Ireland's dual economy

Introduction

A prominent feature of the Irish economy is its dual nature: a global, export-oriented multi-national sector and a more domestically oriented, labour intensive sector dominated by small and medium-sized enterprise (SMEs).[1] The Irish economy has developed strongly in recent decades by attracting and retaining significant investment by multi-national companies.

As seen in the increasing exports in 2020, foreign-owned multi-national companies, especially in the pharmaceutical and IT sectors, have substantially benefited from increased consumer demand. The Irish economy has gained from this sectoral specialisation.

The pandemic has exacerbated the duality of the Irish economy, with many SMEs facing a revenue loss from the restrictions. This was particularly noted in consumer-facing sectors such as Accommodation and Food Services. This divide has increased to an extent that the Draft National Risk Assessment 2021 identifies Ireland's enterprise mix as a key vulnerability.[2] This section discusses issues arising from the duality of the Irish economy, the business profile of SMEs and multi-national companies, and related taxation issues.

Context

As outlined in the economic update section, the dual nature of the Irish economy can be clearly seen in the national income statistics. While the domestic economy contracted, Ireland was the only EU country to have positive GDP growth in 2020. Underscoring the duality of the economy, the substantial fall in personal consumption and domestic investment was largely offset by the increase in exports of goods and services.

Sectoral analysis can provide interesting insights. In the first year of the pandemic, 2020, there was significant growth in two sectors dominated by multi-national companies, industry (including pharmaceutical) and ICT, see the table below. Conversely, other sectors more domestically orientated were strongly hit by the pandemic and the associated restrictions. These sectors include for example construction; professional, science and technical; distribution, transport, hotels and restaurants; and arts and other.

1 The CSO definition of the SME is a business with less than 250 persons engaged.
2 Department of the Taoiseach (2021) Draft National Risk Assessment.

Table 1: Selected sectors impacted by the pandemic

Sectors (2020)	GVA Growth / contraction
Two sectors least impacted by the pandemic – dominated by multi-national companies	
Industry (including pharmaceutical)	+ 22%
ICT	+ 14%
Four sectors heavily impacted by the pandemic – dominated by domestic companies	
Construction	- 10%
Professional administration and support services	- 9%
Distribution, transport, hotels, restaurants	- 19%
Arts and other	- 26%

Source: CSO (2021) National Income and Expenditure 2020, Annual Percentage Changes in Gross Value Added at Constant Basic Prices by Sector of Origin

Productivity gap between foreign and domestic companies

The dual economy is also evident in the productivity statistics. There are several methods for measuring productivity: gross value added, labour productivity, company productivity etc. However, the key metrics all point to a dual economy between the Foreign Direct Investment (FDI) dominated sector and the rest of the economy. They also point to a very high degree of concentration. A small number of companies are generating high productivity growth. This represents a potential vulnerability for the economy. This data is discussed below.

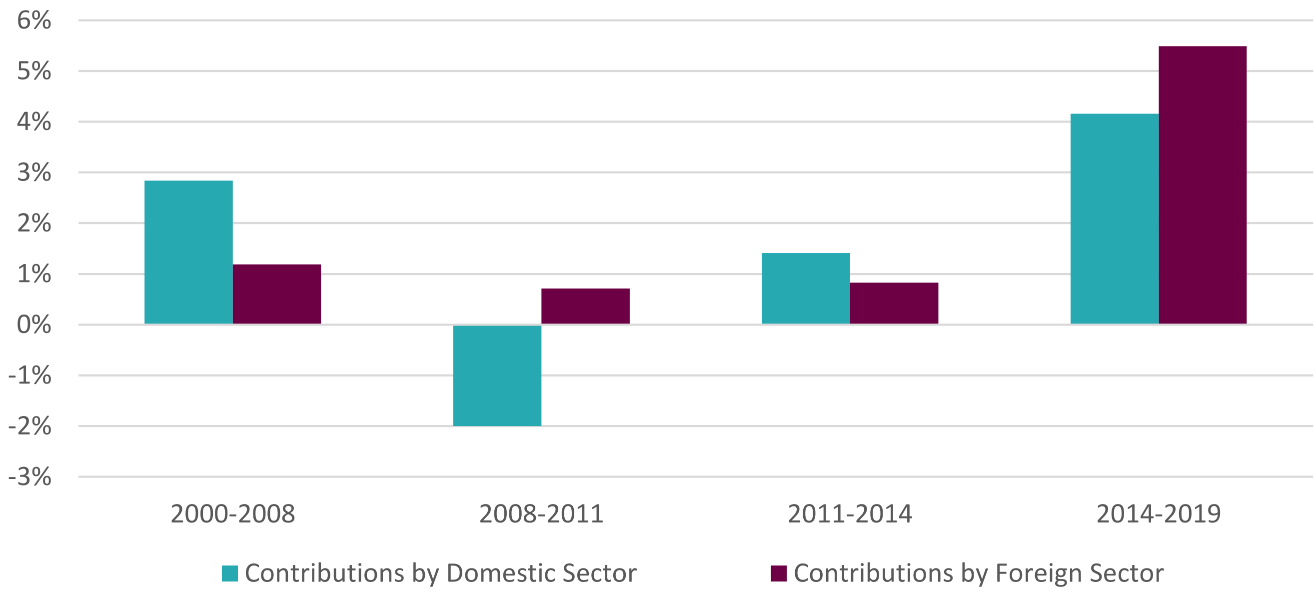
Gross Value Added (GVA)

