



**Irish Exporters Association**

**PRE – BUDGET SUBMISSION 2012**

***Economy emerging from crises***

***How to Maximise on Export Potential***

**Sept 2011**

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- Savings on interest payments arising from the interest rate reduction on EU loans should only be used to reinforce the fiscal consolidation programme. The planned reduction in gross voted current expenditure of €4.8bn over the period 2011 to 2014 will not now be eroded by escalating debt service costs due to savings arising from the interest rate reduction on our EU loans agreed at the July Heads of Government Summit.
- Given very weak domestic demand, cuts in voted current expenditure are preferred to increases in taxation.
- It is noted that the IMF (WP 11/276 Ireland, September 2011) urges consideration of a programme for the orderly disposal of state assets close to €5bn. State assets should not be sold at a discount to NAV.( net asset value).
- Given the scale of fiscal adjustment required to 2015 and beyond cuts in public sector pay may be required especially beyond 2014. It is hard to see how voted current expenditure can be reduced beyond that which is already planned especially post 2014 without tackling public sector pay which accounts for approximately 35% of gross voted current expenditure

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- More rapid growth of Indigenous exporter businesses - Focus on assisting growth from SME to large company.
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## 1. Key Economic Management Focus

The Key economic management focus that the Irish Exporters Association recommends to the Minister for Finance when structuring the Budget 2012 is:

- The Comprehensive Review of Expenditure (CRE) is crucial. The CRE must clearly identify sizable savings in voted current expenditure for Budget 2012 and over the full adjustment period to 2015. Efficiency gains must be clearly specified and quantified within clear timeframes.
- Savings on interest payments arising from the interest rate reduction on EU loans should only be used to reinforce the fiscal consolidation programme. The planned reduction in gross voted current expenditure of €4.8bn over the period 2011 to 2014 will not now be eroded by escalating debt service costs due to savings arising from the interest rate reduction on our EU loans agreed at the July Heads of Government Summit.
- Given very weak domestic demand, cuts in voted current expenditure are preferred to increases in taxation.
- It is noted that the IMF (WP 11/276 Ireland, September 2011) urges consideration of a programme for the orderly disposal of state assets close to €5bn. State assets should not be sold at a discount to NAV (net asset value).
- Given the scale of fiscal adjustment required to 2015 and beyond cuts in public sector pay may be required especially beyond 2014. It is hard to see how voted current expenditure can be reduced beyond that which is already planned especially post 2014 without tackling public sector pay which accounts for approximately 35% of gross voted current expenditure.

The economy continues to be characterized by shrinking domestic demand and a buoyant external sector. This trend will continue for the foreseeable future. Exports of goods and services are the engine of growth as the external sector leverages off competitiveness gains. It is the external sector that will drive economic recovery.

There is no quick or easy solution to Ireland's economic ills. It will take a considerable period of time to restore economic stability.

We have commenced the process of decoupling from other peripheral countries in the Euro area on international bond markets. This is a positive development.

**The brightest spot on our economic horizon is the strong performance of Irish exports. Exports of goods and services grew by 6.3% in volume terms last year. Ireland's export sector will play a crucial role in economic recovery. Exports of goods and services are projected to grow by 7% in volume this year and on average by 5% annually over the period 2012 – 2015.**

**A growth rate in exports in excess of this would be of enormous benefit in helping to achieve a reduction in the General Government Deficit to below 3% by 2015. The detailed recommendations in sections 2, 3 and 4 of this Pre Budget Submission will help enable export growth in excess of 5% and hence they should be implemented despite the constraints on the Exchequer.**

The target of a General Government Deficit below 3% by 2015 can be achieved.

The planned reduction in gross voted current expenditure of €4.8bn over the period 2011 to 2014 will not now be eroded by escalating debt service costs due to savings arising from the interest rate reduction on our EU loans agreed at the July Heads of Government Summit. A substantial cut in overall current expenditure can be achieved. Reductions in expenditure will be addressed in the context of the Comprehensive Review of Expenditure (CRE). The CRE is crucial and it must clearly identify and quantify sizable savings in voted current expenditure over the adjustment period.

Planned increases in taxation and other revenue generating measures will have a significant deflationary impact on the economy through reduced consumer spending.

