

ISME,  
17 Kildare Street,  
Dublin 2.  
28<sup>th</sup> November 2022

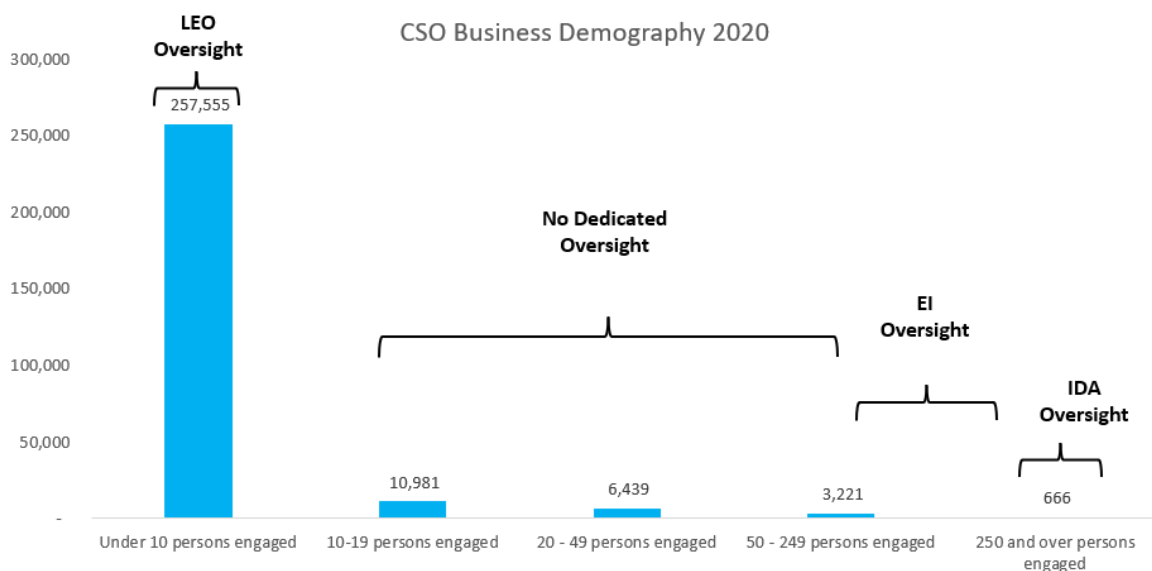
Leo Varadkar TD,  
Department of Business, Enterprise and Innovation,  
Kildare St.,  
Dublin 2.

Dear Tánaiste,

Further to our response to your Department’s consultation, we would like to set out four broad strategic objectives the we believe the White Paper should address, summarised as follows:

1. We need an agency dedicated to industrial policy oversight of the small and medium enterprise sector.
2. Competitiveness remains a persistent barrier to the performance of indigenous businesses in particular.
3. Indigenous enterprise policy must be formulated to deliver on strategy set out in the White Paper.
4. Regulation and legislation must be right-sized and appropriate for the SME sector, and not written with large, quoted foreign multinationals solely in mind.

**Firstly, as outlined in ISME’s pre-budget submission in 2021, we believe an agency dedicated exclusively to steward the needs of small to medium enterprise is required in Ireland.** While the existing agencies are excellent and valued in the services they currently provide, the division of responsibility between IDA, EI and LEOs leaves approximately 21,000 domestic enterprises in the small and medium demography without dedicated oversight of structured support. We are not prescriptive as to how this is achieved, only that it is delivered.



We (broadly) consider the enterprises in the 10-250 employee bracket to be the most likely to scale. With very few exceptions, domestic small and medium enterprises are neither scaling nor listing, and those few which do scale are most regularly purchased by non-Irish entities.

Despite a large footprint of high-technology foreign multi-nationals in Ireland over the past half century, we have seen (with a very few exceptions) little migration of skills and intellectual property into the domestic economy. This is further evidenced by the inability of Ireland to produce domestically-owned enterprises of global scale. Near-peer economies such as Denmark, Finland, Israel, Norway, Sweden and Switzerland have all grown at least one domestic enterprise of global scale. While a larger country, South Korea's focus since its founding has been on family-oriented businesses in the technology sector, which has produced a number of global technology and manufacturing leaders.