The impact of the pandemic is reinforcing the duality of the Irish economy. The gross value added (GVA) of sectors dominated by multi-national companies grew by 23.1% between 2019 and 2020. GVA contracted by 8.7% for the other sectors. In aggregate, GVA grew by 5.6%[3] to €354 billion. GVA for the sectors dominated by multi-national companies was €186 billion and €168 billion for the other sectors.[4] The figures underscore how the aggregate picture is masking the increasing divergence between the two sectors of the Irish economy.

An examination of the trend of contributions to GVA growth during the last decade highlights this divergence. The sources of GVA growth are the Foreign sector and the Domestic sector. The chart shows their contributions in the period 2000–2019 and what is clear, is the dramatic increase in GVA growth in the 2014 to 2019 period, relative to the earlier periods. The 2014–2019 period also saw the contribution by the Foreign sector exceed the contribution by the domestic sector for the first time.

3 CSO (2021) Gross Value Added for Foreign-owned Multinational Enterprises and Other Sectors Annual Results
4 *Ibid.*

Figure 1: Sources of GVA Growth



Source: CSO (2021) Productivity in Ireland 2019

A comparison of the share of GVA in 2019 by sectors dominated by multi-national companies to their share of employment and wage bill also reveals the divergence between the two sectors. Industry and ICT accounted for 35% and 15% of GVA respectively but only for 12% and 5% share of employment. The sectors where SMEs are more prevailing such as agriculture, construction, arts, have a small share of GVA but a relatively significant share of employment in 2019.

Table 2: Selected sectors impacted by the pandemic and their share of GVA

Sectors	Share of Employment	Share of Wage Bill (2019)	Share of GVA (2019)
Sectors where multi-national companies are dominant			
Industry (including pharmaceutical)	12.4%	14%	35%
ICT	5.3%	8%	15%
Sectors where SMEs are dominant			
Agriculture	4.4%	1%	1%
Construction	6.3%	4%	3%
Distribution, Transport, Hotels, Restaurants	25.3%	20%	11%
Financial	4.9%	8%	5%
Professional	10.7%	13%	11%
Public Sector	25.3%	28%	9%

Source: CSO (2021) QESO3 Persons aged 15 years and over in Employment; ISAO5 Gross Value added at Basic Prices; & N2022 Gross Value Added at Constant Basic Price.

Labour productivity

The dual economy is also evident looking at labour productivity statistics. The table below shows the high productivity growth in the foreign sector in 2019. The increase in GVA and labour productivity in the foreign sector is greater than in the domestic sector.

Table 3: Productivity growth statistics, 2019

	GVA growth	Labour Productivity
Foreign sector	7.1%	4.5%
Domestic sector	4.0%	1.8%
Total	**5.4%**	**3.1%**

Source: CSO (2021) Productivity in Ireland 2019

Company productivity analysis

In terms of productivity of individual firms, there is a small group of multi-national companies who are a significant contributor to Ireland's aggregate productivity. Ireland has a significant productivity advantage compared to the euro area, however almost 2/3 of the gap is explained by pharmaceutical and chemical industry, and ICT services, accounting for 8 and 9 percentage points (pp) respectively of the 26 pp gap. In terms of the domestic sector, there is a negative productivity gap between Ireland and the euro area. This is from sectors such as agriculture, construction, wholesale, retail, transportation, accommodation and food services.[5]

The CSO data shows that foreign companies tend to be more productive and larger than domestic companies. For example, in the pharmaceutical sector, foreign companies have a 399 percent productivity premium over domestic companies, and on average 2.8 times as many persons engaged.[6] The productivity levels in foreign-owned companies significantly exceed domestic companies, even within the same sector. Furthermore, the number of high productivity companies is small and responsible for a disproportionately large share of output and value-added.[7] This is a highly concentrated and narrow base for the economy to depend on, particularly for a small and open economy vulnerable to changes in the international economy.

