2019)



Source: CSO Statbank, Labour Force Survey Quarter 4 2019.

The CSO estimates that in 2017[iii], there were 19,205 active enterprises in the Accommodation and Food Services sector. This represents an increase of 10% on 2008.

Hotels, restaurants and pubs are key components of the Irish tourism product and have been integral to the success of Irish tourism over the past decade. These sectors are now under significant pressure due to a variety of factors, but COVID-19 has presented a very real and potentially fatal threat to these sectors.

Hotels

Ireland has 823 registered hotels, accounting for 60,152 rooms and 147,883 beds. The Irish Hotels Federation released data in February 2020, showing that overall hotel occupancy rates in 2019 increased slightly to 73% from 72% the previous year. However, this statistic hides significant regional variations. Dublin had an average capacity of 82%, but it was 53% in the midland region and 65% along the Wild Atlantic Way. Simultaneously, hotel capacity in terms of beds is increasing at a significant pace as many new hotels are being constructed.

Restaurants

The restaurant sector is a key component of the Accommodation and Food Services sector. It is estimated that the sector contributes over €3 billion per annum to the Irish economy in terms of wages and purchases of inputs. The sector is also a significant employer of part-time workers, particularly students. For many young people, experience in the restaurant sector is their first exposure to customer service and as such provides a very solid education and training for young people who want to move on to other careers.

Restaurants are one of the most important elements of Ireland's tourism offering. The sector makes a strong contribution to the overall economy, but it makes a particularly important contribution to rural and regional employment and economic activity. The sector sources much of its raw materials from Irish food producers, supports local employment and is a significant driver of local economic activity.

The sector went through a very difficult adjustment period from 2008 through to 2013 in line with the rest of the economy. The sector was particularly vulnerable as it is very dependent on inward tourism and domestic discretionary spending, both of which came under significant pressure during the severe economic downturn. The sector reacted strongly to the changed and much more difficult economic climate, by reducing costs and menu prices, and improving the quality of the offering. This approach, when combined with the Government decision to cut the VAT rate to 9% in July 2011, enabled the sector to come through the difficult economic circumstances.

Pubs

Pubs are also a vital component of the Irish tourism product. Foley[iv] estimates that in 2019, the drinks sector, which includes public houses and other bars, the manufacturing sector, the off-licence sector, full – and wine – licensed restaurants, wholesalers, and other distributors and drinks-related visitor attractions, provides direct employment to 64,000 full-time and part-time workers. This employment has a strong regional footprint. Foley estimates that bars employ around 42,000 people.

COVID-19 AND THE HOSPITALITY SECTOR

The hospitality sector needs to become fully functional once the restrictions end. Hotels, restaurants, pubs and other food service activities are the most important components of the tourism product and are the key reason why 10.8 million overseas visitors came to Ireland in 2019.

Without an adequate supply of high-quality food service businesses, the ability of tourism in particular and the economy in general to recover will be seriously curtailed. This will be a particular challenge for the rural economy.

Many of the jobs in the hospitality sector will be temporarily lost during this crisis, but it is imperative that measures are put in place to ensure that all of those jobs can be re-created once the health crisis ends.

For many businesses, cash flow is increasingly becoming a big issue. Fixed costs and other business costs simply do not go away, but if revenues collapse, then there is a real businesses survival issue. Banks need to play a role in supporting businesses and households through the crisis, and they need to be given the necessary liquidity to do this. We are also going to have to see the EU fiscal rules relaxed to allow governments spend more money on health and to ease the financial burden on households and businesses. Desperate times require desperate measures.

As well as supporting viable businesses, it is important that households are supported to the greatest extent possible.

THE ECONOMIC CONTRIBUTION OF TOURISM

- **Tourism makes a very significant contribution to overall economic activity in Ireland, but its key characteristic is the economic and employment contribution it makes to parts of the country where not a lot might be happening outside of the peak tourism season.**
- **Tourism businesses employ around 260,000 workers in total, which is equivalent to 11% of total employment in the economy.**
- **Prior to the COVID-19 crisis, the Irish tourism industry was already under pressure due to a combination of factors. Brexit, sterling weakness and the slower UK economy have affected the Great Britain market; the global economy has been performing at a subdued pace; air access issues relating to the grounding of the B737MAX; the increase in the VAT rate to 13.5% in Budget 2019; and the cost competitiveness of the Irish tourism product has been coming under pressure due to rising prices. However, all of these issues pale into insignificance compared to COVID-19.**

Tourism makes a very significant contribution to overall economic activity in Ireland, but its key characteristic is the economic and employment contribution it makes to parts of the country where not a lot might be happening outside of the peak tourism season. The bulk of businesses in the tourism sector are SMEs, with many family-owned.

