



Economic Impact of Foreign-Owned Sector in Ireland

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Introduction

1. Presentation based on Department of Finance research

- Economic Impact of foreign owned sector (Enright, Dalton, O'Connor)
- Literature Review (Hynes, O'Connor)

See here - <http://tinyurl.com/Budget15>

2. Research focused on three key questions:

- What does the literature say about corporation tax and its effects on economic growth?
- What does the foreign owned sector look like in Ireland (level and type of economic activity, employment)?
- What are the economic contributions and impacts of the foreign-owned sector?



Literature review: main findings

1. Incidence of corporation taxation

- Significant pass through of corporation tax burden to reduced wages internationally
- Elastic labour supply in Ireland may mitigate in SR but likely LR pass-through

2. Impacts of corporation tax on growth and output

- Strong evidence of negative effect of CT on growth in both theoretical and empirical literature.
 - Lee & Gordon (2005) -> 0.6% and 1.8% on economic growth for 10 p.p. change in statutory rate
 - Conefrey & Fitzgerald (2011) -> extension of 12.5% rate in 1990s increased GNP by 3.7%

3. Main channels

- Capital accumulation
 - Negative impact on investment - Bond and Xing (2013)
 - Impact varies across asset classes – European Commission (2013)
- Foreign direct investment
 - Negatively affects FDI. De Mooij and Ederveen (2005) find elasticity of 3.7;
- Innovative activity
 - Reduces productivity at industry and firm level through reduced incentives.



The foreign-owned sector in Ireland

Key characteristics of indigenous and foreign-owned enterprises, Business Economy, 2011

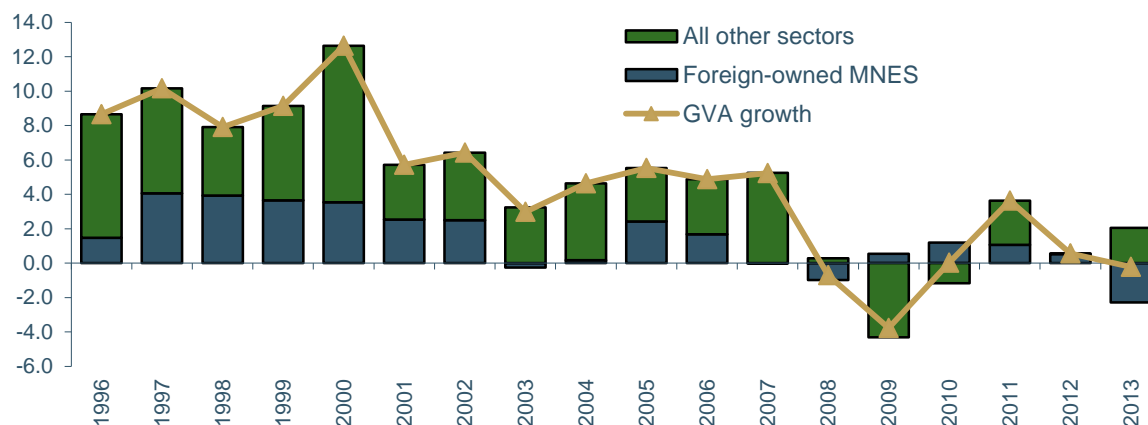
	Firms		Persons engaged		Turnover		Gross Value Added	
	000s	% of Total	000s	% of Total	€bn	% of Total	€bn	% of Total
Indigenous	152.3	98	900.7	78	139.3	44	36.3	43
Foreign-owned	3.3	2	250.4	22	176.9	56	48.9	57
Total	155.6		1,151.1		316.2		85.2	

Source: CSO, Department of Finance Analysis Note: Rounding may affect totals

- The “business economy” excludes agriculture, public sector, self-employment, etc
- Foreign-owned firms account of 58% of gross value added (GVA) in the business economy, and about 22% of employment
- Foreign presence in Ireland is high in Ireland even in non-exporting sectors (retail, etc).