It is likely that savings arising from the interest rate reduction agreed at the Heads of Government Summit in July will be offset to some degree by weaker than anticipated economic growth especially in 2012 and 2013. These savings must be used to reinforce the fiscal consolidation programme.

A General Government deficit of 3% of GDP is only the first step along the road to fiscal recovery. The state will be required to run General Government Surpluses in the latter part of this decade in order to get the General Government Debt to GDP ratio back towards 60%. It is likely that tight fiscal policy will act as a continuous drag on economic performance into the next decade.

**It is hard to see how voted current expenditure can be reduced beyond that which is already planned especially post 2014 without tackling public sector pay which accounts for approximately 35% of gross voted current expenditure.**

Fiscal consolidation measures will exert a dominant influence on economic performance next year. Budget 2012 will be severely deflationary and this will be reflected in very weak domestic demand in particular consumer expenditure.

Real GDP is forecast to grow by 1.5% and real GNP by 0.7% in 2012.

A similar pattern will evolve in 2013 with a strong export performance being offset by weak domestic demand. Real GDP is expected to grow by 1.6% and real GNP by 1%.

Sustained and employment generating economic growth requires growth in consumer and investment spending alongside a buoyant external sector. Unfortunately the achievement of a more balanced growth path is some time away.

**Funding is the biggest problem facing the Irish banks. It is estimated that at end July 2011 Euro system borrowing by the domestic credit institutions and Central Bank Emergency Liquidity Assistance to this group amounted to €122bn. This equates to 95%**

**of GNP and the situation is unsustainable. This source of funding must be reduced to normal levels.**

The Euro crisis has escalated. The seventeen member bloc is in real danger of disintegrating. The most obvious course of action to resolve the problem is a common fiscal policy and the creation of Eurobonds to fund borrowing by the seventeen member states. Such a step cannot be taken immediately given the divergence of funding costs, borrowing requirements and overall debt levels across the Euro area. A successful and sustainable launch of Eurobonds requires convergence of general government balances, debt/GDP ratios and bond yields across the seventeen states.

The roadmap to Eurobonds requires the establishment and achievement of specific targets for fiscal indicators within agreed timeframes for the seventeen countries. Such a position is some considerable time away given the divergence of fiscal indicators that currently exist.

A breakaway group led by Germany to form a new currency is the clear and sustainable solution to current difficulties. This would create a two tier structure with a new strong currency led by Germany, Netherlands, Austria, France, Finland and Luxemburg and the weaker Euro being the currency of those countries left behind.

It is unlikely that this course of action will be taken in the immediate future given the political resolve to maintain the currency in its current form. Thus, further integration to include a common fiscal policy is the more likely approach. A break up would only be considered if some countries persist in dragging their heels in terms of fiscal reform and policymakers in Germany and France finally lose patience and believe there is no other option. Irish policymakers must ensure that our macroeconomic fundamentals are strong enough to maintain our Euro status and should break up occur be in a position to join the new currency arrangement.

**In order for the government to regain access to funding on international financial markets and hence regain economic sovereignty, Ireland's credit rating must improve. Achievement of targets as laid down by the EU/IMF is of paramount importance in this respect.**

**A significantly improved credit rating will not only allow the state to fund directly at reasonable cost but will also spill over into the banking sector through the reestablishment of country lines of credit and hence individual lines of credit for Irish banks by their international counterparts.**

The resultant access to funding on international wholesale money markets will reduce dependence on ECB funding by the Irish banks and help facilitate a resumption of lending in the Irish marketplace.

## 2. Real Export focus, Indigenous and FDI

The global outlook has become increasingly precarious over the past few months, with the path of the euro zone crises over the next several weeks set to determine whether we are passing through a period of weakened developed world growth or on the cusp of a renewed global downturn.

The exceptional growth on exports that has driven the return to growth in the Irish market in the first half of 2011 is unlikely to continue in the second half of 2011 as global trade is clearly now stalling.

In these circumstances it is essential that the focus by Government and the Budget 2012 will show real focus on supporting indigenous industry to continue to grow export sales, and also to ensure the best conditions to attract more FDI associated export businesses.

