National Competitiveness Council Bulletin

NCC Competitiveness Bulletin 18-3: Economic Concentration 2018

National Competitiveness Council

RELIANCE ON A SMALL NUMBER OF FIRMS THREATENS IRELAND'S ECONOMIC MODEL

- While economic performance is strong, beneath the surface, a number of significant vulnerabilities are evident.
- Concentration of output among a very small cohort of sectors and firms represents a risk to sustainable growth. High value-added sectors, such as Chemicals and ICT, account for a significant share of output and exports.
- Ireland's labour productivity performance is strong in an international context but driven by a narrow base of enterprises, disguising the majority of underperforming firms where productivity growth is stagnant or falling.
- Ireland is also exposed to a relatively high degree of export concentration by trading partner and product exports.
- A third of total exports are accounted for by 5 firms. 39% of corporation tax is paid by the top 10 companies.
- This Bulletin exposes the vulnerabilities in the Irish economic model. Fixing these is not easy and remaining competitive requires a relentless focus on innovation, export diversification and productivity enhancement.

Introduction

As the Irish economy continues to grow, ensuring our competitiveness remains sustainable takes on even more importance. The Council is concerned that the sustainability of growth could be threatened by our heavy dependence on the performance of a narrow base of firms and economic sectors. At the same time our indigenous exporting base exports a narrow range of products and services, and relies on a small number of export markets. Brexit has exposed how Irish export markets are geographically concentrated and the range of products and services exported has become increasingly narrow. To remain competitive, we need a relentless focus on innovation, export diversification, productivity enhancement and new markets. While our competitiveness performance in recent years has been positive, we cannot afford to be complacent.

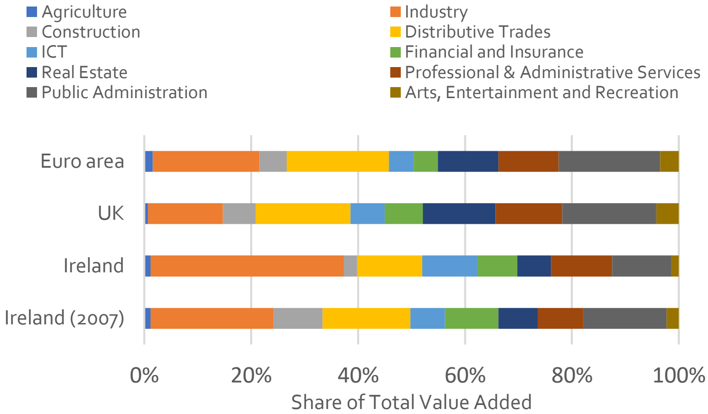
Context

Ireland's relative macroeconomic performance continued to improve over the last year. Improved public finances, productivity growth, export growth and a robust labour market have contributed to improved competitiveness performance. While the headline measures of economic performance are positive, beneath the surface, a number of significant vulnerabilities are evident.

Output and Value Added

National accounts data from the CSO show an increase of 7.2% in GDP in 2017, following growth of 5.1% in 2016. However, the CSO's modified indicators, which exclude significant globalisation effects that disproportionately affect the Irish economic results, show growth has been more modest. Looking at the composition of GDP from the output side, Figure 1 shows the relative importance of 10 activities in terms of their contribution to total gross value added. Between 2007 and 2017, industry's share of value added in Ireland increased by 23% to 36.1% and is now almost double the Euro area level. Services contributed over 70% of the Euro area's total gross value-added in 2017. The relative importance of services is high in the UK (80%) and relatively low in Ireland at around 60%.