Ireland is good at supporting start-ups via the LEO network; it is good at supporting high-performance exporters via EI, and it is good at supporting multinationals via the IDA. It is the "bit in the middle" where we are weak, but conversely where Ireland has the highest potential for advancement. This demands a strategic focus.

**Secondly, while the NCPC has now added productivity to its agenda, competitiveness remains an issue for domestic enterprise in particular.** We need to benchmark the key variables in our domestic factors of production (labour, capital, land, and entrepreneurship) against peer countries, especially small exporting economies, on an annual basis. Some key themes emerge within the competitiveness:

- While the CSO's "Econometric Analysis of the Public-Private Sector Pay Differential" suggests there is no public/private sector pay gap, the CSO's own quarterly earnings figures show a material and substantial pay gap between public and private sector irrespective of enterprise size; and European meta-studies show that this differential is not repeated in peer EU countries. Since the public sector has traditionally benchmarked its pay against large business (although it now exceeds that) we now see a two-tier payroll structure in Ireland, one for the public sector and FMCs; the other for the remaining 60% (approximately) of workers in the wider economy. This is socially and politically undesirable.
- The public desire for the benefits of a "social wage" cannot be completely outsourced to the private sector. Employers will provide for a higher minimum wage, for statutory sick pay, for pensions auto-enrolment, for domestic violence leave and for those other benefits which the Oireachtas wishes to accrue to workers. But as we do so, the cost of labour within the economy increases. While little acknowledged here, Ireland is a high-wage economy,<sup>1</sup> consistently with the third or second-highest minimum wage in the EU,<sup>2</sup> while also having the joint-highest consumer prices in the EU<sup>3</sup> with Denmark. Political acknowledgement of these facts appears impossible. If we are to avoid pricing Irish labour out of EU markets, we will require the social wage to deliver more for Irish workers via the social protection system. A significant amount of the wage pressures facing Irish employers is due to the increasing cost of rental accommodation, and many employers are filling that gap by renting or buying accommodation themselves. Yet as ISME has pointed out many times, the contraction in the supply of rental accommodation is a decade-long phenomenon which has tax and regulatory policy at its core.<sup>4</sup> The

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<sup>1</sup> [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Wages\\_and\\_labour\\_costs](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Wages_and_labour_costs)

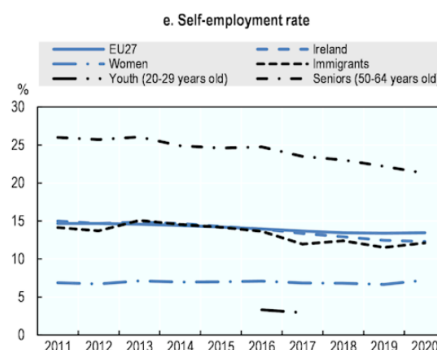
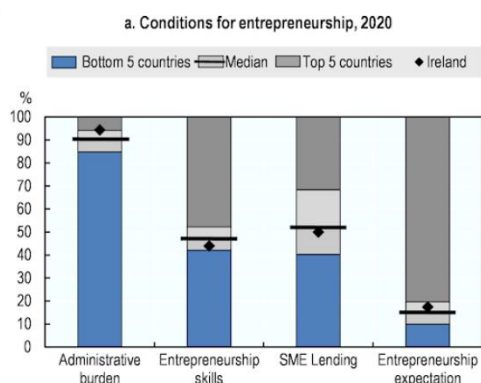
<sup>2</sup> [https://ec.europa.eu/eurostat/databrowser/view/earn\\_mw\\_cur/default/table?lang=en](https://ec.europa.eu/eurostat/databrowser/view/earn_mw_cur/default/table?lang=en)

<sup>3</sup> [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Comparative\\_price\\_levels\\_of\\_consumer\\_goods\\_and\\_services](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Comparative_price_levels_of_consumer_goods_and_services)