There are a number of cross-cutting issues that are preventing these exporter sectors from realising their full potential, and which should be addressed in Budget 2012, if they are to make the maximum contribution to our export led recovery.

These are:

- Assisting growth from SME to large company , and invest more in R & D
- Trade finance and banking support
- Business start up supports

### **2.1 More rapid growth of Indigenous exporter businesses - focus on assisting growth from SME to large company.**

The case for a major focus on Indigenous Irish export oriented businesses is clearly seen from the simple statistic of jobs created for every €100,000 of sales. Indigenous export businesses create one job for every €102,000 in sales,

Whereas multinational foreign owned export businesses create one job for every €790, 000. In times of full employment the focus was correctly on Multinational high value businesses, however in the current high unemployment era we need to create more jobs urgently .From this basic statistic we can see that the indigenous export businesses can create jobs eight times more rapidly, particularly in times of restricted global economic growth, if given the correct support and incentives.

There is also the added issue that needs to be addressed and that is the relatively small number of indigenous Irish companies that reach the scale and size to remain competitive on international markets and remain in Irish ownership. Again a greater focus on the supports to incentivize Irish businesses owners to retain ownership in the long term and build larger sustainable export businesses is now needed more than ever, if we are to ensure the destiny of the country is more within our national control.

## **Recommendations:**

To address these issues the IEA recommends to the Minister for Finance the introduction of the following measures in the Dec Budget for 2012:

### ➤ **Share option scheme for SMEs**

Unlike shares in quoted PLC's shares in SME's cannot be easily turned into cash irrespective of how successful a company has been. In addition the issue of full equity shares in an SME can give rise to major management complications for its owner. Consequently many owners are reluctant to offer sharing schemes to employees. These negatives put a major barrier to management teams being able to identify directly with and share in the success of their companies and adopting the entrepreneurial spirit so necessary if SME's are to play an important role in helping the Irish economy achieve the growth all agree is so necessary. To overcome these problems we are proposing that "SME- Shares" be issued rather than equity shares. The advantages of using SME Shares are that they:

- Give the employee an interest in the growth of the business without requiring the allocation/issue of shares to the employee
- Allow the employer to reward employees based on performance or length of service or other selected criteria
- The employee does not have to fund any purchase of shares

A full explanation of the SME-Share option scheme can be seen in Appendix A attached.

## **2.2 Export Finance Guarantee Scheme - focus on emerging markets and novel products and services.**

There continues to be a lack of finance for a range of indigenous export businesses that have inadequate capital to offer as security, or are developing novel services or trying to enter high risk markets. Many of our competitor countries have recognised the inability of banks to meet these requirements under the new bank loan risk assessments parameters and have introduced State guarantee loan schemes to help these companies develop their products and markets and export more.

The Dept of Jobs, Enterprise and Innovation have indicated the intention to put such a loan guarantee scheme in place early next year, but without specifying the size and nature of the scheme.

**Recommendation:**

To ensure real export and jobs growth from a new State back Loan Guarantee scheme, the IEA recommend that the scheme should cover businesses with up to €25million turnover, and provide loans of up to €1.5 million, with services to cover loans with repayment periods of 2 to 5 years, export collections/invoice discounting, letters of credit, bonds, guarantees and indemnities. The latter are very important to services exporters who have to provide performance bonds and guarantees in order to secure contracts. It will be essential for a good take up of any new scheme that the interest and set up fees will be very competitive.

We urge the Government to take early steps to have a new scheme in place for the start of January 2012.

**2.3 New Enterprise Investment Incentive Scheme (EIIS) - focus to accelerate private sector investment in business and assist more rapid growth of exporting SMEs, and also ease pressure on bank funding**

The EIIS has the potential to release extensive private sector funding which has been withdrawn from Irish banks, and being held dormant, for productive support of SMEs who have the products and services to expand rapidly overseas but lack adequate share capital to sustainable do so, in the current risk averse climate.

**Recommendation:**

A new Employment and Investment Incentive (EII) is planned for introduction to replace the Business Expansion Scheme (BES) but can only come into operation after the necessary approval from the European Commission has been received .We urge the Government to push this through as a matter of urgency, as a key measure to get cash-flow going in the economy again. (The existing BES incentive will continue to operate in the meantime, but is considered inadequate and cumbersome).

