

International Trade and Investment Report, 2000

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Forfás 

A report by Forfás to the Trade Advisory Forum and the Foreign Earnings Committee



Preface

Ireland has been a major participant in the accelerating “globalisation” of economic activity in the 1990s, as evidenced by the fast growth in flows of goods, services and direct investment between Ireland and the rest of the world. The value of international trade in goods and services between Ireland and the rest of the world as a proportion of Gross Domestic Product (GDP) jumped from 112 per cent in 1990 to 161 per cent in 1999, making Ireland one of the most open economies in the world. There are now few businesses in Ireland of a significant size that do not trade in goods and services with foreign customers or suppliers. Moreover, with the exception of Luxembourg, no other country in Europe exports as much per capita as Ireland, and Ireland’s surplus in merchandise trade as a percentage of national income is unparalleled in the industrialised world.

As both a source and destination economy for foreign direct investment (FDI) flows, Ireland has also been a major participant in the efforts of multinational companies to rationalise their activities on a global scale. During the 1990s, Ireland secured a share of global mobile direct investment flows out of all proportion to its economic size – investment flows that underpinned a radical restructuring of Ireland’s industrial base and led to rapid growth in both imports and exports. Of all EU countries, only Sweden received higher flows of FDI per capita in 1998-99. Ireland’s success in attracting high levels of inward direct investment, particularly into the manufacturing sector, over the last decade has been well documented. The flow of direct investment has not, however, been all in one direction. In 1999, outward flows of FDI were only marginally less than inward “industrial” direct investment, reflecting the emergence of a growing cohort of Irish multinational enterprises.

Cross-border flows of goods, services and investment are deeply inter-linked. With the proliferation of cross border mergers and acquisitions, an increasing proportion of global trade is conducted between affiliated units of large multinational enterprises. This has been particularly true for Ireland. Rising merchandise trade, in turn, creates cross-border demand for business support services, such as finance, trade facilitation and professional and technical services. Large and rising cross-border direct investment flows also affect the direction of international trade through their impact on exchange rates, as was evident by the sharp fall in the value of the euro against sterling and the dollar in 1999. Moreover, the establishment of an overseas presence is often the most efficient, and sometimes the only, delivery mechanism for overseas sales of professional, technical and other services.

While closely linked, there are also important distinctions between traditional cross-border trade and foreign direct investments. Unlike trade, foreign direct investment reflects the objective of establishing a more strategic and long-term engagement in a particular market. In contrast to trade, direct investment often comes together with technology transfer, innovation and specific managerial skills. What makes direct investment different from other types of cross-border investment is the entrepreneurial intention of the direct investor, expressed in a long-term investment horizon and the desire to have an effective voice in the management of the direct investment enterprise.

Foreign direct investment flows into Ireland in the 1990s originated mostly from export-oriented U.S. multinationals. By 1998, U.S.-owned companies in Ireland were responsible for 70 per cent of Irish industrial exports. High levels of foreign direct investment between Ireland and the United States have underpinned the remarkable expansion in trade relations between the two countries. If recent trends continue, the United States will overtake the United Kingdom as Ireland’s largest trading partner in merchandise goods by 2001. In the context of Irish participation in EMU, the growing integration of the Irish economy into that of the United States may present challenges for economic management and stability. Also, with a growing proportion of Irish trade conducted with countries outside the EU, multilateral trade rules agreed under the auspices of the World Trade Organisation (WTO) are becoming increasingly important in governing Irish trade relations with the rest of the world. Ireland must ensure that the interests of industry in Ireland are reflected in WTO negotiations likely to resume in 2001 to establish the framework for international trade relations in the 21st century.

The high degree of “internationalisation” of the Irish economy is partly a reflection of the small size of the domestic market. Access to foreign capital and export markets are prerequisites for expansion by Irish companies to a degree not experienced by firms in, say, the UK or the United States. Given the relatively limited pool of capital and labour resources in small countries, globalisation of economic activity allows companies and workers to specialise in the production of those activities where they have a comparative advantage, and to import those goods and services where they do not. In theory, this leads to higher average incomes and cheaper prices than would otherwise be the case.

However, the extreme openness of the Irish economy in terms of trade and investment, even compared with other small EU countries such as Finland, Austria and Denmark, suggests that the small size of the domestic market does not offer a full explanation. It is clear that the “outward” oriented industrial policy pursued by Irish authorities since the 1960s, in the form of generous tax and grant incentives for export-oriented inward investors, has also contributed significantly to the internationalisation of the economy. This is reflected in the dominance of foreign-owned firms in the Irish manufacturing sector and the huge flows of goods and services between multinational giants and their Irish subsidiaries. This policy boosted economic growth and average real incomes, particularly in the 1990s. But FDI-based export growth brings with it constraints as well as benefits. With the economy’s high degree of international exposure comes a requirement to maintain an investor friendly business environment. Government initiatives in the fields of taxation, employment, education, trade and infrastructure must continue to be scrutinised regarding their impact on the competitiveness of the enterprise sector in Ireland.

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Glossary of Terms/Definitions

CSO – Central Statistics Office

ECU – European Currency Unit

Eurostat – Statistical Office of the European Communities

Eurozone – Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

Foreign Direct Investment (FDI) is a category of international investment that, based on an equity ownership of at least ten per cent, reflects a lasting interest by a resident in one economy (the direct investor) in an enterprise resident in another economy (the direct investment enterprise). Using this criterion, a direct investment relationship can exist between a number of affiliated enterprises whether the linkage involves a single chain or a number of chains. Once the direct investment relationship is established, all subsequent financial flows between the related entities are recorded as direct investment transactions, whether they comprise equity capital, reinvested earnings or other capital.

Equity capital includes equity in branches and ordinary shares in subsidiaries and associates.

Other capital covers inter-company debt (including short-term loans such as trade credits) between direct investors and subsidiaries, branches and associates.

Reinvested earnings consist of the direct investor's share of earnings not distributed as dividends by subsidiaries or associates and earnings of branches not remitted to the direct investor.

FDI Flows and Stocks – Through direct investment flows the investors build up a direct investment stock (position), making part of the investor's balance sheet. The FDI stock (position) normally differs from accumulated flows because of revaluation (changes in prices or exchange rates) and other adjustments like rescheduling or cancellation of loans, debt forgiveness or debt-equity swaps with different values.

Portfolio investment covers the acquisition and disposal of equity and debt securities that cannot be classified under direct investment or reserve asset transactions. The securities involved are traded (or tradable) in organised financial markets.

