ISME is grateful for the opportunity to respond to the Department in the formation of a White Paper on Enterprise Policy. The brevity of the submission (which is welcome) requires we adopt a thematic approach to our response; and we have identified 10 key themes.

1. **Industrial policy.** Ireland needs to develop an indigenous industrial policy. We cannot assume that the foreign multinationals will always be the engine of our economic policy. The First Programme for Economic Expansion, 1958-1963 set a template for industrial development that ended protectionism, opened Ireland to international trade, and reversed a century of population decline.

   However, the bifurcation in performance between FME and domestic SMEs in economic performance is no longer in doubt. The IMF's 2022 Article IV Consultation for Ireland[1] notes a 13.5% increase in GDP for 2021, but a 6% increase in GNI*.

   This must not be read as a criticism of our FDI policies. FMEs form a significant customer base for our SMEs, and contribute to Ireland's large corporation tax take. However, their contribution to the wider economy, workforce and society is limited. Recent research by the ESRI[2] (see tables below) shows the contribution to Net National Product by the indigenous enterprise sector to be 3.8 time that of the FME sector; and their employee compensation to income ratio is far higher.

TABLE 1 NNP AT BASIC PRICES, BEFORE ADJUSTING FOR THE STATISTICAL DISCREPANCY, € MILLION

Foreign MNEs	2013	2014	2015	2016	2017	2018
1. Compensation of employees	18,056	18,848	20,201	21,089	22,373	23,308
2. Gross operating surplus/mixed income	52,654	59,552	117,723	118,073	131,425	145,830
3. Consumption of fixed capital	14,710	16,135	42,730	49,244	57,244	62,279
4. (2-3) Net operating surplus	37,944	43,417	74,993	68,829	74,181	83,551
5. (1+2) Gross value added	70,710	78,400	137,924	139,162	153,798	169,138
6. (5-3) Net value added	56,000	62,265	95,194	89,918	96,554	106,859
7. Corporate taxes	3,329	3,427	5,202	5,615	6,258	7,936
8. Factor flows - profit repatriations (allocation of primary income flows)	34,615	39,990	69,791	63,214	67,923	75,615
9. (6-8) Contribution to NNP	21,385	22,275	25,403	26,704	28,631	31,244

Domestic	2013	2014	2015	2016	2017	2018
1. Compensation of employees	52,591	54,250	57,588	61,579	65,778	69,986
2. Gross operating surplus/mixed income	41,267	45,924	48,977	53,266	57,671	63,958
3. Consumption of fixed capital	11,829	12,548	13,603	14,512	15,832	16,989
4. (2-3) Net operating surplus	29,438	33,376	35,374	38,754	41,839	46,969
5. (1+2) Gross value added	93,858	100,174	106,565	114,845	123,449	133,944
6. (5-3) Net value added	82,029	87,626	92,962	100,333	107,617	116,955
7. Corporate taxes	955	1,206	1,689	1,758	1,959	2,485
8. Factor flows - profit repatriations (allocation of primary income flows)	0	0	0	0	0	0
9. (6-8) Contribution to NNP	82,029	87,626	92,962	100,333	107,617	116,955

[1] IMF Article IV Consultation Ireland
[2] https://www.esri.ie/system/files/publications/QEC2020SUM_SA_FitzGerald.pdf

Total	2013	2014	2015	2016	2017	2018
1. Compensation of employees	70,647	73,098	77,789	82,668	88,151	93,294
2. Gross operating surplus/mixed income	93,921	105,476	166,700	171,339	189,096	209,788
3. Consumption of fixed capital	26,539	28,683	56,333	63,756	73,076	79,268
4. (2-3) Net operating surplus	67,382	76,793	110,367	107,583	116,020	130,520
5. (1+2) Gross value added	164,568	178,574	244,489	254,007	277,247	303,082
6. (5-3) Net value added	138,029	149,891	188,156	190,251	204,171	223,814
7. Corporate taxes	4,284	4,633	6,891	7,373	8,217	10,421
8. Factor flows - profit outflows	34,615	39,990	69,791	63,214	67,923	75,615
9. (6-8) Contribution to NNP	103,414	109,901	118,365	127,037	136,248	148,199
10. Residual factor outflows excluding profit repatriations and redomiciled PLCs	1,022	-1,888	-3,176	-6,456	-1,327	280
11. (9-10) NNP adjusted for redomiciled PLCs	102,392	111,789	121,541	133,493	137,575	147,919
12. Redomiciled PLCs	6,492	6,852	4,662	5,781	4,458	5,002
13. (11+12) NNP	108,884	118,641	126,203	139,274	142,033	152,921
NNP adjusted for redomiciled PLCs	102,392	111,789	121,541	133,493	137,575	147,919
Foreign MNEs % of GVA	43	44	56	55	55	56
Foreign MNEs % of NNP adjusted	21	20	21	20	21	21