On the surface, 2019 was another good year for the tourism sector in the sense that overseas visitor numbers hit a new high. However, beneath the surface it proved more challenging. The number of overseas visitors to the country increased by 1.8% to reach a new record of 10.8 million in 2019. However, the Great Britain market was challenging, with growth of just 0.8%. In 2019, visitors from Great Britain accounted for 35% of the total market. This is down from 41% in 2016.

Table 4: Overseas Visitors to Ireland

	2019	% YEAR-ON-YEAR	MARKET SHARE 2019
Great Britain	3,787,700	+0.8%	35.0%
Other Europe	3,910,200	+2.6%	36.2%
USA & Canada	2,412,500	+1.2%	22.3%
Other Areas	697,200	+5.5%	6.5%
Total	10,807,500	+1.8%	

Source: CSO

It is estimated by Fáilte Ireland that despite the record number of overseas visitors in 2019, the tourism spend was down around 1.8%, reflecting a change in the composition of the overseas market. The UK visitor share has been falling significantly, and the growth in North America and Europe has been stronger in numerical terms. However, UK visitors tend to have a higher daily spend, whereas European and North American visitors do tend to be more frugal.

The Irish Tourism Industry Confederation (ITIC) estimates that the Irish tourism industry earned an estimated €9.3 billion in 2019. Overseas visitors accounted for 55.9% of the total; domestic visitors accounted for 20.4%; visitors from Northern Ireland accounted for 4.1%; and 18.8% came from fares paid to Irish air and sea carriers.

Tourism is a sector that employs around 260,000 workers in total, which is equivalent to 11% of total employment in the economy. However, the most important attribute of the sector is that much of this employment is in rural areas, where not a lot else tends to happen outside of the peak tourism season.

Prior to the COVID-19 crisis, the Irish tourism industry was already under pressure due to a combination of factors. Brexit, sterling weakness and the slower UK economy have affected the Great Britain market; the global economy has been performing at a subdued pace; air access issues relating to the grounding of the B737MAX; the increase in the VAT rate to 13.5% in Budget 2019; and the cost competitiveness of the Irish tourism product has been coming under pressure due to rising prices.

For a service export like tourism in the Irish economy, international competitiveness is absolutely crucial to success. If the tourism product is not competitive, foreign visitors will be diverted to other cheaper markets, and domestic tourists will have a stronger incentive to go overseas. The other key element of competitiveness for visitors from outside the Euro area is the value of the euro.

Sterling weakness is pressurising the UK visitor market. In 2015, the sterling/euro exchange rate averaged 72.6 pence; in 2016 it averaged 81.9 pence; in 2017 it averaged 87.64 pence; in 2018, it averaged 88.49 pence; in 2019 it averaged 87.75 pence; and in the first 4 months of 2020, it has averaged 86.6 pence. However, in the midst of the COVID-19 crisis, sterling has come under renewed pressure. This represents a very significant deterioration in what is a very important exchange rate relationship for Ireland.

However, all of these issues pale into insignificance compared to COVID-19. COVID-19 now poses an immense risk to the global economy in general, but to global tourism in particular, given the unprecedented mandatory and voluntary travel restrictions. A global recession is now inevitable; global air travel is grinding to a standstill; tourism activity has effectively been wiped out; and many previously viable businesses have been shut down and may struggle to re-open. This is an unprecedented shock for the global economy and global business.

CONCENTRATION RISK AND THE IMPORTANCE OF SUPPORTING THE SME SECTOR

- **FDI is a very important component of the Irish economy.**
- **A small number of multi-national companies make a very significant contribution to Ireland's manufacturing activity, exports, corporation tax and employment.**
- **There is a real systemic risk that if any of these companies or sectors were damaged by factors such as global corporation tax changes or a movement of manufacturing back to the US, the Irish economy could be seriously undermined.**
- **In recognition of concentration risks in the Irish economy, it is vital that a strong indigenous sector is developed and nurtured and that SMEs in particular can play an increasingly important role in firstly rebuilding the Irish economy post-COVID-19, and secondly in helping to ensure the longer-term sustainability of the Irish economic model.**
- **Between 2012 and 2017, firms employing over 250 people delivered growth of 26.1% in employment, accounting for 101,835 extra employees; firms employing less than 250 employees, delivered employment growth of 21.6%, accounting for 188,795 extra employees.**
- **The SME sector played a very important role is pulling the economy out of the labour market crisis in 2012, and with proper support and policy recognition, it will play a very important role in pulling the economy out of the COVID-19 employment crisis.**