IFSC – International Financial Services Centre

WTO – World Trade Organisation

Section 1 – Introduction and Overview

1.1 Introduction

- This is the first *Forfás International Trade and Investment Report*. The purpose of the report is to monitor trends in flows of trade and direct investment between Ireland and the rest of the world, to place Irish developments in an international context, and to raise international trade and investment issues for policy discussion. As the two main pillars of globalisation, trade and foreign direct investment flows are deeply inter-linked. It is therefore appropriate to examine them in a single context.
- From 2001 onwards, the report will be published each May/June, and will cover trade and investment trends in the previous year. As this is the first report, and is designed to establish a baseline comparison for future reports, analysis of trade and investment trends extends back several years, often covering the ten-year period from 1989 to 1999. The extensive period under review in this report prevented detailed analysis of trends in individual industry sectors. This will be undertaken in future reports.
- As well as analysing recent trade and direct investment patterns, it is envisaged that future reports will also include commentary on global policy developments affecting international trade and investment, market conditions in Ireland's main trading partners, as well as initiatives by Irish agencies to grow foreign earnings.

1.2 Overview - Merchandise Trade

- Global trade developments provided a benign scenario for the Irish economy in 1999. The value of world merchandise trade rose by 3.5 per cent in 1999, reaching \$5.5 trillion. With average trade prices down from 1998 levels, merchandise trade volumes expanded even faster, at an estimated 4.5 per cent.
- The value of Irish merchandise exports surged to an all-time high in 1999, climbing 15 per cent to IR£52.1 billion from IR£45.1 billion in 1998. As a result, the surplus in merchandise trade widened to IR£17.7 billion in 1999, up 28 per cent from IR£13.9 billion in 1998. The surplus in goods trade was equivalent to 26 per cent of GDP in 1999 - without parallel elsewhere in the industrialised world.
- On a per capita basis, Ireland exported more merchandise goods in 1999 than any other EU country with the exception of Luxembourg.
- Between 1990 and 1999 the value of Irish merchandise trade (exports plus imports) jumped by 322 per cent – a growth rate unmatched in any other country. This huge increase in Irish trade is almost entirely as a result of the high levels of foreign direct investment in the manufacturing sector over the last two decades. In the period 1991-98, foreign-owned firms accounted for 95 per cent of the growth in Irish industrial exports and at least 75 per cent of total export growth. The share of industrial exports by Irish-owned firms in the total fell from 26 per cent in 1991 to 12 per cent in 1998.
- FDI flows into Ireland during this period impacted significantly on the structure and market orientation of Irish export flows. The share of manufactured goods in total exports rose steadily during the 1990s, while there was a corresponding fall in the share of primary goods in total exports. There was also a shift in Irish trade away from the UK and other EU countries towards non-EU countries, particularly the United States. If present trends continue, the United States will overtake the UK as Ireland's largest trading partner by 2001.

- Transactions between affiliated units of multinational companies account for a large and growing share of Ireland's trade in goods.
- The export propensity (export sales as a proportion of gross output) of manufacturing industry rose steadily over the course of the 1990s, from an average of 73 per cent in 1991 to 83 per cent in 1998. This means that by the end of the decade only a small, and falling, proportion of Irish industrial output was destined for the home market.

1.3 Services Trade

- As throughout the 1990s, the trade in services account of the Irish balance of payments was in substantial deficit in 1999. At IR£19.3 billion, imports of services were almost twice the level of service exports (IR£10.9 billion), resulting in a services trade deficit of IR£8.4 billion. Service exports and imports both rose quickly in 1999.
- This large and widening services trade deficit is, to a large degree, a mirror image of the growing surpluses in merchandise trade, as there is a direct link between the many high-technology goods exports and payments by Irish-based companies for overseas royalties/licenses and other business services.
- In 1998, Ireland had the second highest level of service exports on a per capita basis of any EU country, behind only Austria. Ireland's largest service exports in 1999 were computer services, tourism and travel, financial services and other business services.
- Forfás data indicate that Irish exports of business services, as with merchandise goods, in 1999 were dominated by foreign-owned companies.

1.4 Direct Investment Flows

- Global flows of foreign direct investment (FDI) surged to around \$800 billion in 1999, an increase of around 25 per cent over 1998 levels. The main factor behind the large increase in global FDI flows was the exceptional wave of cross-border mergers and acquisitions. The United States was the single largest destination for FDI, taking in \$271 billion in direct investment inflows in 1999, mostly from EU countries.
- Total FDI flows into Ireland measured IR£14.0 billion in 1999, up from IR£6.2 billion in 1998. Of the 1999 total, IR£4.8 billion comprised traditional "industrial" direct investment by foreign-owned firms (up from IR£2.8 billion in 1998). The remaining IR£9.2 billion of inward FDI in 1999 went into enterprises associated with the International Financial Services Centre (up from IR£3.4 billion in 1998).
- Ireland attracts a disproportionate share of FDI inflows into the EU relative to its small population and economic size. While accounting for just over one per cent of EU GDP in 1999, Ireland took in over 5.7 per cent of total inward FDI flows into the EU in that year. On a per capita basis, of the EU-15 only Sweden attracted higher FDI inflows in 1998-99 than Ireland.
- Among the small EU economies, Ireland has been by far the greatest beneficiary of the large and rising levels of U.S. FDI into Europe over the course of the 1990s. According to U.S. statistics, in 1999 U.S. companies invested over \$3.4 billion in Ireland, equivalent to over six per cent of total U.S. FDI flows into the EU in that year. Most U.S. FDI in Ireland in 1999 was in the form of reinvested earnings, reflecting the large profits generated by existing U.S.-owned affiliates in Ireland.

- Irish resident companies directly invested IR£4.0 billion overseas in 1999, up from IR£2.7 billion in 1998 and less than IR£1.0 billion in 1990. Although well below total inward FDI in 1999, outward FDI flows were only just below non-IFSC related “industrial” inward investment of IR£4.8 billion.
- On a per capita basis outward investment from Ireland was well behind EU leaders Holland, Belgium/Luxembourg, Finland, and the UK.
- The main destination for outward direct investment for Irish companies in the 1990s was the United States. According to U.S. data, by 1999 the stock of Irish FDI assets in the United States had almost caught up with the stock of U.S. FDI assets in Ireland. These data show that between 1994 and 1999 Irish companies invested more in the United States than U.S. companies invested here.