Source: CSO Institutional Sector Accounts, Non-Financial and author's calculations.

There is a significant concentration risk in our corporate tax base, and a real risk also that FME tax returns may prove unreliable and itinerant.

Despite there being an EU imperative to "think small first" via the SBA Principles,[3] we find that tax legislation and incentives such as SARP, KEEP, the R&D tax credit, and the Knowledge Development Box are written and optimised for large business, notwithstanding the tiny percentage of the business demography they represent. The SBA principles prioritise promoting entrepreneurship, reducing regulatory burden and red tape, promoting access to finance and to markets and internationalisation.

2. **SME learning deficit.** There remains a significant deficit in skills and knowledge among our SME owner and manager base. This is evidenced by the SME sector's productivity shortfall, relative lack of innovation and digitalisation, deficit in export performance, the frequency of action against them by employees in and their inability to scale or develop to IPO stage. Looking at the Global Innovation Index 2021,[4] it is apparent that most of Ireland's "Strengths" are features of our FDI base (c.0.2% of our business demography); while most of Ireland's "Weaknesses" apply to the SME base (99.8% of the business demography). See the chart below.

[3] Small Business Act for Europe 10 Principles
[4] https://www.globalinnovationindex.org/userfiles/file/reportpdf/GII-2021/country/Briefs/IRL.PDF

Strengths and weaknesses for Ireland

Strengths			Weaknesses		
Code	Indicator name	Rank	Code	Indicator name	Rank
2.1.3	School life expectancy, years	2	2.1	Education	69
2.3.3	Global corporate R&D investors, top 3, mn US$	12	2.1.1	Expenditure on education, % GDP	86
3.3	Ecological sustainability	1	2.1.2	Government funding/pupil, secondary, % GDP/cap	89
3.3.1	GDP/unit of energy use	2	4.1	Credit	62
5.1.5	Females employed w/advanced degrees, %	9	4.1.2	Domestic credit to private sector, % GDP	85
5.3	Knowledge absorption	5	4.2.2	Market capitalization, % GDP	39
5.3.1	Intellectual property payments, % total trade	1	4.3	Trade, diversification, and market scale	81
5.3.4	FDI net inflows, % GDP	12	4.3.2	Domestic industry diversification	106
6.2	Knowledge impact	10	5.3.3	ICT services imports, % total trade	61
6.2.3	Software spending, % GDP	3	6.1.3	Utility models by origin/bn PPP$ GDP	48
6.2.5	High-tech manufacturing, %	6	6.2.1	Labor productivity growth, %	92
6.3	Knowledge diffusion	1	7.1.3	Industrial designs by origin/bn PPP$ GDP	63
6.3.1	Intellectual property receipts, % total trade	7	7.2.4	Printing and other media, % manufacturing	95
6.3.4	ICT services exports, % total trade	1			
7.3.1	Generic top-level domains (TLDs)/th pop. 15–69	12			

This absence of learning continues into the SME owner/manager sphere. In our view, we need a basic qualification in business management (such as the ISME Blue Cert[5]), rolled out to as much of the SME base as quickly as possible.

<u>The following three themes are inextricably linked in terms of treatment of the factors of production:</u>

3. **The capital investment environment** (incentives to invest in domestic business, capital taxes, access to credit etc) is poor in Ireland.

   Aside from the deterrent effect a high CGT rate has on the purchase and sale of assets, ISME (conservatively) estimates[6] that the Exchequer is forgoing €500m revenue per annum by maintaining the third-highest CGT rate in Europe at 33%; we have recommended the introduction of a 25% rate.