Ireland's Dangerous Dependence on a Small Number of Companies

Ireland has a very strong multi-national base, that makes a very significant contribution to growth and productivity in the economy. At the end of 2019, IDA-backed multinationals supported direct employment of 245,096 and a further 196,000 indirect jobs are estimated to be supported.

The very significant role played by multi-nationals in Ireland's economic model does pose a very real 'concentration risk.' The top 10% of firms account for 87% of value-added in manufacturing and 94% in services; a third of total exports are accounted for by just 5 firms; and 39% of corporation tax is paid by the top 10 companies.

The obvious vulnerability created by this 'concentration risk' is that if any of those companies or their sectors experienced a shock, then the Irish economic model could be quickly and cruelly exposed.

The Risks

The international attention increasingly focused on Ireland's corporation tax model should be a source of deep concern for Irish policy makers. Base Erosion Profit Shifting (BEPS) and Common Consolidated Corporate Tax Base (CCCTB) are the two policies driving this global agenda.

It goes without saying that the Irish corporation tax model will come under increasing pressure and scrutiny, and this poses a considerable risk to the future prosperity of the Irish economy in general and the public finances in particular.

The Department of Finance[v] is estimating that from 2022 onwards, implementation of the OECD's Base Erosion and Profit Shifting (BEPS) initiative could reduce corporation tax receipts by an incremental €500 million per annum. '*While there is some uncertainty surrounding this figure, it is the Department's best assessment, based on ongoing work being carried out by the Revenue Commissioners, that the overall risk from BEPS-related changes could be in the range of €800m to €2 billion*.'

COVID-19 has possibly exposed another threat to Ireland's FDI model. President Trump has on several occasions expressed concern about the US dependence on imported medical products and devices. There is a real risk that post-COVID-19, there will be increased pressure to bring manufacturing of such products back to the US. In an interview with Fox News on May 3rd 2020, President Trump again made reference to all of the pharmaceuticals manufactured in Ireland and then exported to the US. These exports to the US totalled €21.2 billion in 2019, which is equivalent to 42.7% of Ireland's total exports of medicinal and pharmaceutical products. President Trump is determined to bring such manufacturing activity back to the US as part of his 'America First' agenda.

Data from the IDA show that in 2018, 33,643 people were employed in Medical & Dental Instruments and Supplies sector, and a further 29,989 workers were employed in the Pharmaceuticals sector.

The Imperative to Support and Grow the SME Sector

Given the significant over-dependence on the multi-national sector and the inherent risks, posed by future tax developments, concentration risk and company-specific risk, it is essential that the Irish-owned component of the economy, and particularly the SME component, is developed and nurtured to the greatest extent possible.