**2.4 R & D - focus on export market research and entry costs for indigenous businesses.**

With only 18% of Irish companies claiming R& D credits (and most of these the larger companies) there is a compelling case for expanding the facility to ensure it works to the benefit of

SME exporters to enable them to expand sales of novel products and services into emerging markets and create more jobs.

**Recommendation:**

The IEA recommend the following changes to the R& D provisions in either the Budget in December, or the Finance Bill in February 2012:

- > Allow Research and development of markets and costs associated with entering new emerging markets to be allowed as R& D for tax credits and grant aid.
- > Streamline the RTI grant regime so that if a company is approved for RTI grants they automatically qualify for R& D credits. This is a source of continued difficulty particularly in the internationally traded services sector.

**2.5 Encourage start up entrepreneurs**

It would be beneficial for Ireland if we could encourage a number of would be entrepreneurs who currently have good, relatively well paid employment in typically MNC owned enterprises to take a risk and set up their own enterprise in a niche which they can identify. We suggest that they require some incentive to nudge them to leave what might be secure well paid employment to start up an export venture which may be riskier but has long term potential.

**Recommendation:**

The IEA recommend an incentive be offered that provides an exemption from Income tax for these individuals for a number of years – say 4 or 5. The IEA also recommend that a similar scheme be introduced to encourage mobile individuals from outside the state to establish an enterprise in Ireland.

It would be necessary to build in some safeguards to ensure the incentive is used in the way intended. We would suggest that it only be available to people establishing a business from a given date. It should also only be available to those who employ a minimum number of people – say 3. Furthermore, the maximum amount exempted could be limited to the total PAYE/PRSI/USC withheld by the enterprise. If you were to make it available to existing enterprises, one would restrict the exemption to incremental employees or incremental PAYE/PRSI withheld over the base year of 2010 or 2011. This creates an incentive for an enterprise to hire more people! We think it could have a significant impact in increasing the size of what are currently micro enterprises or establishing new ones. Given the employee requirement and link to tax/PRSI withheld it would be very difficult for

existing enterprises or self employed individuals to take advantage of it without employing incremental people.

## **2.6 Employee/employer income tax breaks - focus to incentivise more in market activity**

A key driver of export sales is the time spent by sales and support staff in the market place. This can be onerous and requires a sacrifice of normal social life by staff. Most of our competitor countries have long standing incentives to encourage extended foreign travel. In Ireland we had a scheme some years ago which was discontinued. It is now urgent that we re introduce a scheme if we are to maximise on the potential for export growth and job creation in the export sector.

### **Recommendation:**

The IEA recommend to the Minister to introduce the following incentives:

- > Irish nationals working for regular periods of 5 days out of Ireland in pursuit of export sales are given a tax incentive to compensate for the unsocial - able requirement to spend continuous periods abroad. Note; the tax incentive that was in place was removed in 2003, was seen as a retrograde move.
- > Alternatively, encourage enterprises to send more people overseas by allowing export sales and marketing costs including staff costs, to be offset against PRSI and PAYE costs

## **2.7 Retaining Multinational export activity from Ireland – focus tax relief for overseas staff working in Ireland.**

In the current economic climate with increasing marginal tax rates and the need to compete harder for mobile foreign direct investment, Ireland is losing it's attractiveness as a location for the key executives and decision makers, required to close the deal on many FDI ventures. Decisions on location are made by individuals rather than corporate. To balance the situation back in Ireland's favour the IEA Recommend enhancing the current SARP regime by:

- reducing the current employment income threshold for eligibility from €100K to €70,000 - this is in line with recent developments in Malta & the Netherlands;
- limiting the excess above the threshold which will be taxable to 30%, down from 50%; and extending the relief to encompass the universal social charge.

### 3. Reform of Government—Resource transfer and allocation to Key State export development agencies and Foreign Affairs & Trade

Exports, FDI to and FDI from Ireland are all critical. However, the world market is increasingly global and Ireland's focus has been largely on the traditional markets of the EU and the US. Ireland's share of global trade has consistently fallen over the past decade (although share in services and a remarkably resilient 2009 show encouraging signs for the future), however, our share of trade in Asia has declined most prominently. FDI from Asia (besides Japan), Russia and Brazil are almost non-existent, despite the fact that businesses in these countries have been investing heavily in other EU member states. Put simply, we are losing share in the fastest growing markets in the world.