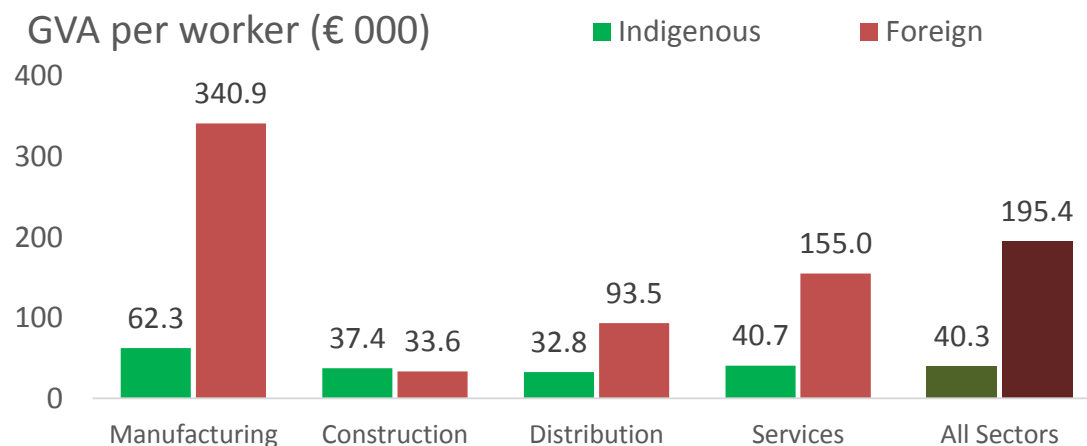
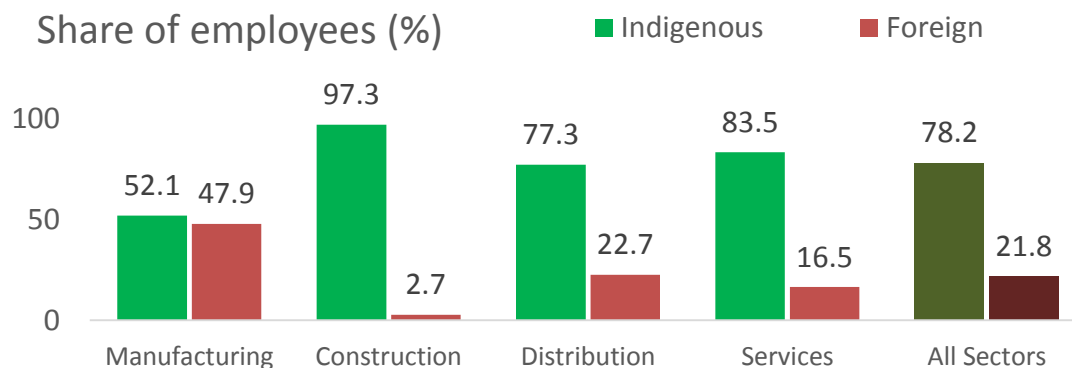
Contribution of foreign-owned sector to growth



- Sectors dominated by foreign-owned MNEs accounted for about [one quarter] of economic activity (gross value added) in 2013
- Foreign-owned sector's contribution to growth declined during the domestic demand-led period of 2002-2007
- Growth in the foreign-owned sector increased from 2008 on, supporting aggregate demand through the downturn



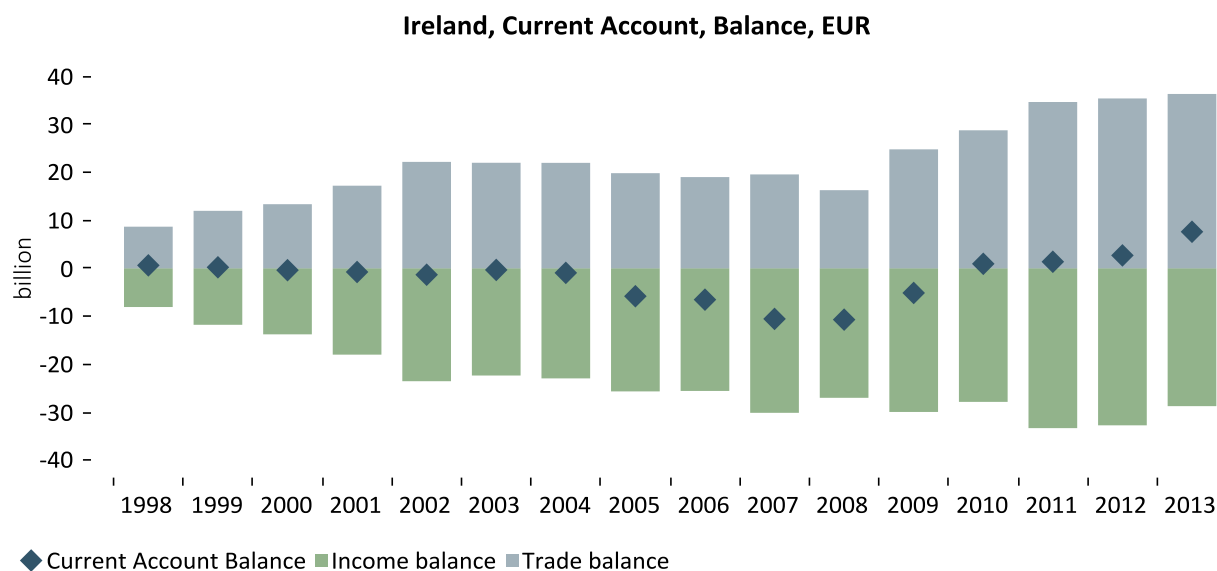
Foreign-owned firms are larger and more productive