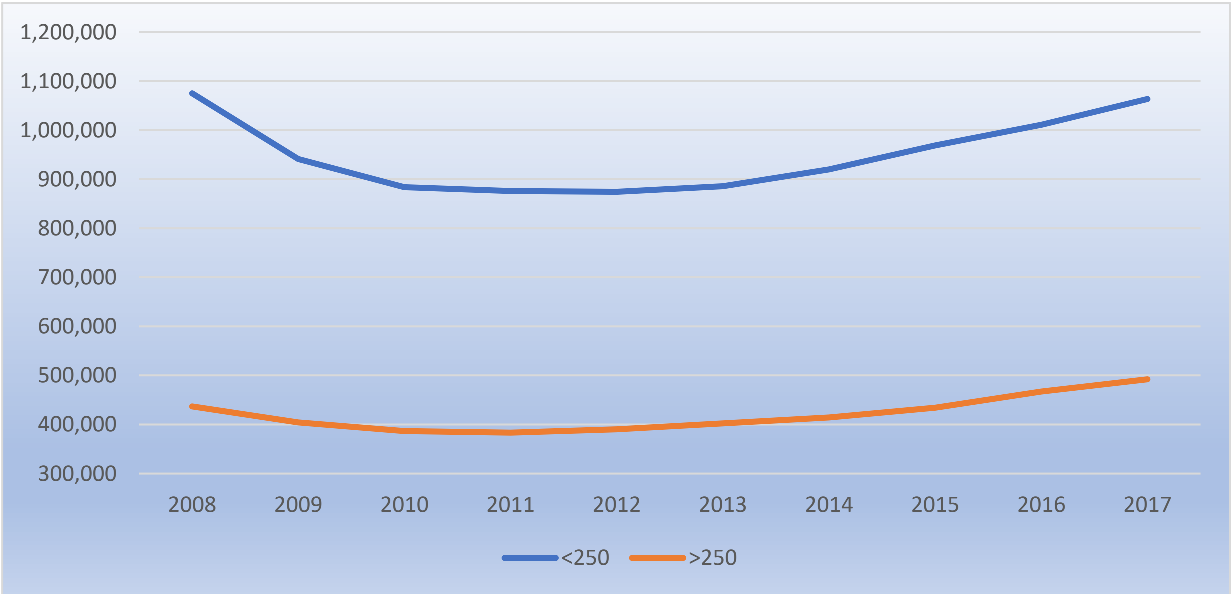
There are concentration risks for the Irish economy. Therefore, it is vital that a strong indigenous sector is developed and nurtured and that SMEs in particular can play an increasingly important role in firstly rebuilding the Irish economy post-COVID-19, and secondly in helping to ensure the longer-term sustainability of the Irish economic model.

The SME sector played a very important role is pulling the economy out of the labour market crisis in 2012, and with proper support and policy recognition, it will play a very important role in pulling the economy out of the COVID-19 employment crisis.

Figure 3 shows the trend in employment by size of employer between 2008 and 2017. Following the crash, both sectors experienced a sharp decline in employment, but smaller businesses were hit harder. However, both components of the economy made a strong contribution to the recovery in employment that occurred between the bottom of the labour market in 2012 and 2017.

Between 2012 and 2017, firms employing over 250 people delivered growth of 26.1% in employment, accounting for 101,835 extra employees; firms employing less than 250 employees, delivered employment growth of 21.6%, accounting for 188,795 extra employees.

Figure 3: Trends in Employment by Employer Size



Source: CSO Statbank

Just as SMEs payed a key role in re-building the economy and the labour market after the last crash, they will have to play a key role in re-building the economy and the labour market after the COVID-19 economic shock.

The likelihood is that SMEs will in fact have to play a more significant role in the future re-building of the Irish economy, this time compared to the last crash. This is because the environment for growing net FDI employment is likely to be more challenging over the coming years, due to upcoming global corporation tax changes, and the possibility that the COVID-19 crisis will convince the US in particular of the need to manufacture medical devices and pharmaceutical products at home rather than overseas.

It is imperative that official policy facilitates and supports the SME sector to the greatest extent possible in order to ensure that the sector will be capable of achieving its full potential and contributing to the maximum extent to the future growth and development of the Irish economy.

THE OPERATING ENVIRONMENT FOR THE SME SECTOR

- **SMEs dominate the Irish economy in quantitative terms and in employment terms. However, a considerable body of research shows that many SME owners were finding the environment challenging prior to COVID-19, and many are now in serious difficulty.**
- **The operating environment for many SMEs is challenging at the best of times, with tight margins a typical characteristic.**
- **The business cost environment has been deteriorating on a range of fronts over recent years, a fact that is consistently highlighted by the National Competitiveness Council.**
- **COVID-19 has clearly exacerbated the pressures. Sustaining and supporting SMEs is now a national imperative that will require unorthodox support and policy initiatives. There is no choice if Ireland is to re-create a functioning economy and bring unemployment down again.**

SMEs dominate the Irish economy in numerical terms and in employment terms. However, a considerable body of research shows that many SME owners were finding the environment challenging prior to COVID-19, and many are now in serious difficulty.

Costs of Doing Business

Every year the National Competitiveness Council benchmarks business costs in Ireland against costs in competitor countries. The National Competitiveness Council (NCC)[vi] (July 2019) pointed out that while Ireland is performing well in aggregate in terms of competitiveness, Ireland is a high cost economy and there are still areas of concern that should be addressed. These include low productivity in many sectors, and costs that are out of line with our international competitors in areas such as the cost of credit, commercial rents, and business services.