   Despite having a population only 5% larger than Ireland, Norway's Euronext hosted 67 IPOs in 2021. In Ireland, we had two. This suggests systemic problems in our publicly owned equity environment. The failure to provide a fertile IPO environment means that Irish businesses which scale are the subject of trade sales, usually to foreign buyers who take ownership of IP and good will.

   This ongoing policy failure is depriving Ireland of a significant pool of indigenous wealth, and the Exchequer of hundreds of millions of stamp duty annually.

[5] https://www.isme.ie/blue-cert-proposed-for-irish-sme-sector-2/
[6] https://www.isme.ie/wp-content/uploads/2022/06/ISME-Pre-Budget-Submission-2023.pdf

4. **Employee reward.** Ireland needs to address the rewards environment for employees. While our marginal tax rates and social insurance contributions are low by international standards, our marginal taxes kick in at very low levels of income (below the average industrial wage) and our social insurance contributions are uncapped, despite benefits being capped.

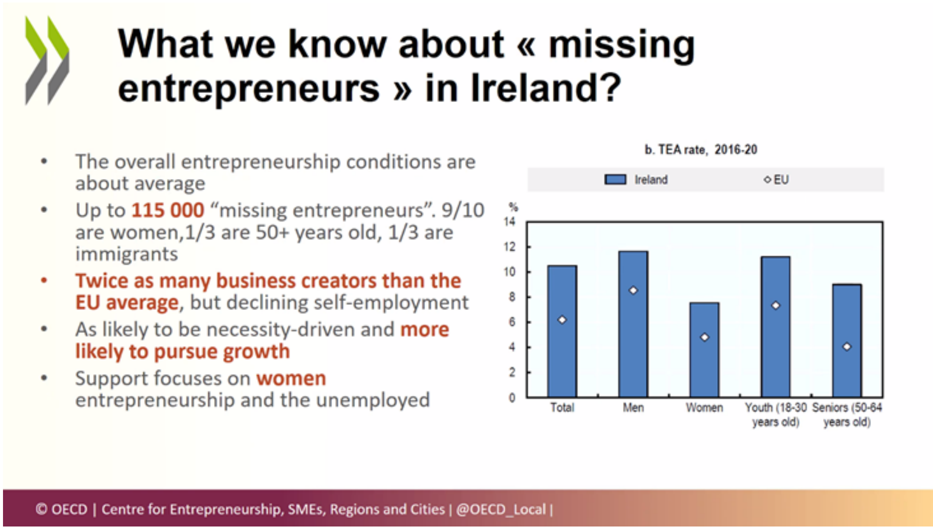
   Section 135 (3A) of the TCA 1997 needs amendment to address the penal tax treatment of management buy-outs, which encourages sale of businesses beyond employees to non-Irish buyers.

   The Key Employee Engagement Programme (KEEP) has been a failure since launch as it has been too restrictive for SMEs. It needs substantial overhaul to make it work for unlisted businesses. The time limit attached to KEEP must be removed.

   With the average price-earnings ratio on the Irish Euronext market at 17, Irish employees are being denied access to a significant source of wealth because so few Irish businesses list on the stock exchange. This is evidenced by a low rate of financial participation[7] by Irish employees. The Exchequer similarly loses out.

5. **Entrepreneur and employer reward.** Ireland needs to address the rewards environment for entrepreneurs and employers, and more actively encourage the formation of listed companies.

   Despite inaccurate domestic spin to the contrary, it was noted at the OECD Inclusive Entrepreneurship Training Workshop hosted by DETE on 28th April that numbers of self-employed people are declining in Ireland, notwithstanding the fact we have twice as many business creators as the EU average (see slide below). The OECD figures suggest Ireland is "missing" some 115,000 entrepreneurs, of whom 90% are women.