- 98% of firms are Irish-owned. But the foreign-owned sector accounts for higher share of employees (22%) as firms are much larger
- GVA per worker is considerably higher in foreign-owned firms, particularly in manufacturing
- This also holds in sectors where neither firm type dominates



Balance of Payments Impact of foreign-owned sector



- Chart shows Ireland's current account balance (blue diamonds) since the late 1990s
- The trade balance (blue bars) is persistently large and positive. The income balance (green bars) shows the opposite sign
- This is the result of the large export volumes of the foreign-owned sectors, offset by profits remunerated to foreign parents. This is why GDP > GNI
- Recently, arrival of some foreign-owned firms has pushed up income inflows and as a result GNI. This in turn results in increased EU Budget contributions



FDI and its spillover impacts

1. Main channels

- Labour mobility – positive (knowledge) and negative (crowding out)
- Demonstration effects
- Competition effects – positive (upskilling) and negative (loss of market share)

2. International evidence

- Spillovers depend on productivity gap
- Competition effects less likely where FDI is export based
- Government policies have a role -> Kokko and Blomstrom (1995)
- Overall evidence is mixed: Gorg and Stobl (2000) & Havranek and Irsova (2011)

3. Evidence in Ireland

- Labour productivity – weak evidence (Ruane and Ugur, 2002)
- Crowding out effects on domestic exporters (Barry et al, 2001)
- Higher probability of exports and export intensity (Ruane and Sutherland, 2005)
- Mixed evidence in services sector (Haller, 2012)



Multipliers – economy-wide impacts

- Own modification of input-output tables carried out to calculate multipliers and employment effects for the foreign-owned sectors and the rest of the economy
- Reduced economy to two sectors – foreign owned and rest of economy

Sector	Multiplier effect	Employment effect
Foreign-owned	1.2	3
Rest of economy	1.4	10

Note: the multiplier effect is the marginal whole-economy impact on *output* of an increase in final demand for either sector's products

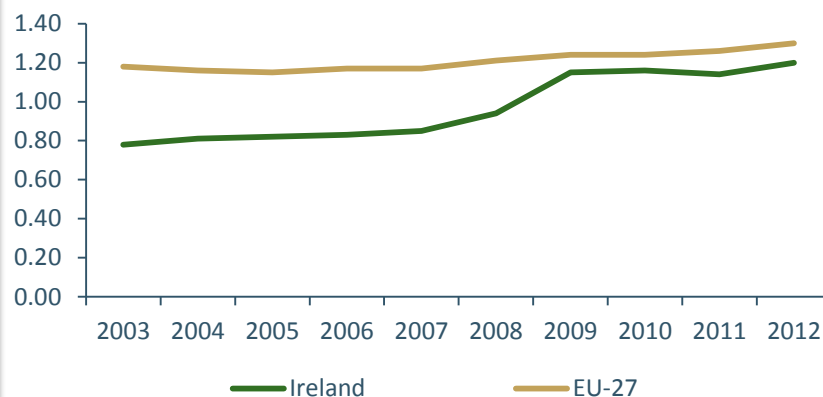
The employment effect is the marginal economy-wide impact on *employment* of a €1m increase in demand in a sector

- Shows that the whole-economy impact of additional demand in the foreign-owned sector is considerably *lower* than indigenous
- This is due to a) higher import content; b) lower employment intensity; c) higher profit share
- One interpretation might be that stimulating domestic sectors generates short-term returns, but in the long run productivity is a key determinant of living standards