1.5 Issues for Policy Consideration

- Ireland is unique among the 11 EU countries participating in European Economic and Monetary Union (EMU) in that its two largest trading partners, the UK and the United States, are outside the euro-zone. Only 20 per cent of Irish goods imports were sourced in other euro-zone countries in 1999. If present trends continue, the United States will overtake the UK as Ireland’s largest trading partner by 2002.
- While most Irish goods trade is still conducted within the Single European Market (SEM), and governed by EU rules, a growing share of trade is conducted outside the SEM, and is therefore mostly governed by multilateral agreements under the auspices of the World Trade Organisation (WTO). In conjunction with the Department of Enterprise, Trade and Employment, Forfás is planning an industry consultation process to determine the trade priorities of Irish industry in the new round of comprehensive WTO negotiations likely to resume in late 2001.
- In 1998, foreign-owned firms accounted for 88 per cent of industrial exports. Most of this comprised “intra-firm” trade between affiliated units of multinational companies. This may result in the absence of an extensive pool of workers skilled at export marketing available to work in Irish industry. On the positive side, growing trade between foreign-owned firms in Ireland and affiliated units around the world opens up new distribution channels for indigenous Irish exporters.
- The slowdown in measured industrial export growth by Irish-owned enterprises over this period may in part reflect a movement of firms from Irish to foreign ownership. It is also possible that indigenous firms have substituted domestic for export sales to exploit faster demand growth in the home market. For some industries, outward direct investment may have replaced traditional exporting as the most effective mechanism for exploiting foreign markets. The reasons behind the modest export performance of indigenous industry needs to be further explored.
- Further liberalisation of services trade, together with new advanced communications and information technologies will reinforce the “internationalisation” of global service industries over the coming years. Ireland is in a strong position to tap into the growing global market in services trade. Earlier this year, Enterprise Ireland published its *Internationally Traded Services 2007 (ITS 2007)* strategy, which targets four high-potential service sectors for export support. There is also a need to develop a more broadly based strategy for the development of tradable service industries in Ireland.

- Outward direct investment is often the most efficient delivery mechanism for overseas sales of many business, professional, and technical goods services. Ireland does not provide direct or indirect financial assistance to companies interested in investing overseas. Instead, Government currently facilitates outward investment through its network of Double Taxation Agreements and “soft” supports from Enterprise Ireland and its overseas network. The effectiveness of these services in facilitating companies investing overseas should be kept under review.
- Attracted by improved communications and transport links with the United States, the low corporate tax rate, improved communications and falling tariffs on trade in industrial goods between the EU and the United States, many U.S. multinationals are establishing in Ireland to sell not only into Europe and the Middle East, but also back into the domestic U.S. market. This may have implications for how the IDA markets Ireland as a base for U.S. industry.
- While the “internationalisation” of the Irish economy is partly a reflection of the small size of the domestic market, the extreme openness of the Irish economy in terms of trade and investment, even compared with other small EU countries such as Finland, Austria and Denmark, suggests that market size is not a full explanation. It is clear that the “outward oriented” industrial policy pursued by Irish authorities since the 1960s, in the form of generous tax and grant incentives for export-oriented inward investors, has also contributed significantly to the globalisation of the Irish economy.

Section 2 - Trade in Merchandise Goods

2.1 Global Developments in Merchandise Trade

Global trade developments provided a benign scenario for the Irish economy in 1999. As with every year since 1995, the U.S. economy provided the major stimulus to world trade and economic expansion, absorbing more than half of the increase in global merchandise exports. The more conservative projections of the negative global impact of the financial crisis in Asia and Latin America in 1997-98 on global output and trade flows turned out to be too pessimistic. The output of developing countries in Asia rebounded by six per cent, Russian GDP recovered by three per cent and Brazil's economy achieved positive growth for the full year of 1999. The main exception to the global recovery and expansion story in 1999 was Japan, whose economy continued to stagnate, while Western Europe's GDP growth decelerated to 2 per cent. Overall, the value of world merchandise trade rose by 3.5 per cent in 1999, reaching \$5.45 trillion.

Table 1 Growth in the Volume of World Merchandise Trade by Selected Region

(Percentage change)	Exports			Imports		
	1997	1998	1999	1997	1998	1999
World *	10.5	4.5	4.5	10.5	4.5	4.5
North America	11.0	3.5	4.5	13.0	10.5	10.5
Latin America	11.5	7.5	7.0	22.5	8.5	-2.0
Western Europe	9.5	5.5	3.5	9.0	8.5	3.5
European Union (15)	9.5	6.0	3.5	8.5	8.5	4.0
Transition economies	10.5	5.0	-3.0	13.5	5.0	-10.0
Asia	13.0	3.5	6.0	5.5	-8.5	9.0

* Average of export and import growth.

Note: Separate volume data are not available for Africa and the Middle East, although estimates for these regions have been made in order to calculate a world total.

Source: WTO, *Annual Report 2000*

Preliminary data on merchandise trade by region are provided in Table 1. The large variations in import volumes by region largely reflect the differences in regional demand and output growth. Demand in the United States and the Asian recovery were the motors of the global trade expansion in 1999, and both regions recorded import growth of nine per cent or above, or two times faster than the global average. The outstanding strength of U.S. investment and private consumption benefited not only the North American Free Trade Area (NAFTA), but also sustained the recovery in Asia and to a lesser extent output in Western Europe. A major factor behind the excellent performance of the U.S. economy was the high level of investment in information technology, the backbone of the "new economy." All countries with strong trade and investment ties with the United States, including Ireland, benefited from this development. The large increase in the U.S. current account deficit caused by increased imports was a positive cyclical element in the world economy in 1999, as it allowed output and employment growth to be sustained in foreign export industries, particularly in Asia, which faced excess capacity. The deficit also eased inflationary pressures in the United States where labour and capital are increasingly scarce.

At a sectoral level, the information technology sector and the automobile industry were the strongest performers in merchandise trade in 1999. Within the information technology sector, unit sales of personal computers rose by 22 per cent to 114 million units, and the dollar value of global sales of semi-conductors expanded by 18 per cent, to a new record level of US\$160 billion. One of the most dynamic branches of the global information technology industry in 1999 was mobile telephony. World-wide sales of cellular mobile phones reached 283 million units, an increase of two-thirds over 1998 sales. New registrations of passenger cars are estimated to have expanded by 5.5 per cent, lifting the production of passenger cars to a new high of 48.6 million units in 1999.