The following are the key conclusions of the NCC that impact on the competitiveness of Ireland as an operating environment for small businesses:[vii]

- In 2017, total hourly labour costs in Ireland were the 8th highest in the Euro Area – 2.3% higher than the Euro Area average 20.6% higher than the UK;
- In 2018, the monthly minimum wage in Ireland was higher than Spain and the UK;
- Certain utility costs such as electricity and gas tend to be higher in Ireland than other jurisdictions, but Ireland is more competitive regarding other utility costs such as telecoms;
- In the first half of 2018, the Irish weighted average non-household electricity price for non-household consumers consuming between 20 and 500 MWh was €0.14/kilowatt hour, compared to €0.13 in the UK and €0.10 in the Euro Area;
- Gas prices for non-household consumers have been consistently above the UK since 2013;

- Business Fixed Broadband costs in Ireland have been trending lower and at €42.46 are lower than the UK, but higher than Germany, Denmark and Spain;
- Business post-paid mobile services in Ireland at €30 per month are more than twice the UK at €13.71;
- Businesses in Ireland face higher interest rates than the average business in the EU or Euro area, regardless of size of company or duration of loan;
- Irish interest rates for non-financial corporations stood at 3.3% in January 2019, compared to just under 2% in the Euro Area. Irish businesses now face higher interest rates than in 2014;
- For non-financial corporations, in January 2019 loans up to €0.25 m had an average interest rate of 5.5%, compared to 2.2% in the Euro area;
- Ireland is a relatively expensive location in which to resolve a commercial dispute through a first-instance court. The total cost of enforcing a contract was 27% of the total award. Lawyers' fees account for 70% of the cost. In the World Bank's Ease of Doing Business Report, the analysis suggests that the time taken for filing and service, trial and judgment and enforcement is 650 days in Ireland, compared to 437 days in the UK and 578 days on average across OECD countries.

Other SME Pressures

These conclusions from the National Competitiveness Council highlight the extent that Ireland is an expensive location in which to do business. This is a particular issue for small companies who typically operate on tight margins.

Other issues for SMEs include:

- The over-dependence on the banking system for credit;
- The recruitment and retention of staff;
- Brexit and its impact on sterling, the UK economy and ultimately on the ability to trade with the UK;
- Insurance costs and availability;
- The VAT rate increase in Budget 2019 had a very negative impact on the hospitality sector;
- Commercial rates and other local authority charges;
- Commercial rents; and
- Too much dependence on the UK and domestic markets.

COVID-19 has clearly exacerbated these pressures and challenges. Sustaining and supporting SMEs is now a national imperative that will require unorthodox support and policy initiatives. There is no choice if Ireland is to re-create a functioning economy and bring unemployment down again.

POLICY SUPPORT FOR THE SME SECTOR

- **A range of measures are now necessary to ensure that as many small businesses as possible survive the shock posed by COVID-19 as they will have to play an essential role in re-building the Irish economy once the virus passes and the economy is re-opened.**
- **The businesses included in the *Local Jobs Alliance* span retail, hospitality and many other areas of SME activity. Many of these businesses are now shut down as a result of COVID-19, while others are playing a vital role in supporting the economy and society during these difficult times.**
- **Local family-owned grocery shops are keeping the local food supply chain functioning and providing a safer shopping environment than the large multiples. These local shops are proving once again just how important they are to the Irish economy and Irish society, particularly local communities. Local convenience stores and newsagents are fulfilling a similarly important role.**
- **Specific COVID-19 measures need to be introduced to cover issues such as liquidity and solvency supports, fiscal grants, lower VAT rates, reduced Excise Duties, a commercial rates holiday for 12 months, a commercial rent scheme and insurance cost alleviation measures.**
- **The agenda of an incoming government should include a number of priorities to nurture, support and grow the SME sector, which makes such a strong regional and national economic contribution, and which will play an essential role in re-building the economy.**
- **The SME sector must be mainstreamed into the heart of government policy and has to become an integral part of economic and business policy formulation. A structure needs to be created at the heart of government policy to include the SME perspective on economic and fiscal policy measures.**
- **A specific action plan needs to be included in the Programme for Government that gives due recognition to the very significant role the sector plays in Irish economic life at both the national and the local level.**

THE COVID-19 BUSINESS CHALLENGE

The businesses included in the *Local Jobs Alliance* span retail, hospitality and many other areas of SME activity in the Irish economy. Many of these businesses are now shut down as a result of COVID-19, while others are playing a vital role in supporting the economy and society during these difficult times.