[7] https://www.worker-participation.eu/National-Industrial-Relations/Countries/Ireland

6. **Life-long learning.** While Ireland's educational performance at secondary/school-leaver level is relatively good; among our broader population, measured literacy skills of Irish adults remained close to the OECD average, and numeracy and problem-solving skills were significantly lower for all age cohorts.[8] Simultaneously, Ireland demonstrates the highest level of academic overeducation in the EU & UK,[9] with over 30% of fulltime employees overeducated, defined as "*the proportion of employees in employment whose ISCED level of schooling lies one level or more above the occupational mode*." This suggests we need to pivot our educational effort towards skills, vocational education, and life-long learning.

   We believe the national universities are prioritised for spending ahead of the technical universities. Given their greater geographic spread, we would like the TUs prioritised for expenditure on subject areas like marine technology, biogenics, renewables, recycling systems, rainwater recovery, energy generation etc., and providing technical training for businesses in the mechanical, electrical, and internet of things spaces. Businesses need upskilling in the circular economy such as plastics to fuels, biomethane, hemp, sustainable construction, etc.

   Fraunhofer-Gesellschaft provides a useable model for this.[10] Educational institutes working in related subject areas cooperate in Fraunhofer Groups and foster a joint presence on the R&D market. Fraunhofer-Gesellschaft already has a footprint in Dublin, and the Fraunhofer model should be much more widely used.

7. **Enterprise Supports.** Government supports for large enterprises (c.700) tend to be good. Micro businesses and start-ups (c.257,000) tend to have lower levels of support, although the LEO network actively supports the former.

   There is a more significant perceived deficit in supports for established enterprises with between 10 and 250 employees (c.21,000),[11] the business demography which is more likely to scale. For the reasons set out in Theme 1, we believe this cohort of the business demography must be prioritised above FDI in the White Paper.

8. **The business cost and competitiveness agenda remain largely unresolved**. While there are higher cost economies in Europe, they are not located on peripheral islands, limited to air and sea access only. Ireland needs to adapt its cost and competitiveness agenda to economic realities, and must address unacceptably high costs in accommodation, insurance, energy and services. On a like-for-like basis, Ireland's business costs ***must be lower*** than those of our competitors.

   The cost of professional services, particularly legal services, is high. Despite partial and questionable assertions from the legal lobby to the contrary,[12] legal costs remain

[8] OECD Economic Survey Ireland 2020
[9] https://docs.iza.org/dp10678.pdf
[10] https://www.fraunhofer.de/en/institutes/institutes-and-research-establishments-in-germany/fraunhofer-groups.html
[11] https://www.cso.ie/en/releasesandpublications/ep/p-bd/businessdemography2020/
[12] https://www.lawlibrary.ie/eyreport-3/

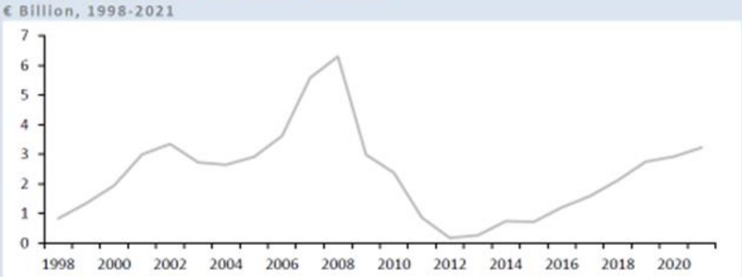
prohibitively high,[13] free speech, investigative reporting and public interest investigation is restricted by our defamation laws,[14] and the time taken in court hearings is too long, and lengthening.[15][16]

9. **The public capital formation environment** (short, medium and long-term infrastructure) has improved, but key infrastructure is not being built in adequate time. Our urban areas require high-volume public transport solutions that are taking decades to progress beyond even the planning stage. Our energy-generation and storage systems are lagging the demand forecasts for the medium term. Our potable and waste-water infrastructure remains severely under-developed.

   While net fixed capital formation has been increasing steadily since 2012 (see charts below) we remain concerned that current expenditure within the public sector trumps all other demands, and crowds out capital expenditure needed for an expanding population. Preliminary results for Census 2022[17] suggest Ireland (26 counties) has breached the 5m threshold for the first time since 1851.

   We therefore share the concerns expressed by IFAC in their Pre-Budget Statement 2022[18] about the trajectory of current spending, and we recognise it impacts all areas of Irish society and the economy, including enterprise policy.