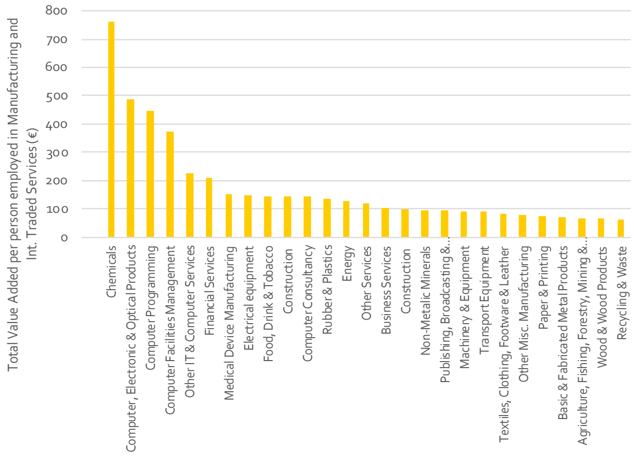
Figure 1: Gross value added at basic prices, (share of total) 2017



Source: Eurostat

Data from the Annual Business Survey of Economic Impact illustrates the gap between high value-added sectors, such as Chemicals and ICT, and other sectors of the economy. Among enterprise agency client firms, value-added per person employed in 2016 ranged from €761,000 in the Chemicals sector, €445,000 in computer programming, to €65,000 and €60,000 in agriculture and waste respectively.

Figure 2: Value-added per person, ABSEI, 2016

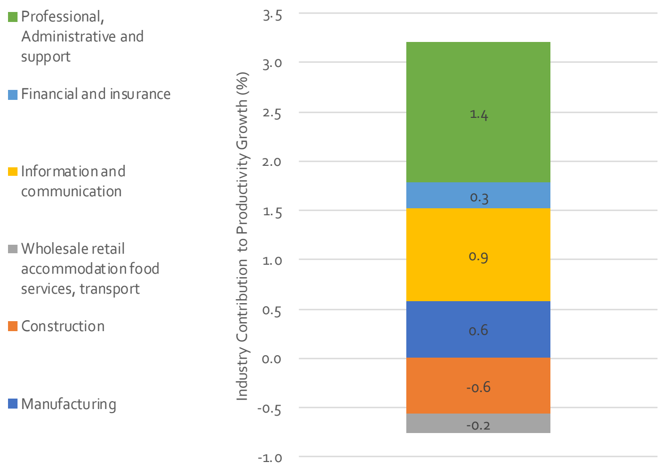


Source: Department of Business, Enterprise and Innovation

Productivity

Productivity growth is a key driver of national competitiveness. Ireland's labour productivity performance is strong in an international context. Irish productivity growth rates and levels have been above the rate of growth in most advanced economies since the recession. In 2016 output per hour grew at 2.4%, compared with growth of 0.6% in the EU and Euro area. Figure 3 shows that overall productivity growth in 2016 was driven by the professional, manufacturing and ICT sectors with negative contributions from construction and the wholesale, retail and accommodation/food services sectors.

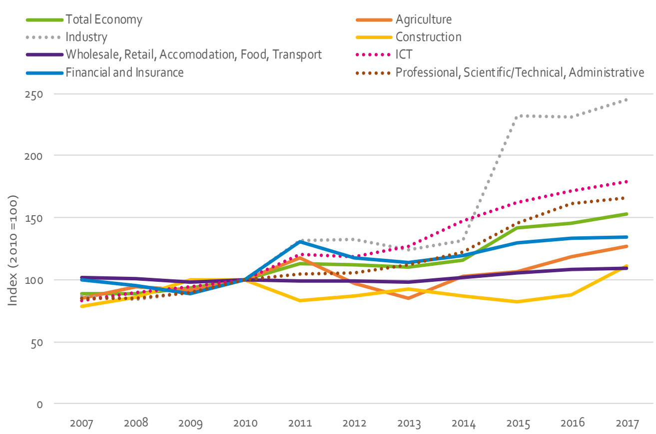
Figure 3: Industry Contribution to Irish Productivity Growth 2016



Source: OECD

Ireland's performance is greatly affected by the influence of the manufacturing and ICT sectors and within those sectors a small cohort of high performing firms. This is in keeping with the highly-concentrated nature of Ireland's economy, as evidenced by the share of value add, exports and aggregate productivity accounted for by the largest and most productive firms. Figure 4 shows recent trends in Irish value added per hour worked and underlines the significance of industrial output on overall growth since 2014.

Figure 4: Gross Value added per hour worked 2007-2017



Source: OECD

The narrow base of enterprises in high value-added sectors, and within sectors, disguises the majority of underperforming firms where productivity growth is stagnant or falling. Recent research by the Department of Finance shows most businesses have experienced a decline in productivity in recent years.