<sup>4</sup> <https://isme.ie/2022/05/12/isme-expresses-concern-at-rent-inflation-report-and-the-impact-for-small-employers/>

availability of affordable housing is arguably the single biggest challenge facing the state, yet the recent Commission on Taxation and Welfare<sup>5</sup> baldly stated “*The Commission recommends that tax incentives should not be used in order to stimulate the supply of housing.*”

- While Government is considering the “carrying capacity” of the Irish economy in terms of stock of housing, public transport, health, education etc., we cannot afford to increase the stock of public goods at any cost. The public service must deliver efficient, affordable services. For example, the 73% differential in the cost of nursing home care<sup>6</sup> between the public and private sectors is intolerable. If we attempt to increase Ireland’s carrying capacity with this degree of inefficiency, we will simply bankrupt the Exchequer.
- The cost of both capital goods and capital itself is significantly higher here relative to our near peers. The cost of credit is too high, the availability of credit to SMEs is constrained, and new lending to SMEs is muted and declining.<sup>7</sup> The taxation of capital gains is high by peer standards. The costs of capital asset inputs such as steel, prefabricated windows and doors, plumbing and electrical parts remains stubbornly higher than those in other EU countries but small construction companies lack the buying power to import them.
- Entrepreneurship in Ireland fares relatively poorly relative to peers. The OECD states<sup>8</sup> that “*eliminating these gaps in entrepreneurship activity rates would result in an additional 115,000 entrepreneurs. About 90% of these “missing” entrepreneurs are female, 33% are over 50 years old and 33% are immigrants.*” In particular, per the charts below, the OECD notes a higher than average administrative burden, a lower level of entrepreneurial skills, and more expensive lending than OECD norms. Our rate of self-employment is also falling faster than the rest of the EU, especially among seniors. Our taxation system discriminates against the self-employed<sup>9</sup> and our pensions system imposes limits upon them that do not apply to the public service.<sup>10</sup>



<sup>5</sup> <https://assets.gov.ie/234316/b4db38b0-1daa-4f7a-a309-fcce4811828c.pdf>

<sup>6</sup> <https://nhi.ie/discrimination-in-funding-of-nursing-home-care-laid-bare-by-department-of-health-analysis/>

<sup>7</sup> [https://www.centralbank.ie/docs/default-source/statistics/data-and-analysis/credit-and-banking-statistics/business-credit-and-deposits/2022q1\\_trends\\_in\\_sme\\_and\\_large\\_enterprise\\_credit\\_and\\_deposits.pdf?sfvrsn=f087961d\\_3](https://www.centralbank.ie/docs/default-source/statistics/data-and-analysis/credit-and-banking-statistics/business-credit-and-deposits/2022q1_trends_in_sme_and_large_enterprise_credit_and_deposits.pdf?sfvrsn=f087961d_3)

<sup>8</sup> <https://www.oecd-ilibrary.org/sites/71b7a9bb-en/1/3/4/15/index.html?itemId=/content/publication/71b7a9bb-en&csp=d8d0020b2c4308e7c5bf88c928ccd139&itemIGO=oecd&itemContentType=book>

<sup>9</sup> [https://www.citizensinformation.ie/en/money\\_and\\_tax/tax/income\\_tax/universal\\_social\\_charge.html#l62fd2](https://www.citizensinformation.ie/en/money_and_tax/tax/income_tax/universal_social_charge.html#l62fd2)

<sup>10</sup> <https://www.revenue.ie/en/jobs-and-pensions/pensions/tax-relief-for-pension-contributions.aspx>