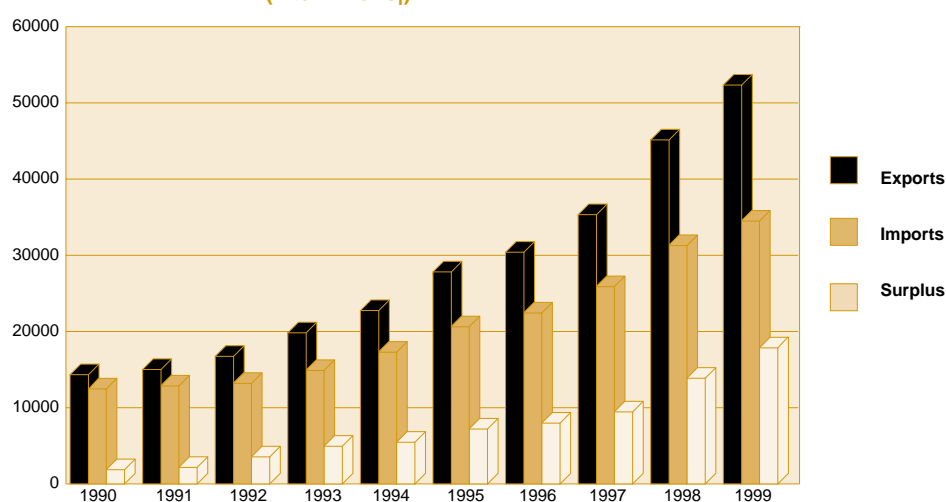
Prices of internationally traded goods decreased slightly in 1999 as the large increase in oil prices was offset by a further decrease in the prices of non-fuel commodities and manufactured goods. Among non-fuel commodities, the price of food and beverages decreased by more than 15 per cent while those of agricultural materials and metals remained roughly unchanged, although they started to strengthen in the second half of 1999. The decrease in the dollar price of manufactured goods can be attributed to the fall in prices of office and telecom equipment as well as the strength of the U.S. dollar vis-à-vis the euro and the near absence of inflation in the goods sector of all major economies.

Oil prices tripled from ten dollars per barrel in February 1999 to 30 dollars in the first quarter of 2000, and concerns about the downstream impact on consumer prices were evident throughout most of the world. However, the marked reduction in the oil intensity of output in the industrial countries - by about 40 per cent since the first oil price hike more than 25 years ago - has reduced the risk of an oil-induced inflationary surge considerably. The impact of rising oil prices has also been softened by the increased role of natural gas in world fuels trade. While the impact of the rebounding oil prices has been small on consumer prices in 1999, the impact was dramatic on the export revenues of the oil exporters. The Middle East recorded export growth in excess of 20 per cent in 1999, but this did not fully offset a corresponding decline in 1998.

2.2 Growth in Irish Merchandise Trade

Rising global import demand and increased competitiveness in Ireland's manufacturing industry provided a major stimulus to Irish trade with the rest of the world in 1999. The value of Irish merchandise exports surged to a new all-time high, climbing 15 per cent to IR£52.1 billion from IR£45.1 billion in 1998. Comparing the 1999 figures with those of 1998 shows that exports of computer equipment rose from IR£10.2 billion to IR£11.8 billion (up 17 per cent) and exports of organic chemicals rose from IR£7.8 billion to IR£8.9 billion (up 14 per cent). Import growth was also buoyant, reflecting strong growth in domestic demand and the import-intensity of merchandise exports. The value of merchandise imports in 1999 measured IR£34.3 billion, up 10 per cent from IR£31.3 billion in 1998. Altogether, the surplus in merchandise trade widened further in 1999 to reach IR£17.7 billion, up 28 per cent from IR£13.9 billion in 1998. Between 1998 and 1999, export prices rose by 0.4 per cent and import prices rose by three per cent. These changes, taken in conjunction with the increases in the value of trade, imply year-on-year volume increases of 6.5 per cent for imports and 14.9 per cent for exports.

Figure 1 Growth in Irish Merchandise trade, 1990-99 (IR£ Millions)

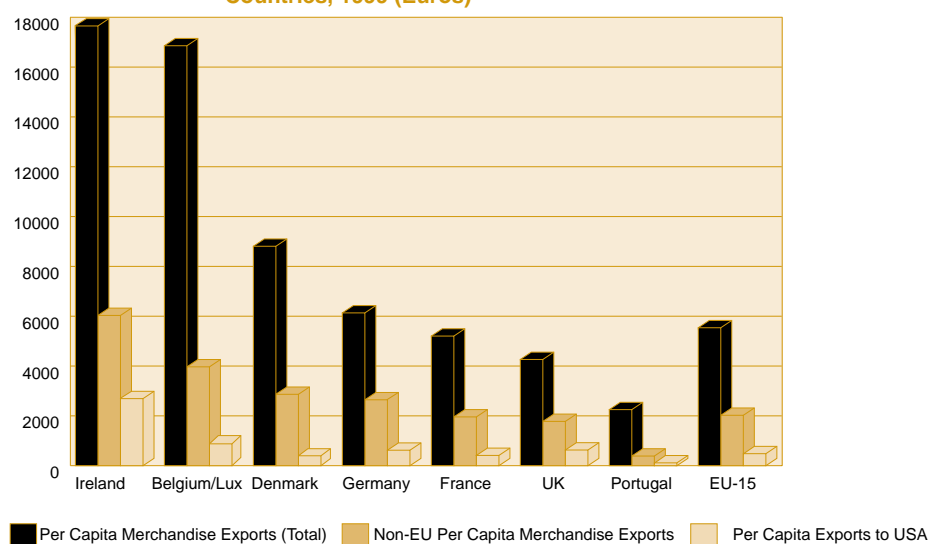


Source: Central Statistics Office, *Trade Statistics*

The size of Ireland's merchandise trade surplus, equivalent to over 26 per cent of GDP in 1999, was without parallel elsewhere in the industrialised world. With Ireland's terms of trade deteriorating gradually over the course of the 1990s, the ballooning of the trade surplus over this period reflects massive growth in Irish export volumes. During a period when the value of world exports increased by around 75 per cent, the value of Irish merchandise exports grew by 263 per cent, from just IR£14.3 billion in 1990 to IR£52.1 billion in 1999. While average export prices over this period were up by just over 10 per cent, export volumes in 1999 had more than tripled from 1990 levels. While import volumes also grew rapidly, and import prices moderately, the size of the merchandise trade surplus nonetheless grew almost tenfold from IR£1.8 billion in 1990 to IR£17.7 billion in 1999. Altogether, between 1990 and 1999 the value of Irish merchandise trade (exports plus imports) increased by 322 per cent – a growth rate unmatched in any other industrialised country. This huge expansion in merchandise trade was the main driver of rapid Irish economic growth over this period. By 1999, net merchandise trade (exports less imports) accounted for 26 per cent of total Irish economic activity, up from just 6.5 per cent in 1990. The widening of the merchandise trade surplus accounted for 42 per cent of the increase in Ireland's GDP during the 1990s.