5 IGEES – Irish Government Economics and Evaluation Service (2018) Patterns of Firm Level Productivity in Ireland: Technical background paper for the Economic Development Review Committee
6 *Ibid.*
7 *Ibid.*

Sectors – Industrial production

In terms of industrial production and sales, there is a concentration in the food, chemical and pharmaceutical sectors. These sectors account for 75% of Net Selling Value[8], amounting to €95.4 billion in 2020. The other sectors amounted to €31.9 billion.[9] The pharmaceutical sector was the largest, accounting for 41.7% of Net Selling Value compared to 4.1% in the European Union. Industrial production in the EU was also more evenly spread over a larger number of industrial sectors compared to Ireland.[10]

In terms of companies, the top 10 industrial companies accounted for 52.3% of Net Selling Value in Ireland in 2020, amounting to €99.6 billion. The other 3,272 industrial companies were responsible for €60.7 billion of Net Selling Value.[11] These figures highlight that industrial production is very dependent on a small number of companies.

Enterprise Profile

According to the CSO Business Demography 2019, there were 272,531 enterprises in Ireland in 2019. Small and medium enterprises accounted for 99.7% of all enterprises. The CSO definition of SMEs is a business with less than 250 persons engaged. The number of people engaged in SMEs in 2019 was 1,156,143 and that is 66.4% of people engaged by enterprises. The number of persons engaged by SMEs increased by 22.8% between 2009 and 2019.[12]

The services sector had the largest number of people engaged in SMEs, with 519,068 persons in the Table below. The number of persons engaged is also significant in the distribution, construction, and industry sector, however, the figure for the financial sector is relatively smaller.

Table 4: Number of persons engaged in SMEs by sector

	2018
Services	519,068
Distribution	267,160
Construction	133,932
Industry	128,787
Financial & Insurance	36,289

Source: CSO (2019) Business in Ireland 2018

Multi-national enterprises have a very different profile in Ireland to that of SMEs. There are only 6,137 foreign-owned affiliates enterprises in Ireland, although the number of persons engaged was 403,536 in 2018.[13] These figures are lower than the numbers for SMEs.

8 According to the CSO, Net Selling Value relates to the net selling value i.e. the net amount (excluding VAT) invoiced to customers. This includes amounts charged by enterprises to customers for transport of goods by their own vehicles and packaging costs. This excludes duties and taxes payable on the goods, separately charged freight costs, any customer discounts, and goods resold with further processing.
9 CSO (2021) Irish Industrial Production by Sector
10 *Ibid.*
11 *Ibid.*
12 CSO (2021) Business Demographics 2019
13 CSO (2020) Business in Ireland 2018

In addition to SMEs, the services sector had the largest number of persons engaged in foreign-owned affiliates, with 177,706 persons. The number of persons engaged is also significant in the distribution and industry sector, however, the figure in the construction sector is minuscule.

Table 5: Number of persons engaged in Foreign-owned affiliates by sector

	2018
Services	177,706
Distribution	106,212
Construction	9,288
Industry	110,330
Financial	Not available

Source: CSO (2019) Business in Ireland 2018

However, as mentioned, in terms of GVA, the multi-national sector is more productive than the domestic SME sector.

Implications for the public finances

The concentration of economic activity and tax revenue around a limited number of multi-national companies represents a risk to the economic stability and the resilience of tax revenue. In 2019, the PBO estimated that if one large multi-national company left Ireland, it would reduce Government revenue by around €440m, and lead to a reduction of 2% in Gross Value Added[14]. This potential revenue loss includes both direct and indirect taxation. This revenue loss was roughly equivalent to, at the time, a €20 increase in the Carbon Tax (€430m) or a 1% increase in the higher-rate of Income Tax (€347m) and represented approximately 0.7% of General Government revenue.

The dual economy and the pandemic

Despite the pandemic lockdowns, the economic activity and tax revenue from the multi-national sector have contributed to a positive fiscal position. In 2020, corporation tax increased by 8.7% or nearly €1 billion and is the highest level of corporation tax revenue in the history of the State. Corporation tax receipts accounted for 20% of total tax revenue in 2020. It only accounted for 12% in 2010.[15] The strong performance in corporation tax is a result of profits from multi-national companies, especially in the pharmaceutical, ICT and financial sectors[16] and an increase in ICT and pharmaceutical exports. Conversely, SMEs, due to the sector they operate in, faced a difficult time.