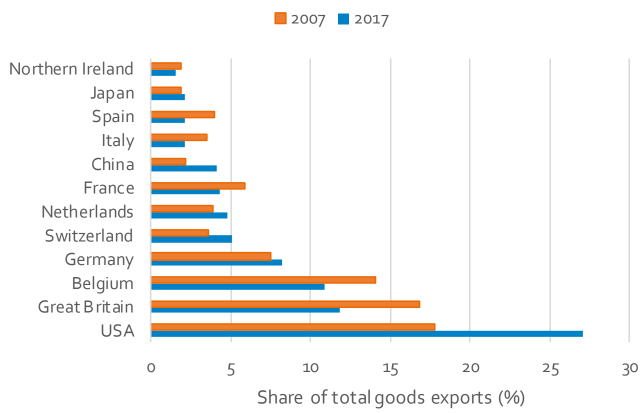
The research also highlights that in some high value-added sectors, a small group of firms are the dominant source of productivity growth and the productivity gap between the frontier firms and lagging firms is widening. Foreign-owned firms tend to be more productive. Productivity spillovers to local firms are limited. The research suggests that the top 10% of firms account for 87% of value-added in manufacturing and 94% in services. This highlights Ireland's exposure to firm-specific shocks. While Ireland's productivity growth is relatively strong, there is a need to increase productivity across many firms and sectors.

Export Markets

Figures from the CSO show that goods exports totalled €122,139m in 2017, the highest annual total on record and an increase of 2% over 2016. While acknowledging this strong performance, Brexit has underlined how Ireland faces two significant and complex export challenges. Firstly, Irish export markets are geographically concentrated with exports particularly dependent on the EU, the US and UK markets. Ireland's relatively high degree of export concentration by trading partner is reflected in our rank of 55th in the IMD's ranking which measures exports to top 5 countries as a percentage of total exports.

Total service exports increased by €14.7bn, from €126.3bn in 2015 to €141bn in 2016. The UK, US, Germany and the Netherlands are Ireland's key trading partners. Euro area markets account for 28% of services exports. The UK and US accounted for 16% and 10% of services exports. Exports to countries such as Canada, Mexico, Switzerland, China and Japan have increased in value- and share-terms over the last five years. However, Ireland's trade performance remains heavily dependent on the EU, US and UK markets.

Figure 5: Goods Export Markets 2007-2017



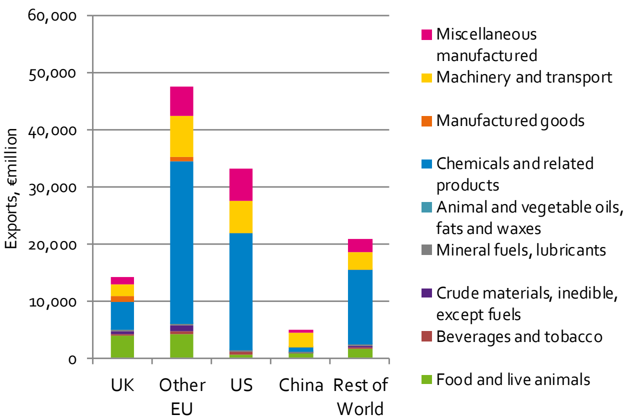
Source: CSO

Figure 5 shows Ireland's principal export destinations as measured by share of total export value. Ireland's principal trading partners in terms of goods exports are the US (27.2%) and the UK (13.4%). In terms of EU markets, in 2017 the Euro area accounted for 33% of goods exports, with the Belgium, Germany, Netherlands and France the EU primary markets. While the share accounted for by these trading partners (84%) is relatively unchanged in a decade, the importance of the US market has increased. Switzerland and China account for an increased share of total exports. The UK, France, Spain and Italy account for a smaller share of goods exports compared to 2007.

Characteristics of Exports

The composition and range of exports from Ireland is very dependent on a relatively narrow base of sectors and commodities. Chemicals and related products account for 55% of goods exports, up from 47% in 2007. Machinery and transport equipment exports account for - 17% down from 25% in 2007, with exports of food and live animals relatively unchanged at 10%. Exports in computer services represent 47% of the total export in services.