The key to understanding Ireland's merchandise trade performance in recent years lies with foreign direct investment (FDI) flows. During the late 1980s and early 1990s, the capacity and competitiveness of the Irish manufacturing sector was transformed by large FDI inflows, mostly into the chemicals, computers (both hardware and software) and high-tech engineering sectors (see Section 4.2). This led to a situation where, by the mid-1990s, Irish manufacturing had become heavily concentrated in those high-tech sectors that were to enjoy exponential global demand growth over the remainder of the decade. Only through the introduction of foreign capital, technology and world-class management techniques was the manufacturing sector in Ireland able to sustain the 14 per cent average annual increase in merchandise exports between 1990 and 1999. It is striking that in the period 1991-98, foreign-owned firms accounted for 95 per cent of the growth in Irish industrial exports, and by 1999 foreign-owned industry accounted for an estimated IR£38 billion, or almost three-quarters, of total Irish goods exports¹. With high-tech, foreign-owned, manufacturing dominating Irish economic activity to a degree not seen elsewhere in the industrialised world, the corollary has been limited development in the services industry compared with other advanced economies, as reflected by a large and widening deficit in cross-border services trade (Section 3.2).

Figure 2 Per Capita Merchandise Exports by Selected EU Countries, 1999 (Euros)



Source Eurostat, *EU Trade Statistics*

The high merchandise export intensity of the Irish economy is further evidenced by comparative per capita merchandise export figures. In 1999, Ireland exported €17,651 (IR£13,909) worth of goods for every man, woman and child in the country, over three times the average of €5,537 for the EU-15 as a whole. Our nearest challenger in the per capita export stakes was Belgium/Luxembourg², with €16,857

¹ Industrial exports comprise manufactured items such as machinery and transport equipment (including computers), packaged software, chemicals and other miscellaneous manufactured items. Non-industrial exports comprise food and other unprocessed primary materials and commodities.

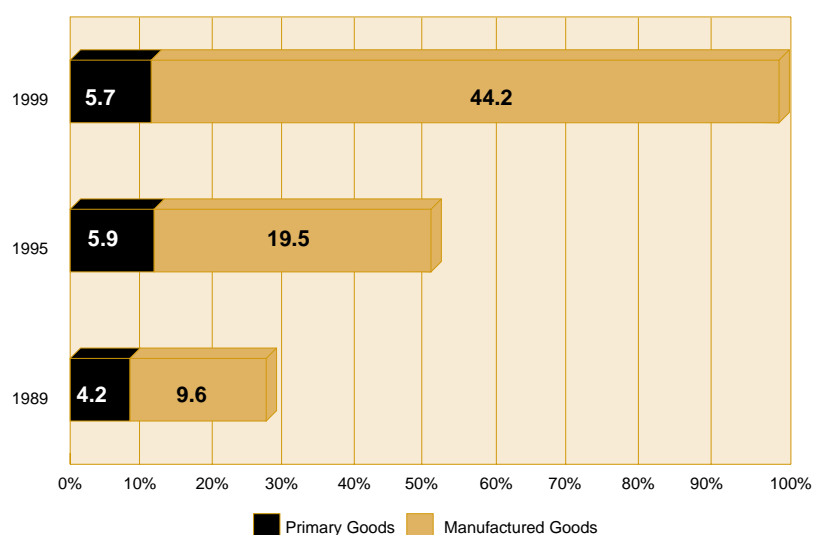
² Treated as a single economic unit in international trade statistics.

in merchandise exports per capita in 1999. At the bottom of the ladder was Portugal, which exported just €2,251 worth of merchandise goods on a per capita basis. As shown in Figure 2, on a per capita basis Ireland recorded well-above average levels of both EU and non-EU exports in 1999, with Irish exports to the USA particularly well above the average.

2.3 Structure of Irish Merchandise Exports and Imports

As well as boosting the volumes of Irish goods exports during the 1990s, FDI flows into Ireland during this period also brought about significant changes in the composition and market orientation of Irish export flows. In 1989, primary goods³ still accounted for 30 per cent of total Irish goods exports by value, with manufactured exports⁴ accounting for 70 per cent of the total. Reflecting the high levels of FDI into manufacturing industry during the 1990s, the share of manufactured exports in the total rose to 89 per cent by 1999. Correspondingly, the share of primary goods in total merchandise exports fell to 23 per cent in 1995 and to just 11 per cent by 1999. This development is significant, as both value-added and wages are higher in manufacturing than in primary goods industries.

Figure 3 Structure of Irish Merchandise Exports 1989-99 (IR£ Billions)



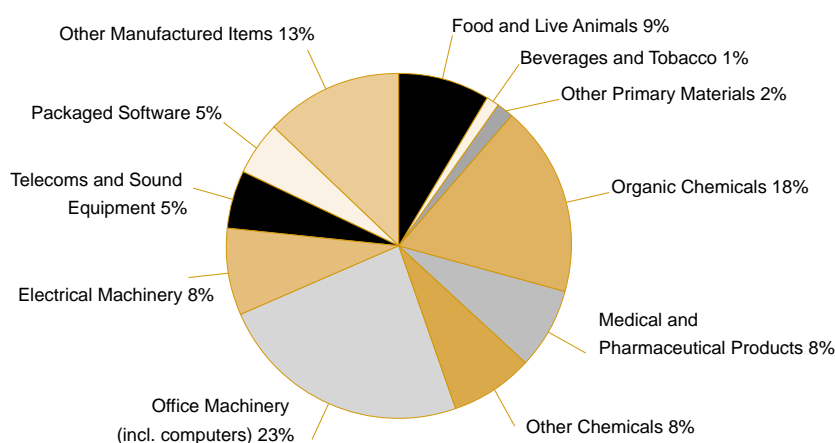
Source: Central Statistics Office, *Trade Statistics*

Of the IR£24.8 billion increase in merchandise exports between 1995 and 1999, IR£22.5 billion was made up by just two manufacturing sectors, chemicals (IR£11.5 billion) and machinery and transport equipment (IR£11.0 billion), while the value of primary goods exports actually declined over the same period. By 1999, export sales of machinery and transport equipment alone measured IR£20.4 billion, or just under 40 per cent of total Irish goods exports. Within this sector, the greatest foreign earnings generators were export sales of office machinery and computer equipment (IR£11.9 billion), electrical machinery (mostly integrated circuit boards and microchips) (IR£4.1 billion) and sound and telecoms equipment (IR£2.7 billion). The chemicals industry generated IR£16.6 billion in export sales in 1999, or just under 32 per cent of total goods exports. Within this, organic chemicals was the largest export, with IR£8.9 billion in overseas sales, followed by medical and pharmaceutical products (IR£3.8 billion) and essential oils and perfume materials (IR£1.9 billion).