14 PBO (2019) Pre-Budget 2020 PBO Commentary
15 Department of Finance (2021) Annual Taxation Report
16 *Ibid.*

Tax revenue of the dual economy

Before the pandemic, multi-national companies were already a key driver of tax receipts. In 2019, multinational companies were responsible for 27% of all employment, 45% of all income tax receipts, and were liable to pay 79% of corporation Tax.[17]

The pandemic increased the divide between multi-nationals and SMEs. In 2020 multi-national companies accounted for 32% of employment, 49% of employment taxes and 82% of corporation taxes. Whereas, corporation tax payments from SMEs were down 40% in 2020.[18] The table below shows that corporation tax payments are mostly from large corporates, likely to be multi-national companies.

The table clearly highlights the different impact of the pandemic on the multi-national sector, with increasing sales and profits driving a 18% increase in corporation tax payments. Whereas smaller businesses had a 40% decrease in corporation tax payments, as SMEs faced significant reductions in consumer demand. This is despite the significant supports offered by the Irish State to the SMEs sector throughout this pandemic.

Table 6: Corporation tax payments in 2020 by Revenue Division

Revenue Division	Payments (€m)	+/- 2019
Large Corporates	10,322	+18.0%
Medium Enterprises	917	-24.8%
Business	594	-40.0%

Source: Office of Revenue Commissioners (2021) Corporation Tax – 2020 Payments and 2019 Returns

Concentration of personal and corporate income tax revenue

In addition to corporation tax, there is also a potentially significant vulnerability in income tax, the largest tax revenue stream for the State. Multi-national companies tend to employ highly skilled, educated and highly paid workers, responsible for a substantial portion of income tax. In Ireland, the top 25% of income earners contributed around 80% of income tax revenue and top 1% of income earners contributed more than 20% of income tax revenue.[19] Ireland's personal and corporate income tax revenue is heavily reliant on high earners and multi-national companies. While this is equitable, it results in a tax system that is vulnerable to shocks and to global economic trends.

The concentration of economic activity around a limited number of multinational companies exposes tax revenue, as well as employment and domestic output, to firm and sector specific shocks. The profitability of exports by multi-national companies and the location of global supply chains are also dependent on international factors that the Irish State has no or limited control over.

This macroeconomic vulnerability is compounded by the fact that multi-national companies tend to benefit from spatial agglomeration and regional specialisation, therefore firms in the same sectors tend to co-locate. This can become a positive or negative loop, with an entry or exit of a multi-national company incentivising the inflow or outflow of multiple multi-national companies. Therefore, any risk to

17 Office of Revenue Commissioners (2021) Corporation Tax – 2020 Payments and 2019 Returns
18 *Ibid*
19 Department of Finance (2021) Annual Taxation Report

one multi-national company could become a risk to a whole sector to a small open economy like Ireland.

As the enterprise mix, and the vulnerability created by a reliance on multi-nationals has been identified as a concern, some suggested areas for future focus are discussed below.

Productivity challenges facing SMEs

There are a number of difficulties facing SMEs. A key challenge is boosting innovation and productivity levels. Overall, the World Economic Forum's index of international competitiveness sees Ireland ranked 24 out of 141 countries.[20]

Denmark, Finland and New Zealand, similar countries to Ireland, were some of the top performing economies. This is the competitiveness context the Irish SMEs are operating against, both a vibrant multi-national sector in Ireland and a very competitive international environment. This is important as an OECD report finds that Irish SMEs are not very active in international markets, and SME productivity growth is stagnant. There are weaknesses in SME management skills, capital investment levels and technology adoption. Access to finance and skills shortage are also issues.[21]

This section looks at issues facing SMEs in terms of investment, I.T. capacity and skills base, Irish management practices and infrastructure.

Investment in Innovation

Innovation entails the transformation of new ideas into products or services and is generally progressed through research and development (R&D) as well as the acquisition of knowledge, machinery and equipment. Innovation expenditure in the Irish economy amounted to €5.5 billion in 2018, with the largest contributors being the foreign manufacturing sector (€1.6 billion or 29% of total) and foreign ICT sector (€1.2 billion or 21% of total). The largest domestic contributor was the manufacturing sector at €726 million. Other domestic orientated sectors such as agriculture, electricity and water sectors spent the least on innovation.[22]

As mentioned, a key driver of innovation expenditure is R&D, with the foreign sector spending €1.9 billion and the domestic sector spending €1.1 billion.[23] While the foreign sector spending is exceeding the domestic sector spending on R&D, the domestic sector expenditure is still substantial. The figure for R&D expenditure does not include inter-affiliate imports of intellectual property products, which would be an important source of high productivity in the sectors dominated by multi-national companies.