Local family-owned grocery shops are keeping the local food supply chain functioning and providing a safer shopping environment than the large multiples. These local shops are proving once again just how important they are to the Irish economy and Irish society, particularly local communities. Local convenience stores and newsagents are fulfilling a similarly important role.

Re-opening the businesses that have been shut down or curtailed as a result of COVID-19 will be challenging. There are three broad issues for SMEs in the immediate and longer-term. These are:

1) The immediate issue is the impact of business closure on business costs and revenues. Revenues have fallen dramatically or totally disappeared, while costs such as loan servicing, rents, commercial rates, employee costs and paying suppliers are still an issue.
2) The second issue will involve re-opening. The priority is now rapidly moving towards re-opening as many businesses as possible in a safe manner, and the Government has published a 5-stage plan. However, even after businesses fully re-open it will take some time for pre-COVID-19 levels of economic activity to be achieved again. Measures to ensure social distancing will be essential until a vaccine is developed and this will prove costly and will curtail business volumes.
3) The third issue is the economic environment that will prevail over the next couple of years. The economy is experiencing a dramatic collapse in activity at the moment; unemployment has increased at an unprecedented rate; consumer confidence has fallen sharply; and the Government is being forced to increase expenditure in a very significant way. The consensus view is that there will be economic recovery later this year and into 2021. The extent and timing of the recovery will be largely dependent on the evolution of the virus and the timing of the opening up of the economy. It will take up to 2 years for economic activity levels to return to a semblance of normality.

It is very clear that Government will have to support business and households for the duration of the lockdown. However, even after businesses re-open, activity is likely to be slow to recover and remedial support will be necessary for many businesses for a prolonged period. The key requirement is to ensure that as many businesses as possible across the economy survive, re-open and re-hire staff as quickly as possible.

SMEs will have to be put at the top and centre of the effort to re-boot the economy over the coming months and become a central part of the policy-making agenda. That has not been the case in the past, but that must change with immediate effect. The SME sector is too significant to ignore.

COVID-19 REQUIRED RESPONSE

A range of measures are now necessary to ensure that as many small businesses as possible survive the shock presented by COVID-19 as they will have to play an essential role in re-building the Irish economy once the virus passes and the economy is re-opened.

Specific ongoing measures are required to keep those businesses solvent during the crisis, but once the crisis ends, economic recovery will not be possible without those businesses, and they will require ongoing support until there is a return to a semblance of economic normality.

For small businesses there is a range of policies necessary to ensure that they can survive in the first instance, and ramp up business activity in the second once the crisis eases.

(1) LIQUIDITY AND SOLVENCY SUPPORTS

Those SMEs who were forced to shut down or significantly curtail their business operations did so for the common good. Their problems were not caused by poor business practices or recklessness, but rather due to acting for the good of society as a whole. As a consequence, there is now an obligation to provide very strong financial assistance to affected companies.

It is estimated by ISME that the average creditor's ledger for SMEs amounted to €78,000 at the beginning of the COVID-19 crisis. Many of those who owe the money are themselves small businesses, who are experiencing their own cashflow difficulties. This suggests inter-company debt of close to €11 billion. There is a high risk of substantial bad debts and insolvency over the coming months. The SME sector is not highly profitable as a general rule and they will very quickly use up their working capital in the cashflow crisis environment that COVID-19 has created. Official intervention to ensure adequate liquidity for all businesses is essential. Without the immediate provision of working capital, many small firms will go out of business and many jobs will be permanently lost, but longer-term more permanent support will be necessary in many cases.

There is now a significant risk of 'economic deleveraging' as firms whose cashflow has collapsed are faced with ongoing costs such as rents, commercial rates, and insurance. Wage costs have been largely covered by the Government's COVID-19 wage schemes, but other non-payroll expenses are ongoing.

In some cases, liquidity supports will be essential to cover these costs. This support could take the form of zero-interest loans; loan re-payment holidays; or credit guarantee schemes. However, for many affected firms, particularly those concentrated in services where the containment and social distancing measures have hit the hardest, solvency is a bigger issue than liquidity.

Some firms may not have ready access to bank lending or are not prepared to take on a debt legacy that could weigh down the business for years. This means that there is also a role for direct fiscal aid, in the form of direct grants or tax offsets. Some firms should be allowed make a claim for all losses incurred, which would be difference between cashflow earned during the period of shutdown or business curtailment and the expenses incurred.