#### **Recommendation:**

- The IEA Recommends that the Government should ensure additional resources are found to stimulate businesses from Asia and the other rapidly growing economies to invest in Ireland, as well as assist indigenous exporters to focus their efforts on the rapidly growing BRIC markets.
- Specifically we recommend Government should:
  - > Provide a detailed plan of Public Sector Reform, inclusive of transfer of resources to trade promotion agencies to replace key staff retirements.
  - > Embassy Resources – to maximise the effectiveness of our overseas diplomatic and agency representatives in key markets the IEA recommend the transfer of additional staff into the DFA to support their overseas embassy network. This will be essential if Irish small and medium-sized enterprises are to accelerate their entry into new markets and drive the jobs growth at home. In particular the IEA have in its Asia trade Policy 2011-2015 document outlined the case for increasing the staffing of the Irish Embassies in Asia, where current levels are very low and do not allow of sufficient support to expand the reach of Irish exporters in the vast and rapidly growing Asia markets.
  - > Extend Trade Missions — we have fallen behind significantly over the past 5 years in representing and facilitating Irish industry in international markets, with Government led Trade Missions compared to our trading competitor governments. As an example the Ministerial trade mission to India setting out on 17<sup>th</sup> April is the first in 5 years to this vast rapidly growing country with high potential for Irish exporters – our close to zero growth in exports to India in the intervening 5 years, compared to the double digit growth of our trading partners must in part be taken as a reflection of this lack of official interest.

- > To repair much of the recent reputational damage to Ireland's business reputation, as well as help expand exports abroad and the result jobs at home, we need the DFA to be much more pro – active in the generation of Trade Mission with Government backing .Again the DFA must ensure it is adequately resourced for this task.
- > Align Ireland's visa policy with strategic business interests — trade expansion into a number of key markets has been compromised due to the current visa policy and the lack of Schengen compatibility. The solution to this long standing issue has been identified, but it will require an investment by each of our embassies in a biometric passport encryption system similar to that is use in the British embassies. The IEA urge the Min for Finance to set aside the necessary funding for this vital investment.
- > Business should be educated on Asia's opportunities and potential, particularly in relation to the impact of globalisation and the strategic imperative to at least consider Asia in corporate strategy development. This calls for further investment in programmes and network events to share the experiences of other Irish companies securing competitive advantage through their dealings in Asia.
- > The network of Irish Country Directors and the Asia Business Support Programme should be re - established with all those from EI through to local embassy staff actively focusing on identifying business partnerships and opportunities. Business people in particular should be engaged as they represent business first and foremost. Databases of those with local in - country experience should be established. Irish business networks, in country, should be better utilised and supported to this end. Simple market entry supports can be coordinated between the agencies in order to encourage more companies to look seriously and productively at Asia. The ATF, with some basic support, is happy to take a role in driving this.
- > Political commitment to Asia's potential must be shown in practical ways. Personnel serving Asian markets, from the various promotional agencies through to embassy staff, must be prioritised according to greatest opportunities. In market presence should at least match that of the EU and US regions and there should be a focus on additional incubator and trade support in the priority markets. This is a significant challenge, but should nonetheless be prioritised.
- > Asian companies - 'In country' business parks in *Ireland* Similar to schemes run by Shannon Development, Asian companies, by means of a 'one stop shop' for all their service and manufacturing needs should be targeted to invest in Ireland. An all-inclusive approach of enabling of increased FDI into Ireland.

## 4. Bolster the Basic Export Infrastructure

- Cost Competitiveness
- Access to and from markets
- Focus Transport efficiency supports

### 4.1 Cost Competitiveness

A further issue that weighs heavily on indigenous as well as foreign owned export businesses is the cost of doing business in Ireland.

One statistic gives a clear example of the magnitude of the issue; In the ten years 1999 to 2009 average public sector wages increased by 110% in Ireland, whereas in Germany over the same period it increased by 16%.