In terms of productivity, the ICT sector has been a top performing sector for GVA growth and labour productivity. Even though the employment profile is relatively balanced between foreign and domestic companies (56% versus 44% in 2018), 88% of the GVA in the ICT sector is accounted for by foreign companies.[24] The relatively similar employment levels has not produced relatively similar levels of output and productivity.

20 World Economic Forum (2019) Global Competitiveness Report 2019.
21 OECD (2019) SME and Entrepreneurship Policy in Ireland
22 CSO (2021) Productivity in Ireland, 2019
23 *Ibid.*
24 *Ibid.*

I.T. capacity and skills of SMEs

A factor contributing to low productivity of SMEs in Ireland may be their IT capacity. A CSO *Survey on E-Commerce and ICT 2020* highlighted the challenges for SMEs in dealing with the digital transformation of the economy. The survey was carried out in the first half of 2020 and therefore the impact of the pandemic might not be accurately counted. The survey found that 79% of the companies had a website, half of the companies purchased at least one type of Cloud Computing service and only 22% of the companies use big data analysis.[25]

Infrastructure

There are also infrastructural gaps limiting business. The IMF's Investment and Capital Stock Dataset 2019 found that Ireland's public capital stock per capita lags behind the best performing economies in Europe whose cost base might be more similar to the Irish economy.[26] This places Irish companies, especially SMEs, at a competitive disadvantage.

A Digital Economy and Society Index (DESI) 2020 report found that Ireland has overall connectivity levels that remain low, at 23rd position in the EU. However, overall, Ireland is ranked the 6th most advanced digital economy in the EU, particularly strong in integration of digital technology, use of e-Commerce by SMEs, and digital public services' ranking that is 9th, above the EU average.[27]

In 2020, Ireland's competitiveness ranking dropped from 7th to 12th position according to the Institute for Management Development (IMD), with the infrastructure sub-component being the weakest element. Infrastructure is an important element in boosting productivity and generating growth.[28]

Multi-national companies and SMEs linkages

Better linkages between multi-national companies and SMEs could help strength the productivity of SMEs. The knowledge and international experiences of management practices and organisational development of multi-national companies could be transferred to SMEs, through sectoral networks and horizontal collaborative activities, and through labour movement. The adoption of best management practices and tools by SMEs could boost their productivity.

Such productivity spill-overs are limited at present. Co-operation between multi-national companies and SMEs are also limited and this includes supply chains. The CSO has found that high productivity growth in foreign-dominated sectors "results in limited spill-over into other more domestic sectors and in limited gains for Irish households"[29]. The ESRI finds that there is limited evidence of a link between the performance of a domestic company and the presence of foreign-owned companies.[30]

25 CSO (2020) *Information Society Statistics – Enterprises*
26 *IMF (2021)* Estimating Public, Private, and PPP Capital Stocks, cited in National Competitiveness and Productivity Council (2020) Ireland's Competitiveness Challenge 2020
27 European Commission (2021) *Digital Economy and Society Index (DESI) 2020 Ireland*
28 *IMD (2020) World Competitiveness Rankings*, cited in National Competitiveness and Productivity Council (2020) Ireland's Competitiveness Challenge 2020
29 CSO (2021) *Productivity in Ireland 2019*
30 Di Ubaldo, M Lawless, M & Siedschlag, I. (2018) *Productivity spillovers from multinational activity to indigenous firms in Ireland*

However, a 2018 OECD study using Irish micro-level firm data found that SMEs raise their productivity levels by being part of the supply chain of multi-national companies.[31] These SMEs must already have the ability to be competitive suppliers and the capacity to absorb the knowledge and technological transfers (which is linked to investment in R&D) from the multi-national companies.

The solution to fostering productivity linkages between multi-national companies and SMEs requires development of industry standards and the enhancement of the capacity to absorb innovation. First, industry standards can assist in SMEs achieving quality requirements and signalling to multi-national companies their capability to proving quality products and meet their needs in the global supply chains. Standards can also contribute to SME's innovation, internal processes, outsourcing and scaling up.

Secondly, on the development of the absorption capacity of SMES, a study of companies in Ireland has indicated that the productivity spill-overs tend to be in SMEs that invested in research and development.[32] This issue of linkages is important as the productivity gap between multi-national companies and SMEs increased in 2020.

31 OECD (2018), OECD Economic Surveys: Ireland 2018
32 Di Ubaldo, M Lawless, M & Siedschlag, I. (2018) Productivity spillovers from multinational activity to indigenous firms in Ireland