3 Food and Live Animals, Beverages and Tobacco, Crude Materials, Mineral Fuels, Lubricants and Related Materials, and Animal and Vegetable Oils Fats and Waxes

4 Chemicals and Related Products, Manufactured Goods Classified Chiefly by Material, Machinery and Transport Equipment, and Miscellaneous Manufactured Items

Figure 4 Irish Merchandise Exports by Industry Sector, 1999



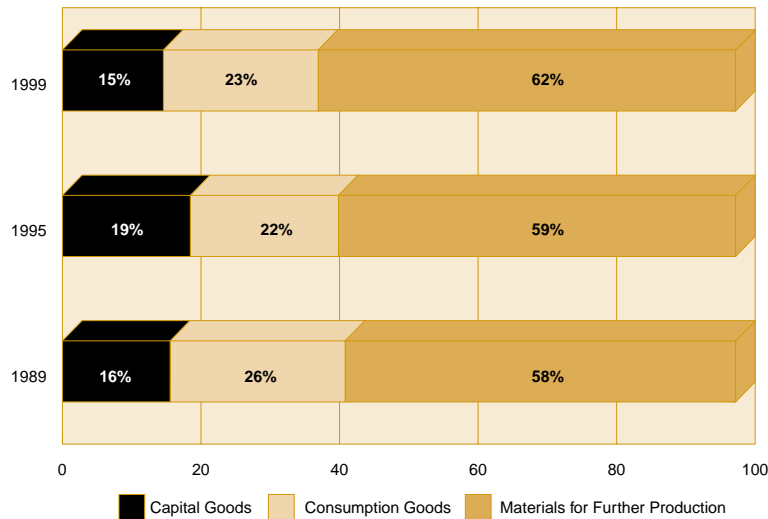
Source: CSO, *Trade Statistics*

At IR£4.3 billion in 1999, the value of food and live animal exports increased only moderately during the 1990s. As a result, the industry's contribution to total goods exports fell from 22 per cent in 1990 to just nine per cent last year. Within the food industry, beef and dairy products were the main export generators, bringing in IR£1.4 billion and IR£785 million in export sales respectively. Other industries generating strong overseas exports in 1999 were packaged software (IR£2.5 billion), scientific equipment (IR£1.1 billion) and beverages and tobacco (IR£601 million).

Ireland's export base is highly concentrated compared with most other advanced economies. In 1999, forty per cent of Irish merchandise exports by value were accounted for by just two industrial sectors, organic chemicals and office machines and data processing equipment (including computers). While this leaves the Irish economy vulnerable to unforeseeable technology developments, such export concentration may be unavoidable for a small open economy seeking higher living standards. With a population of just 3.7 million, Ireland is too small to support a highly differentiated industrial base. To achieve economic efficiency and prosperity, it is necessary that Ireland specialises in a small number of high-technology tradable industries, relying on imports to satisfy a wide range of industrial and consumer needs.

High levels of inward FDI and the resulting export boom were also reflected in changes in the composition of Ireland's merchandise imports during the 1990s. In 1989, goods for final consumption accounted for 26 per cent of total merchandise imports, while capital goods and materials for further production made up 16 per cent and 58 per cent of the total respectively. Reflecting the high levels of investment in manufacturing industry by foreign (and domestic) companies, the share of capital goods (primarily plant and machinery) in total merchandise imports had risen to 19 per cent in 1995. This fell back to 15 per cent in 1999, although absolute levels of capital goods imports continued to rise throughout the intervening period. Likewise, the strength of export-intensive manufacturing activity, which is highly dependent on imported inputs, pushed the share of materials for further production in total goods imports up to 59 per cent in 1995 and 62 per cent in 1999. The share of consumer goods in total merchandise imports fell over the 1989-1999 from 26 per cent to 23 per cent, although there has been a small increase since 1995 reflecting the strong upturn in domestic consumption demand in recent years.

Figure 5 Irish Merchandise Imports by Main Use, 1989-99



Source: CSO, *Trade Statistics*

2.4 Intra-firm transactions account for a rising proportion of total Irish trade

Cross-border transactions between affiliated units of multinational companies account for a growing share of Ireland's trade in goods - yet another effect of the surge of inward FDI over the last decade. Although detailed statistics are not available, it seems likely that the vast bulk of imported materials for further production is accounted for by transactions within multinational systems. As noted earlier, the share of materials for further production in total goods imports rose steadily during the 1990s, reaching 62 per cent in 1999. This development reflects the growing tendency of large manufacturing companies, particularly from the United States, to split complex manufacturing production processes between affiliated entities in different geographic regions and countries. For most U.S. and other foreign manufacturing companies in Ireland, the activities here represent but one stage in a long transformation from raw materials to final finished products.

It is certain that a significant proportion of Ireland's total goods exports are also intra-firm sales by foreign-owned MNCs to their parent companies or other related entities. This applies particularly to the chemicals and machinery and transport equipment sectors, which in 1999 accounted for 71 per cent of total Irish goods exports. The focus on intra-firm, rather than arms-length, sales by foreign multinationals in Ireland is generally reflected in the skills profile of their Irish workforces. The high demand from multinationals for skilled workers in finance, logistics and operations is not matched by demand for sales and marketing executives. With the emergence of a new cohort of "multinational" Irish companies, it also seems likely that a growing, albeit still small, proportion of indigenous merchandise exports are intra-firm sales, although this is more likely to be connected with goods for resale by foreign affiliates through distribution and marketing activities without further manufacture.

The rising share of intra-firm trade in total Irish goods trade may also be a reflection of Ireland's steady march up the value-added chain in the distribution of global economic activity during the last two decades. Research in the United States has demonstrated that there is a positive correlation between the share of intra-firm trade in total goods trade between two countries and the income levels in the trading partners⁵. A local presence in overseas markets through the establishment of wholesale trade affiliates or manufacturing entities - and the associated replacement of arm's-length transactions with intra-firm trade - is often required for the marketing of sophisticated, heterogeneous manufactured products (such as advanced machinery products), which tend to be both supplied from and sold to higher income countries.