Such measures are unorthodox in nature, but this reflects the nature of the crisis. A significant upfront cost of up to €5.7 billion[viii] could be incurred for a three-month period. However, the alternative is that many businesses would disappear, resulting in higher unemployment, lower tax revenues and a considerable loss of economic output in the medium-term.

International Examples

Almost every country has sought to address liquidity and solvency issues for the SME sector, through a combination of grants, loan guarantee schemes, very low interest rates and debt repayment holidays. For example:

In **Denmark**, the State agreed to compensate companies for their fixed expenses, like rent and other contract obligations, depending on their level of income loss. Businesses able to demonstrate a loss of earnings of more than 40% since the beginning of the crisis, will be eligible for direct compensation in respect of between 25% (in case of 40-60% loss of income) and 80% (in case of 80-100% loss in income) of their fixed costs, including rents. Businesses that have been ordered to close will receive 100% of fixed costs. There is also a loan guarantee scheme to help companies bridge the lockdown period.

In **Germany**, the state is guaranteeing unlimited liquidity to impacted companies and a fund has been launched in buy stakes in struggling companies.

In **Sweden**, business will receive grants to help them cover between 25-80% of their fixed costs. Self-employed and firms with less than 10 employees who experience a revenue decline of more than 30% will also be offered compensation worth 75% of their normal monthly income, up to a maximum of €3,000 per month. These measures are for a 3-month period.

In the **UK**, small firms are to get access to 100% taxpayer-backed loans after they raised concerns about slow access to the existing COVID-19 rescue schemes. Firms will be offered loans up to £50,000 within days of applying. The scheme requires filling in a two-page self-certification form online. No capital or interest payments will be due for 1 year – the Government will pay the interest for the first year. The State guarantee aims to unlock a backlog of credit checks by banks amid fears that many small firms could go out of business before getting loans.

The **IMF** has a package of soft finance packages in the EU, with no repayments for the first 12 months and a 7-year repayment term.

In the **US**, the Paycheck Protection Programme (PPP) provides 100% federally guaranteed loans to small businesses to retain workers and meet payroll costs, or make mortgage, lease and utility payments. Payments can be deferred for 6 months; a fixed rate of 1% apples and the loan is due in 2 years.

(2) LOWER VAT RATE FOR ACCOMMODATION AND FOOD SERVICES SECTOR

A Zero % VAT rate for the accommodation and food services sector should be introduced to the end of 2021. This should then be followed by a reversion to the 9% VAT rate on a permanent basis to assist recovery, create certainty, and secure a viable and sustainable future for the sector.

These changes to VAT would help the international competitiveness of the tourism sector, and would be particularly supportive of regional economic activity.

At the end of 2019, a Zero % VAT rate applied to 11% of activity in the Irish economy. The application of a Zero % VAT rate would be resisted by the European Commission on the basis of the EU VAT directive, However, in an environment where the accommodation and food services sector is under so much pressure due to unprecedented circumstances totally outside of its control, the Irish Government should do its utmost to seek a derogation from the EU. Desperate times require desperate measures.

A reduced VAT rate of 9% for the hospitality sector proved very effective after it was introduced in July 2011 in terms of saving many vulnerable businesses; in supporting a recovery in employment in the sector; in rebuilding Ireland's tourism sector; and in helping the recovery in the national economy and the regions.

(3) COMMERCIAL RATES

A holiday on commercial rates for affected businesses for a 12-month period. Local authorities will need to be funded directly by central government to ensure that they can continue to provide essential local services.

(4) A COMMERCIAL RENT SCHEME

In **France** a 60/20/20 scheme has been introduced. For a 12-month period, the Governments supplements rent payment up to 60%; the landlord cuts rent by 20%; and the commercial tenant pays 20% of the rent.

(5) TACKLE INSURANCE COSTS

The cost of insurance has been identified as a serious issue for business for a prolonged period. The claims culture needs to be addressed in a meaningful way; insurance companies need to be more transparent in all issues relating to premium levels and claims; and the legal system needs to reformed in order to eliminate the claims culture.