- Our CGT regime encourages passive investing in listed FMCs while discouraging domestic investment in (higher-risk) Irish enterprises via the 33% CGT rate, which is the fourth highest in Europe.<sup>11</sup>
- According to the Council of Europe Commission for the Efficiency of Justice Report, our legal system has only a sixth of the judges that the typical European country has, but has twice as many lawyers.<sup>12</sup> As noted by successive EU Semester Reports,<sup>13</sup> Ireland suffers excessively high legal costs for excessively slow delivery of justice, and requires “*ongoing modernisation measures – as part of the Courts Service long-term strategy for ‘supporting access to justice in a modern, digital Ireland’ – including electronic filing, establishing a case management system, and putting in place courtroom technology.*” The Implementation Plan on Civil Justice Efficiencies and Reform Measures<sup>14</sup> published by the Department of Justice permitted its membership (with a majority of current or former fee-earners) to recommend non-binding guidelines only to address high legal costs. This absurd recommendation must be rejected in its entirety in favour of the minority report produced in that implementation plan.
- This antiquated legal system encourages rent-seeking and unethical behaviour among its participants, leading to unaffordable levels of liability and professional indemnity insurance in the state, as well as an inability to construct housing, transport, energy or environmental infrastructure without lengthy, costly delay. Historical “upward-only rent reviews” remain in place for older leases, many of which are held by the state or local authorities, while our commercial rates structure dates back to 1898 and charges business on an open-market rather than a site valuation basis. While we tout our common-law system in the interest of attracting commercial litigation here, the capriciousness with which our courts disregard the decisions of higher courts is anathema to the principles of common law and makes the legal environment here unpredictable, risky and expensive.

**Thirdly, indigenous enterprise policy must be strategy-based.** There is broad economic consensus on the need to reduce reliance on the FMC sector and the large flow of corporation tax<sup>15</sup> from it; and ensure a robust indigenous enterprise sector. However, our taxation and industrial policy does not follow in tandem. When the Programme for Economic Expansion<sup>16</sup> was laid before the Oireachtas in 1958, it was no mere academic pamphlet. It was a template for a radical economic pivot towards an open, trading economy, willing to attract foreign multinational enterprise to the country and eliminate protectionism. Ireland’s population decline was immediately arrested following the rollout of recommendations in the program, and barring one small dip in the 1991 census, our population has grown every year since 1961. This year’s Enterprise White Paper must be equally radical, and like its 1958 ancestor, must be the strategic blueprint to drive policy change across multiple Government departments.

While the OECD has identified our “missing entrepreneurs” versus peer economies, no one is asking why this is happening. The White Paper cannot merely express a desire to focus on indigenous enterprise, it must identify specific taxation, employment, educational and financial measures to achieve desired outcomes. Therefore we believe that the White Paper should not merely pose the questions below, but should propose policy prescriptions to address them:

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<sup>11</sup> <https://taxfoundation.org/capital-gains-tax-rates-in-europe-2021/>

<sup>12</sup> <https://rm.coe.int/cepej-fiche-pays-2020-22-e-web/1680a86276>

<sup>13</sup> [https://ec.europa.eu/info/sites/default/files/2022-european-semester-country-report-ireland\\_en.pdf](https://ec.europa.eu/info/sites/default/files/2022-european-semester-country-report-ireland_en.pdf)

<sup>14</sup> [https://www.justice.ie/en/JELR/DOJ\\_CJERM\\_2022.pdf/Files/DOJ\\_CJERM\\_2022.pdf](https://www.justice.ie/en/JELR/DOJ_CJERM_2022.pdf/Files/DOJ_CJERM_2022.pdf)

<sup>15</sup> <https://www.fiscalcouncil.ie/fiscal-assessment-report-may-2022/#SummaryAssessment>

<sup>16</sup> <https://opac.oireachtas.ie/AWData/Library3/Library2/DL006590.pdf>

- Where are our “missing” female and senior entrepreneurs?
- Why are they leaving entrepreneurial activity?
- Why are so many of our indigenous businesses failing to scale?
- Of those indigenous enterprises which do scale, why are so many of them disposed of to foreign rather than domestic acquirers?
- Why do so few indigenous enterprises list, relative to near peer European countries?