5 "U.S. Intrafirm Trade in Goods", William Zeile, Bureau of Economic Analysis, U.S. Department of Commerce

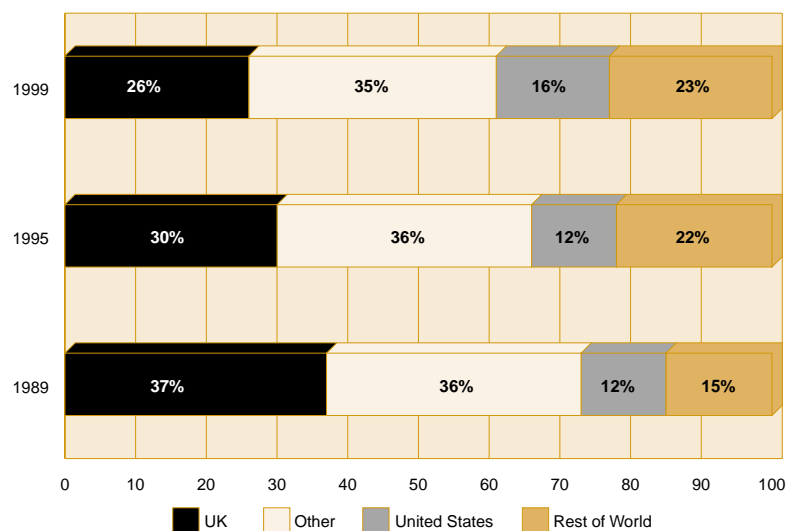
From Ireland's perspective, the rising share of intra-firm trade in total goods trade is important because intra-firm trade may respond differently than trade between unrelated parties to changes in economic conditions. Intra-firm trade may, at least in the short-run, be more insulated from competitive forces in particular markets or from overall changes in prices, exchange rates or general economic conditions. Furthermore, "transfer prices" – the prices for intra-firm trade arranged by the affiliates – have their own unique characteristics often unrelated to market prices and costs.

2.5 Export Orientation - Multinationals have caused a shift away from UK trade

As well as impacting on the size and composition of Irish merchandise trade flows, FDI flows into the Irish manufacturing sector over the last decade have caused a significant shift in the market orientation (geographic focus) of Irish goods trade. The UK's share of Irish goods trade fell from 37 per cent in 1989 to 30 per cent in 1995, and down to 26 per cent in 1999. Conversely, the share in total Irish trade of both the United States and the rest of the world (non-EU) grew strongly, while the share of other EU countries (besides the UK) dropped marginally over the same period. This falling trade dependence on the UK, and the corresponding rising exposure to non-EU trade, in large part reflects the global export and import linkages of foreign (and particularly U.S.) manufacturing multinationals operating in Ireland. These operations import raw materials and other inputs from affiliated and non-affiliated companies around the world, and produce not just for the domestic, UK and continental EU markets, but also increasingly for Asian, Middle Eastern and, most of all, for export back to the United States (see below).

In 1998, only 17 per cent of industrial exports from foreign-owned firms in Ireland was destined for the UK market, in contrast to over 41 per cent from Irish-owned firms. From a trade policy perspective this development is significant. While most Irish goods trade is still conducted within the EU, and governed by single market rules, a growing share of our trade is conducted outside the EU, and is therefore conducted in the framework of multilateral agreements under the auspices of the WTO (see Section 5.2).

Figure 6 Irish Merchandise Trade by Region, 1998-99



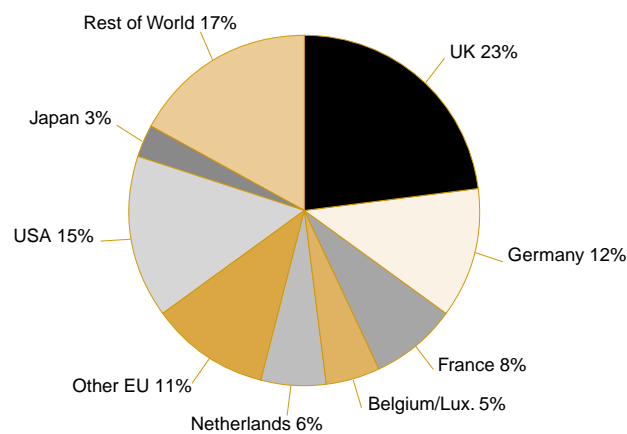
Source: CSO, *Trade Statistics*

Despite its falling share of total Irish trade, the UK remains, not surprisingly, by far Ireland's most important trading partner. In 1999, for example, the UK accounted for 23 per cent of total goods exports, while a third of all goods imports came from the UK. After the UK, the United States was Ireland's next biggest trading partner in 1999, both as a destination for merchandise exports and a source for imports, accounting for 15 per cent and 17 per cent of the totals respectively. After the USA came Germany, accounting for 10 per cent of Ireland's merchandise trade flows, France (seven per cent), the Netherlands (five per cent) and Belgium-Luxembourg (four per cent). In total, the EU took in 65 per cent of Irish goods exports, and supplied 55 per cent of our goods imports. Beyond the EU and the

United States, Japan was our next biggest trading partner, accounting for six per cent of our goods imports and three per cent of our exports. Other significant non-EU destinations for Irish exports in 1999 were Australia, Malaysia, Norway and Switzerland. China, Taiwan, Malaysia and Singapore were significant sources for imports.

Irish export performance in individual markets in 1999 broadly reflected overseas economic conditions. The booming U.S. market was Ireland's fastest growing export destination, with total goods exports there increasing by an impressive 32 per cent to surpass IR£8.0 billion, up from IR£6.1 billion in 1998. Strong economic growth and rising interest rates in the United States also attracted huge capital inflows from Europe (including Ireland), driving down the euro against the dollar, and further spurring Irish U.S.-bound exports. The weak euro and a strong economy also saw Irish goods exports to mainland Britain rise quickly to IR£10.2 billion in 1999, up 11 per cent on 1998 levels. Weaker growth in the Northern Irish economy partly explains a four per cent fall in Irish goods exports there to IR£1.1 billion over the same period, although the balance of trade remains in the Republic's favour.

Figure 7 Irish Merchandise Exports by Destination, 1999
Total = IR£52,061 Million



Source: CSO, *Trade Statistics*

In continental Europe, there were large increases in the value of merchandise exports to Italy (up 28 per cent), the Netherlands (up 27 per cent) and France (up 17 per cent). In contrast, there was a five per cent fall in the value of goods exports both to Germany, down to IR£6.2 billion, and to Belgium/Luxembourg, down to IR£1.1 billion, partly reflecting difficult economic conditions in both these countries in 1999. Economic recovery in South East Asia over the course of 1999 was clearly reflected in Ireland's export performance in the region. The value of Ireland's combined goods exports to Hong Kong, Malaysia, Singapore, South Korea and Thailand rebounded to IR£1.6 billion in 1999, a rise of 42 per cent, following a small contraction in exports to the region in 1998 in the wake of the Asian financial crisis. Goods exports to Japan rose by 28 per cent to IR£1.5 billion, despite ongoing economic difficulties there.