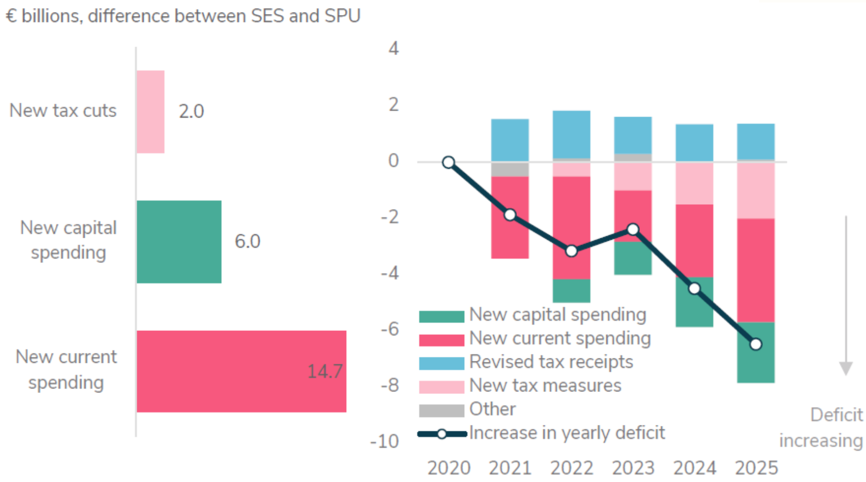
Figure F.4: Net Fixed Capital Formation
€ Billion, 1998-2021



Sources: CSO; Department of Finance; and internal IFAC calculations.
Note: Depreciation (GG Consumption of Fixed Capital (CFC)) is assumed to be 4 per cent per annum over the period 2016-2021. GFCF forecasts 2017-2021 as per *SPU 2017.*

Gross fixed capital formation is forecast to grow at an average of 9 per cent per annum over the forecast period (2017 – 2021). After a prolonged period of negative growth (an average of -5 per cent 2008-2016) it may be expected that a certain degree of unmet demand is present. Given this limited level of investment since 2008, maintaining such low growth in capital expenditure may be difficult in view of expected economic growth and demographic projections. For example, the Department of Transport, Tourism and Sport (2015) estimated a €300 million gap to maintain the land transport system.[1] One area where investment pressures might be expected to arise is in relation to the housing sector where supply is understood to have fallen short of estimated annual demand in recent years (see Chapter 2).

[13] https://www.justice.ie/en/JELR/Pages/PR20000298
[14] https://ec.europa.eu/info/sites/default/files/20_1_194011_coun_chap_ireland_en.pdf
[15] https://ec.europa.eu/info/sites/default/files/2022-european-semester-country-report-ireland_en.pdf
[16] https://ec.europa.eu/info/sites/default/files/20_1_194011_coun_chap_ireland_en.pdf
[17] https://www.cso.ie/en/releasesandpublications/ep/p-cpr/censusofpopulation2022-preliminaryresults/
[18] https://www.fiscalcouncil.ie/pre-budget-2022-statement/



Source: Department of Finance projections (SPU 2021 and SES 2021).

10. **Social Culture.** There appears to be a general consensus towards greater state spending, but no appetite for revenue-generation to support it. Furthermore, the tax system discriminates against business owners and the self-employed in a manner which asserts a negative view by the state of the wealth and employment creation sectors. This is inconsistent with a modern democracy, and must change. If we wish to increase state spending, citizens must be willing to pay for it. We must discuss how the Exchequer will fund it, and who will pay. Ireland's tax take is already over-concentrated among a small cohort of FMEs and high-income earners. Politically, we must have an ability to discuss this issue in a mature fashion, which links risk, reward, and effort.

    Similarly, the partnership process in Ireland has traditionally involved Government discussing employment issues with big business and big unions. This is acceptable once it does not produce binding outcomes for parties who are not involved. Unless its recommendations are non-binding, any revival of social partnership which does not involve the SME sector will be unacceptable to employers.

    The existence of a vibrant, profitable and expanding indigenous enterprise base is essential to all economic and political interests in Ireland; but perhaps counter-intuitively, it is most important to those who wish to see a "bigger state" and more public spending.