**Fourthly, regulation and legislation must be “right-sized” and appropriate for indigenous enterprise.** The EU Small Business Act, and our own Regulatory Impact Analysis (RIA) guidelines indicate that SMEs must be considered when introducing new policies. This does not occur, and SMEs find that new policies or regulatory requirements tend to be “right-sized” for large enterprises, despite the fact they make up only 0.3% of Ireland’s business demography. This failure is at least partially explained by the State’s failure to engage with the SME sector in its LEEF structures: If one only engages with big business, legislative output will suit big business. Where new regulations/legislation are deemed necessary, Government should follow the “think small first” and “one-in-one-out” principles.

Right-sizing policies for SMEs requires that the White Paper revisit the following:

- Entrepreneur relief is too tightly restricted to owner-managers and discourages external and serial passive investors from the possibility of a lower CGT rate.
- Despite increase in the standard-rate cut-off to €40,000 in Budget 2023, the marginal rate still kicks in at €5,324 below the average industrial wage (Q2 2022).
- The KEEP scheme was not written with SMEs in mind and remains too complicated and restrictive for use.
- The definition of “basic research” is so onerous in qualification for the R&D tax credit<sup>17</sup> that it discourages SMEs from applying for it. The administrative blockers for businesses in claiming the R&D tax credit must be removed. Limitations on outsourcing in the R&D tax credit regime restrict collaboration among Irish businesses and between businesses and third-level institutions. These restrictions do not exist under the OECD Modified Nexus rules and should be removed.
- The Knowledge Development Box (KDB) remains in need of reform and simplification for SMEs.
- Ireland has few individuals who have funds to invest in business through the Employment and Investment Incentive (EII). SMEs are too reliant on the pillar banks, and need a more diverse range of finance options. The split relief concept reduces the attractiveness of the EII and should be removed. EII rules require the investor to hold less than 30% of the company’s shares, denying relief to the founder shareholder. This restriction should be removed.
- The Start-Up Refunds for Entrepreneurs (SURE) scheme should be extended to include new business founders who were previously self-employed and are starting up another business.
- Dividend income is taxed at high marginal personal tax rates of up to 55%, which does not encourage equity investment in Irish business.

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<sup>17</sup> <https://www.revenue.ie/en/tax-professionals/tcm/income-tax-capital-gains-tax-corporation-tax/part-29/29-02-03.pdf>

Whitaker's Programme for Economic Expansion was a remarkable success, and was the beginning of the end for Ireland as the "poor man of Europe." However, the current economic data expose the limitations of a policy so focussed on non-domestic enterprise. The gulf between our modified GNI and our GDP is now so large that the former is but 54% of the latter.<sup>18</sup> We know of no other country with so large a gap between GNI and GDP. Beyond corporation taxes and high salaries, little else of this high GDP figure (which is close to the GDP if Israel) leaks into the domestic economy. Yet we measure State expenditures "as a percentage of GDP" and we pay our EU remittances based on GDP. This would be tolerable if there were signs of convergence between the two. There is not. GDP continues to soar ahead, while GNI expands at half the rate or less, increasing the annual divergence between the two. We believe 2023 will exacerbate the bifurcation between them.

In summary, we must grow the wealth-generating capacity of the domestic economy, and the Enterprise White Paper must set out the strategic roadmap to do so.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Neil McDonnell', written over a light blue horizontal line.

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**Neil McDonnell**  
**Chief Executive**

Copy: Paschal Donohoe TD, Minister for Finance  
Michael McGrath TD, Minister for Public Expenditure and Reform  
Damien English TD, Minister of State, Department of Enterprise Trade and Employment  
Dara Calleary TD, Minister of State, Department of Enterprise Trade and Employment  
Dr Orlaigh Quinn, Secretary General Department of Enterprise Trade and Employment  
Pauline Mulligan, Department of Enterprise Trade and Employment  
David Hegarty, Department of Enterprise Trade and Employment  
Declan Hughes, Department of Enterprise Trade and Employment  
John Hughes, Department of Enterprise Trade and Employment  
Dermot Coates, Department of Enterprise Trade and Employment

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<sup>18</sup> <https://www.cso.ie/en/interactivezone/statisticsexplained/nationalaccountsexplained/modifiedgni/>