Figure 6: Exports by commodity and principal countries 2017

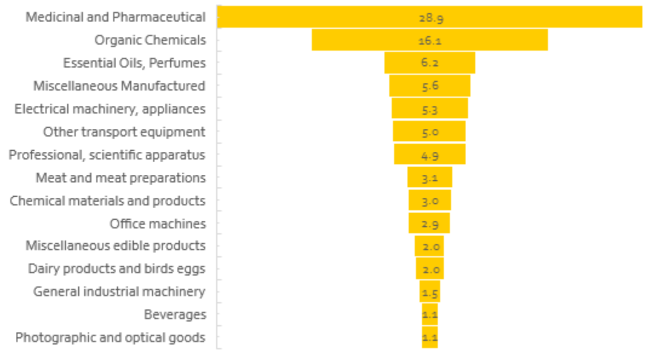


Source: CSO

Figure 6 shows Chemicals count for the largest share of exported goods to the US, UK, and the rest of the EU. The UK accounted for €14.4bn, (12%) of total exports and is the primary destination for Food exports, accounting for 28% of total food exports.

Figure 7 shows the top 15 commodities which account for approximately 90% of total goods exports. The significance of pharmaceuticals and chemical products is clear with these two commodity groups alone accounting for 45% of exports. According to IMD, Ireland is the 50th most export diverse economy in terms of export concentration by product, which measures the top 5 export products as a percentage of total exports.

Figure 7: Goods Exports Top 15 Commodities 2017

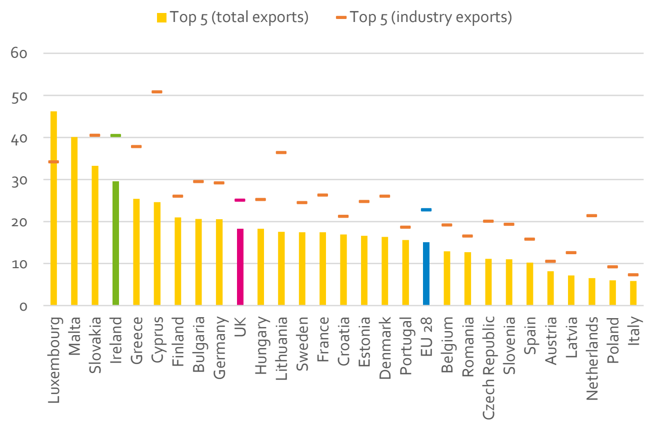


Source: CSO

Characteristics of Exporters

Ireland's export base in terms of the range of products and destinations, and the profile of exporters, appears relatively concentrated. CSO data shows that the top five exporters accounted for almost one-third of all goods exports in 2016. Approximately 75% of total goods are exported by the top 50 exporting enterprises. Figure 8 shows that Ireland's high share of total trade accounted for by a small number of traders is high relative to many EU Member States. Across the EU Member States, in Industry, the top five traders accounted for 22.8% of total exports (in value terms) in 2015 compared to 40.4% in Ireland.

Figure 8: Value of exports by enterprise concentration, 2015



Source: Eurostat

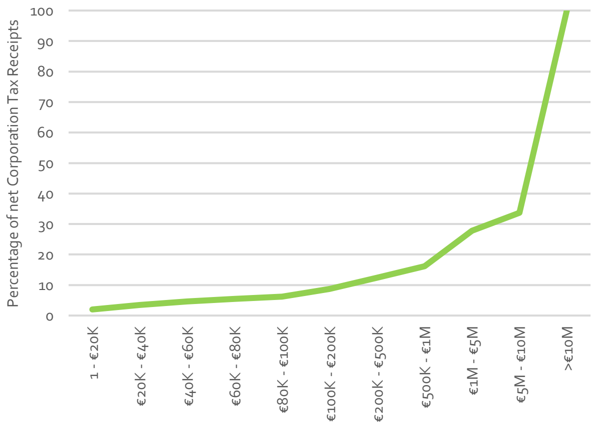
Research by the ESRI shows that, like exporters across a wide range of countries, most Irish-owned goods exporters have a narrow range of products. Overall, export volumes are heavily influenced by a small cohort of large exporters with wide product and market scope. 16 % of Irish-owned goods exporters export just one product to one market and account for just 1.4% of total export value. Over 20% of Irish-owned firms export one product with almost 50% exporting fewer than five. Food products account for close to half of the export value of Irish-owned exporters, and 40% of firms export a single product. In 2015, one product, Meat of Bovine Animals, accounted for 23% of total exports by Irish-owned enterprises. Related research suggests a similar pattern of concentration with services exports with overall performance dominated by a relatively small number of enterprises.