GOVERNMENT BUSINESS SUPPORT SCHEME MAY 2020

On 2nd May 2020, the Government announced a number of measures to support businesses impacted by COVID-19. These included:

- A commercial rates waiver scheme. This will involve the establishment of a Restart Fund for micro and small businesses, which would provide €250 million to support ratepayers. The fund will provide up to €10,000 per business, and will be implemented either through a rebate or waiver scheme based on rates payment for 2019;
- A 3-month commercial rates waiver for impacted businesses beginning on 27th March;
- A €2 billion Pandemic Stabilisation and Recovery Fund within the Ireland strategic Investment Fund (ISIF), which will make capital available to medium and large enterprises;
- A €2 billion COVID-19 Credit Guarantee Scheme up to 80% of the loan to support lending to SMEs for terms ranging from 3 months to 6 years, which will be below market interest rates; and
- The warehousing of tax liabilities for a period of 12 months after re-commencement of trading, during which time there will be no debt enforcement action taken by the Revenue Commissioners and no interest charge accruing in respect of the warehoused debt.

The measures contained in the package represent another positive step in helping business survive the COVID-19 crisis and successfully re-commence operations once the economy is opened up again. However, the measures cannot be implanted until a new government is in place; the serious liquidity issues for SMEs have still not been adequately addressed; and further measures will be required.

The Irish Government will have to accept a higher level of government borrowing in the medium-term. There cannot be a return to policies of fiscal austerity. Government spending on public services will have to be maintained and the tax burden cannot be increased.

Significant and unorthodox measures need to be Implemented immediately to prevent viable businesses from becoming vulnerable.

Ireland's Gross Government Debt to GNI* stood at 99.2% at the end of 2019 and is expected to rise to 125.1% in 2020, before declining modestly to 121.6% at the end of 2022. This debt level is very high, but it does highlight the need to have a functioning economy and functioning businesses to generate tax revenues and support a sustainable level of Government expenditure.

CREATING A POLICY PLATFORM FOR SMEs

COVID-19 will eventually pass, but the priority to support the SME sector will then become even more crucial to the future viability of the Irish economy.

It is clear that the Irish economic model, which is successfully and heavily focused on attracting FDI in to the country is under pressure from global corporation tax developments and President Trump's agenda to bring the manufacturing of pharmaceutical and medicinal products back to the US in order to create jobs and strengthen the US supply chain.

Ireland has a very significant economic and financial dependence on a small number of large multi-nationals. This poses a potentially significant concentration risk for Ireland. It is imperative that Irish policy becomes increasingly focused on developing a strong indigenous economic model with a heavy concentration on supporting and developing the economically significant SME sector.

Efforts are under way to form a Government at the moment, and then a programme for Government will have to be developed. From a chronological perspective, re-building the economy from the COVID-19 shock will dominate. Thereafter the focus will have to be on ensuring a strong and sustainable economy is developed and that sufficient financial resources are generated to address areas such as housing and health, and to reduce the high budget deficit and debt that will result from the COVID-19 shock. The SME sector will have to play a central role in this economic and social agenda.

The agenda of the incoming government should include a number of priorities to nurture, support and grow the SME sector, which makes such a strong regional and national economic contribution, and which will play an essential role in re-building the economy. The role of SMEs in supporting and nurturing local economies and local communities needs to be properly recognised and supported.

The SME sector must be mainstreamed into the heart of government policy and has to become an integral part of economic and business policy formulation. A structure needs to be created at the heart of government policy to include the SME perspective on economic and fiscal policy measures. That perspective is lacking at the moment and SME issues are not reflected in a formal way at a policymaking level.

A specific action plan needs to be included in the Programme for Government that gives due recognition to the very significant role the sector plays in Irish economic life at both the national and the local level. The Government will need to outline a sector by sector plan to re-open the economy.

Given the challenges now facing the economy from COVID-19 and the pressurised FDI model, it is time to create a more formal and professional approach to developing the SME sector.

The IDA is a State agency with specific responsibility for attracting FDI into Ireland. Enterprise Ireland is a State agency with responsibility for the development and growth of Irish enterprises in world markets. Both organisations fulfil an important role in achieving their objectives, but there is no such agency for SMEs. Government should set up a State agency with specific responsibility for SMEs. It should drive policy change; develop and implement an SME strategy; and identify and address in a formal way the skill requirements for SME owners such as workforce and managerial skills, financial education, SME internationalisation, marketing, innovation, and R&D. The new body should become an engine to drive urban and rural regeneration, based on an evidenced based strategy; build social capital; deliver a circular economy; and be heavily driven by community aspirations. This is what SMEs are very effective at doing, but the model needs to be developed in a very significant way.

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