There are many areas of the economy that remain uncompetitive despite recent improvements, and must be tackled in the upcoming Budget. These include electricity a gas costs, property rate and rental costs, waste processing costs and legal fees. A failure to tackle these issues will see recent competitiveness gains eroded, competitiveness weaknesses amplified and ultimately our export and economic and jobs growth restricted.

#### Recommendations:

The IEA recommend the following to the Minister for Finance for implementation at Budget time, or thereafter:

- > Restoration of the user rebate for large users of electricity.
- > Introduction of a temporary reduction of 20% in rate charges to Small businesses.
- > A fixing of landfill charges at a max of €80 per tonne.
- > Take necessary steps to encourage low cost next generation telecoms networks to support the rapidly growing ICT services sector.

### 4.2 Access to and from markets

Irish exporters need an integrated transport policy that will ensure that Irish exporters can offer an efficient, competitive supply service to overseas clients, as well as to ensure their input costs for materials are competitive.

### 4.3 Road and sea freight transport

The vast bulk of our exports and imports arrive by sea and use road transport. The rising cost of fuel is having a detrimental effect on the cost of getting high volume goods to market. Fuel prices have risen by 33% from €0.90 to €1.20 per litre over the past 18 months, which has increased the running cost of one HGV vehicle burning 1,000 litres of fuel a week by as much as €300 a week, or €15,000 a year. Diesel costs amount to 30 percent of the operating cost of a transport truck, thereby forming a significant part of the final cost of bringing goods to market. The IEA estimate that fuel cost inflation has added €200 million to the export cost base over the past 12 months.

The Agri-food sector is particularly affected because of the high tonnage and volume nature of the produce. It is the largest export employment sector in the state with 253,000 people in full time employment. The sector is the only fully integrated industry in the state encompassing:

Initial producers > Processors > Wholesalers > Retailers > Hauliers

It is an integral part of the indigenous exporting sector, accounting for two thirds of total indigenous exports abroad.

It is essential to maintain the competitiveness of this sector.

#### **Recommendation:**

The IEA recommended the introduction of an **'Essential User rebate for diesel fuel'** In 2009, the Government took a yield of €1.1 billion in excise from auto-diesel or almost 45 cents per litre in excise to the Revenue.

The IEA acknowledge that the Government may need to raise the excise rate on auto-diesel, but strongly call on Government to provide a 5 cent per litre rebate to essential users who are supporting our export industry.

In the Agri-food sector 1,470,000 tonnes of produce are exported out of the country. The diesel used in the transport of these Agri-food products is estimated to be 293 million litres of diesel, which contributes €105 million in excise to the Revenue.

Five cents per litre essential user rebate would boost the competitiveness of the Agri-food sector. The cost to the exchequer would be €15 million and would be recovered by a very small increase in excise on petrol.

This Special User Rebate system for diesel users is in operation in France. There is clear benefit to French exporters in their scheme. Clearly the Rebate system has merits, but we understand that the Dept of Finance have estimated that it would cost the Exchequer €200 million to implement in Ireland. Again we recommend the Task Force mentioned above should meet with the Dept of

Finance Officials and re investigate the matter, as in our opinion it should be possible to implement a system that will be cost neutral to the Exchequer and still support Irish export industry and ensure we have a level playing field in Europe with competitors from other EU member states (reference prior submissions to your office from the IEA).

### **Euro Vignette (1999/62/ec) Directive**

There are also threats to the competitiveness of our exports arising from the proposed Euro Vignette directive which is planned to harmonise levy systems across the EU – involving road taxes, tolls and use of road infrastructure charges (German Maut system). It is essential that the Dept of Transport review the best balance between our current road tax system and the new Euro Vignette user charge regime, to ensure Irish goods do not suffer higher costs in their transport routings than their European competitors.

The IEA have already made a detailed submission to the Dept of Transport this matter, and are ready to discuss the matter further.

On the Euro vignette issue, we recommended that the Dept should immediately start the process of setting up a Task Force to agree the best system for Ireland and Irish export industry taking into account the impacting factors of HGV Road Tax, Existing Road Tolls, and a methodology for monitoring road usage which is inherent in the Euro vignette charging system. We should in the process take into account the UK's intentions in this matter also, as it is our main transit foreign territory en route to market.