Irish exports, particularly indigenous SME goods-exports to the UK, tend to be concentrated in a small number of sectors and a small number of products. The principal exported goods to the UK are Meat & Meat preparations, Medical & pharmaceutical products, Organic chemicals and Dairy & Eggs. CSO data show the UK accounts for 37% and 41% of Food and live animals exports and imports respectively. The UK accounts for 43% of exports and 36% of imports in the category of manufactured goods, classified chiefly by material including products such as leather, cork and wood, textiles and rubber. This narrow base means that Irish exporters may be more vulnerable to sector-specific trade barriers or tariffs or to any other developments such as a loss of cost competitiveness which weakens Ireland's relative export competitiveness.

Corporation Tax

The Revenue Commissioners report that both the numbers of gross and net corporation taxpayers increased in recent years. In 2017, the number of gross corporation tax payers increased by almost 7,000 (15%), whereas the number of net payers increased by nearly 6,300 (14%) in the same period. Nearly two- thirds of net corporation tax paid in 2017 was attributed to payments greater than €10m.

Figure 9: Distribution of Net Corporation Tax Receipts, All Cases, 2017



Source: Revenue Commissioners

The proportion of corporation tax paid by the top 10 companies is 39% showing a high degree of concentration. Reflecting the large number of small and micro enterprises in the economy, three-quarters of corporation tax payers paid an amount less than or equal to €20,000. These account for slightly less than 2% of total net corporation tax receipts. Shocks affecting any of the top 10 companies could have an impact on receipts. Ireland's exposure related to the concentration of receipts among a small cohort of firms is a risk in terms of the sustainability of public expenditure.

Conclusions

- The sustainability of Irish growth is not only threatened by the potential for boom and bust, but the reliance of the economy on a small number of highly productive large companies. Many Irish-owned companies export a narrow range of products and services, and rely on a small number of export markets.
- Dependence on a narrow base of revenues (particularly regarding corporation tax receipts, which can be volatile) makes the public finances more vulnerable to the risk of future shortfalls in revenue. A broad tax base is crucial in achieving tax revenue stability.
- Broadening our enterprise and export base is key to ensuring our economy is resilient and adaptable. Brexit means that further company-led expansion into new markets and a deepening of trade links is required.
- Ireland's trade performance remains heavily dependent on the EU, US and UK markets. Supporting the internationalisation and market diversification of Irish enterprise would contribute to making the economy more resilient to external market shocks, such as Brexit.
- The availability of qualified, work-ready skills and talent is a fundamental source of competitive advantage and a key driver of productivity growth. As the economy is approaching full employment, job vacancy levels are increasing and the need for certain skills is becoming more pronounced. A challenge is to equip more than half of the population with at least basic digital skills.
- Targeted and timely capital expenditure in infrastructure is a principal means by which government can enhance productivity and competitiveness. Ireland's planning and development framework must be evidence-based, focused, transparent, timely and agile.
- Innovation is key to evolve into new products, markets and sectors as well as improving management quality and further training in smaller enterprises.
- Ireland has significant potential to increase productivity. Supporting an uplift in productivity performance at firm level, particularly amongst Irish-owned firms, represents a significant competitiveness challenge.

Further Reading: The NCC Competitiveness Challenge 2017 sets out policy challenges and actions to enhance Irish competitiveness and is available at www.competitiveness.ie

The NCC reports to the Taoiseach and the Government, on key competitiveness and productivity issues facing the Irish economy and is Ireland's National Productivity Board.

This Bulletin has been issued by the Chair (Professor Peter Clinch) and Secretariat.