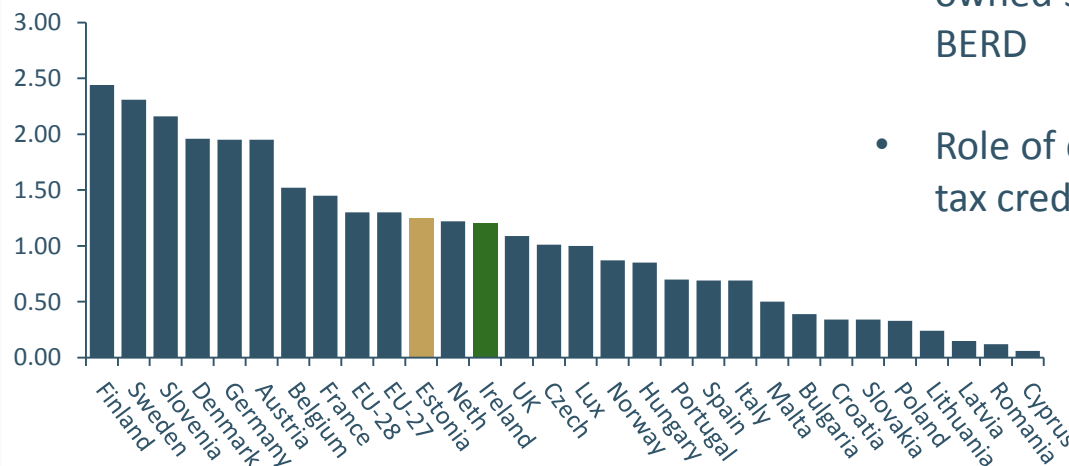


R&D Impacts – Business expenditure on R&D (BERD)

BERD/GDP ratio converging on EU-27

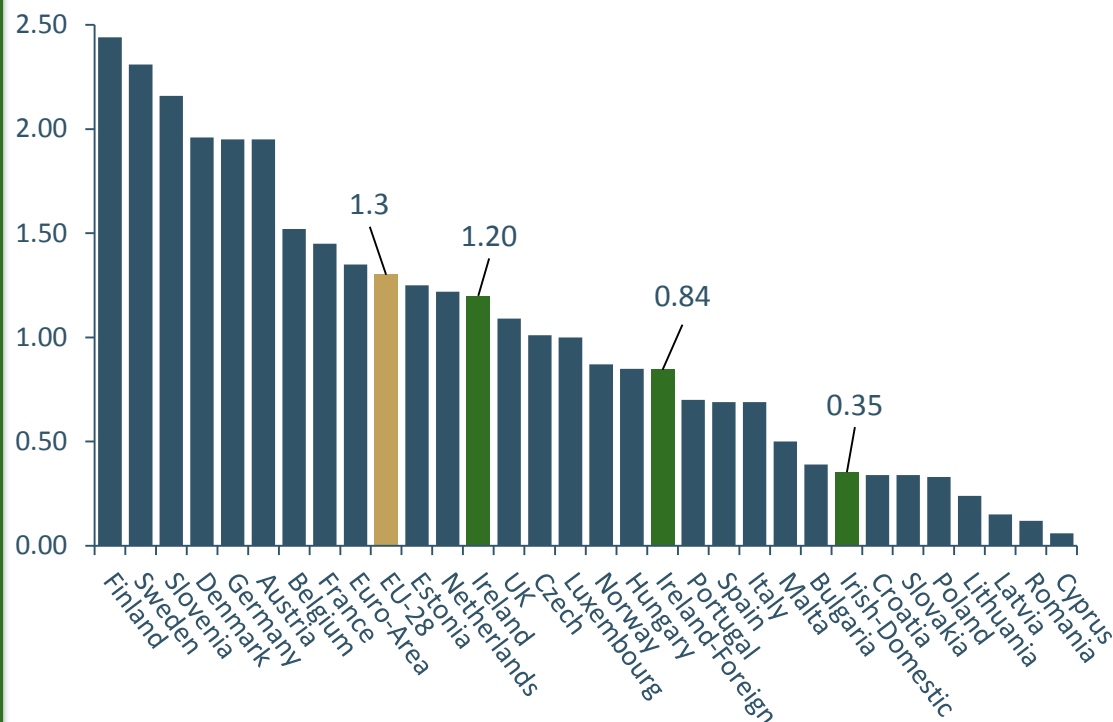


- Ireland has an R&D target of 2% of GDP by 2020
- BERD typically 66% of overall R&D (rule of thumb)
- Ireland's gap to the EU-28 average has converged
- But Ireland's BERD driven by foreign-owned sector – accounts for 70% of BERD
- Role of corporation tax regime and R&D tax credit





Research & Development (foreign and indigenous)



- EU-28 Business Expenditure on R&D (BERD):GDP ratio of 1.3%
- Ireland approximately 1.1% (formal target of 2.5%)
- Foreign-owned sector accounting for most of Ireland's BERD
- R&D activity by indigenous firms is at very low levels in comparative terms and is likely linked to the productivity story



Wrap-up

1. The foreign owned sector is very important for Ireland
 - 25% of overall GVA
 - 57% of business economy GVA
 - 22% of private sector employment
 - 50% of manufacturing employment
 - Highly productive
 - Very R&D active
2. But wider spillover benefits to the rest of the economy could be greater:
 - Mixed evidence of spillovers
 - Lower multipliers relative to rest of economy



Thank you

For more information please go to:

<http://www.finance.gov.ie>

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