**END**

## Appendix A

### An effective Option Scheme for SME's

There is an issue with encouraging HPSUs to stay the course and with encouraging SMEs to put in place mechanisms for the employees to participate in growth. We suggest that a revised Approved Share Option scheme should be out into place. This is probably more appropriate for the Finance Bill and we would be willing to draft such a scheme if you thought it useful. Such a scheme should be capable of being used by both HPSUs and SMEs and ideally should not be used by large MNCs. It should provide for a CGT rate on a reward which is separate to the normal salary and it should not be offered in lieu of salary.

The abolition of the Approved Share Option Scheme in last year's budget was a retrograde step despite the fact that only thirty five such schemes are in existence. The old scheme clearly cannot be deemed a success in influencing the behaviour corporate Ireland, but it should have been modified to ensure greater take up and not summarily disposed of.

It is the view of the IEA that a new scheme should be introduced which allows management of all companies and not just PLC's and MNC's share in a meaningful manner in the success of their enterprises. Such a scheme has the potential to ensure that those running Irish businesses focus not solely on the current difficulties being encountered but also on the potential that exists for future success. If this happens there would be a meaningful lifting of the spirits of those who can make things happen which can be achieved at zero cost to the exchequer in the next three years. To the extent the Exchequer "losses out" thereafter it will be against a background of new wealth and success being generated in Ireland which will deliver new jobs and new sources of tax revenue for the Exchequer. This proposal is therefore clearly a win - win for the economy and the exchequer.

Unlike shares in quoted PLC's shares in SME's cannot be easily turned into cash irrespective of how successful a company has been. In addition the issue of full equity shares in an SME can give rise to major management complications for its owner. Consequently many owners are reluctant to offer sharing schemes to employees These negatives put a major barrier to management teams being able to identify directly with and share in the success of their companies and adopting the entrepreneurial spirit so necessary if SME's are to play an important role in helping the Irish economy achieve the growth all agree is so necessary. To overcome these problems we are proposing that "SME Shares" be issued rather than equity shares. The advantages of using SME Shares are they:

- Give the employee an interest in the growth of the business without requiring the allocation/issue of shares to the employee
- Allow the employer to reward employees based on performance or length of service or other selected criteria
- The employee does not have to fund any purchase of shares

The value of these SME Shares ("SME-S") would be linked to the performance of the company. To encourage decisions by management which promote the long term rather than the short term value of the company, valuation rules could be based not on the ultimate bottom line of the P&L account but an adjusted one e.g. prior to allowance having been made for R&D expenditure. To ensure that real success is the basis for any declared growth in the value of a SME-S, profits from trading with related parties would not be taken into account.

One of the major shortcomings of the Approved Share Option Scheme in the past has been that it had to be offered to all employees. This proposal removes this requirement and will allow the management decide who may participate in the scheme and to what extent.

This Success Sharing Scheme therefore has the following characteristics:

- 1 SME Shares ("SME-S") would be issued
- 2 Management would be free to determine who receives the SME-S's
- 3 The SME-S's would have to be held for a minimum of three years before they could be turned into cash
- 4 The value of the SME-S's would be calculated by way of a predetermined formula which would be such as to ensure that short terms profits are not chased to the long term detriment of the business.
- 5 The increased value of the SME-S's would be subject to Capital Gains tax when the gains are realised.

Many PLC's offer share option schemes to their key employees. This proposal seeks to put SME's in a similar position.

We all now recognise that if Ireland is to get out of the current economic problems we must achieve growth. To do this it is critical that we seek to encourage an entrepreneurial spirit and approach in the management teams of our SME's. We know from our strong defense of the twelve and a half per cent corporation tax rate that the rates of tax applied to economic activity strongly influences the outcome. This proposal is seeking to ensure that this logic is also applied to the taxing of long term gains when made by those who are in a position to make things happen within the SME sector. In accordance with the needs of our time **this scheme will cost the State nothing in the next crucial three years.** Yet it has the potential to strongly encourage a focus on the positives and breed a spirit of success within the business community and thereby give a psychological lift to the SME sector. Markets need confidence to make progress and this proposal can help generate a

sense of confidence in the decision makers of SME's by getting them to focus on growth and development.