The value of total trade between Ireland and the United States increased by a factor of almost five in the decade to 1999, increasing the U.S. share in total Irish goods trade from 12 to 16 per cent. This blooming of Ireland's trade relationship with the world's largest economy reflects not only the strong growth in domestic demand conditions in both countries over the period, but also Ireland's deepening links with the U.S. economy brought about by high levels of two-way direct investment flows (see Section 4). This is evidenced by the fact that Irish export growth to the United States is mostly accounted for by those sectors of the economy dominated by U.S. multinationals - chemicals and computer hardware and software. Attracted by improved communications and transport links with the United States, the low Irish corporate tax rate, a skilled English-speaking workforce and falling tariffs on trade in industrial goods between the EU and the United States, many U.S. multinationals are

establishing in Ireland to sell not only into Europe and the Middle East, but also back into the domestic U.S. market. Accordingly, while Ireland accounts for only one per cent of total EU economic activity, Irish-U.S. trade makes up over five per cent of total merchandise trade between the EU and the United States. Indeed, Ireland's share of U.S.-EU trade is significantly larger than that of much bigger EU economies such as Belgium, Spain, the Netherlands and Sweden. At a sectoral level, Ireland accounts for over a third of EU exports of organic chemicals to the United States, over 14 per cent of EU exports of pharmaceuticals and medical equipment, and almost 10 per cent of EU computer exports to the United States. It is clear that Ireland is no longer at the periphery of a large European market, but is instead at the centre of a fast-growing transatlantic market in industrial goods.

Table 2 Irish Merchandise Trade Balances by Region, 1999

(IR£ millions)	Exports	Imports	Trade Balance
EU	33,625	18,824	14,801
Rest of Europe	2,797	1,073	1,724
North America (USA + Can.)	8,301	6,005	2,296
Central and South America	475	231	244
Asia	3,854	6,432	-2,587
Near and Middle East	752	247	505
Africa	758	252	506
Australasia	508	68	440
Total	52,061	34,317	17,744

Source: Central Statistics Office, *Trade Statistics*

With the exception of Asia, Ireland enjoyed a strongly positive merchandise trade balance with every region of the world in 1999. Of the total merchandise trade surplus of IR£17.7 billion, trade with other EU countries made up IR£14.8 billion, with trade with the rest of Europe and North America making up most of the rest of the overall surplus. Ireland's trade with Africa was relatively insignificant, and was dominated by trade with South Africa, Nigeria, Guinea, Egypt, Morocco and Algeria (mostly exports of computers, chemicals and food items and imports of vegetables and fruit, and metal ores and other minerals). Irish trade with Latin America was also modest, and was dominated by Mexico, Brazil, Argentina and Costa Rica, mostly involving imports of computers, electrical machinery, beef, coffee, animal feed, vegetables and fruit and exports of organic chemicals, medical and pharmaceutical products and computers. Merchandise trade between Ireland and Asia expanded rapidly in the 1990s, with imports from the region in 1999 exceeding exports by IR£2.6 billion. Trade in both directions consisted mostly of organic chemicals, medical and pharmaceutical products, computer hardware and software, electrical machinery and road vehicles. Other large import items from Asia included toys, consumer electronics and road vehicles.

Israel was by far Ireland's largest trading partner in the Near and Middle East, accounting for 86 per cent of all imports from the region and 30 per cent of all exports (most Irish oil imports come from the UK's North Sea). Imports from Israel consisted mostly of software, scientific equipment and telecommunications equipment, while computer hardware and software and chemicals formed the bulk of exports there. Other major Irish exports to the Near and Middle East included food and live animals, computer equipment and chemicals destined for Saudi Arabia, United Arab Emirates, Lebanon and Kuwait. In 1999, Ireland exported IR£455 million worth of goods to Australia, while importing only IR£49 million of goods. Exports there consisted mostly of computer software and hardware and chemicals, while the largest individual import item from Australia was beverages (mostly beer and wine). Other trade with the Australasia region in 1999 was dominated by New Zealand, the destination for IR£37 million worth of Irish-made goods, and the source of IR£17 million of goods imports.

2.6 Merchandise Trade and EMU

Ireland is unique among the 11 EU countries participating in European Economic and Monetary Union (EMU) in that its two largest trading partners, the UK and the United States, are outside the euro-zone. This leaves the Irish economy more vulnerable than other euro participants to fluctuations in the external value of the euro, particularly against sterling and the U.S. dollar, and to changes in economic conditions outside the euro-zone. The arrival of EMU was expected to lead to a diversion of trade away from non-euro countries, particularly the UK, towards other euro-zone members, as Irish businesses sought to lower their exposure to currency fluctuations. There has, however, been little evidence of this to date. While the share of Irish goods imports originating in other euro-zone countries increased in 1999, to 20.4 per cent from 18.7 per cent in 1998, it remains very small relative to that of other countries participating in EMU. The share of total goods exports destined for other euro-zone countries declined in 1999, to 39.9 per cent from 42.3 per cent in 1998. Altogether, just 32.2 per cent of Irish merchandise trade (imports plus exports) was conducted with other euro-zone countries in 1999, down marginally from 32.6 per cent the previous year, and the lowest percentage of any euro-zone member. Of course, these data are based on only one year's trade developments, and may reflect cyclical economic trends that more than offset the euro's impact.

While the recent weakness in the external value of the euro is a plus for Irish exporters to the UK and the United States, it also leaves many Irish exporters to other euro-zone countries vulnerable to rising costs and declining competitiveness. This is because of the large disjunction between the shares of Irish imports originating from other euro-zone countries (20 per cent) and the share of Irish exports destined for other euro-zone economies (40 per cent). With almost 80 per cent of Irish goods imports sourced outside the euro-zone in 1999, the cost of imported consumer goods, capital equipment and materials for further production is highly sensitive to fluctuations in the external value of the euro. As a result, a weak euro (particularly against sterling and the dollar) raises the costs of business for most Irish exporters. While the impact of competitiveness for Irish exporters into the UK and U.S. markets is more than offset by higher euro-denominated export prices, this is not the case for the 40 per cent of Irish export sales that are destined for other euro-zone economies.

2.7 Market Share Analysis

Import market share is the proportion of a country's total imports accounted for by a particular trading partner. For the trading partner in question, import market share is a good indicator of national competitiveness and demonstrates in a meaningful way the results of efficient production and trade delivery mechanisms. Specifically, import market share analysis can help explain whether a country's export growth is the result of growing aggregate import demand among its trading partners, or improved competitiveness and export penetration in overseas markets.

Figure 8 Share of World Import Market by EU Member States, 1993-98

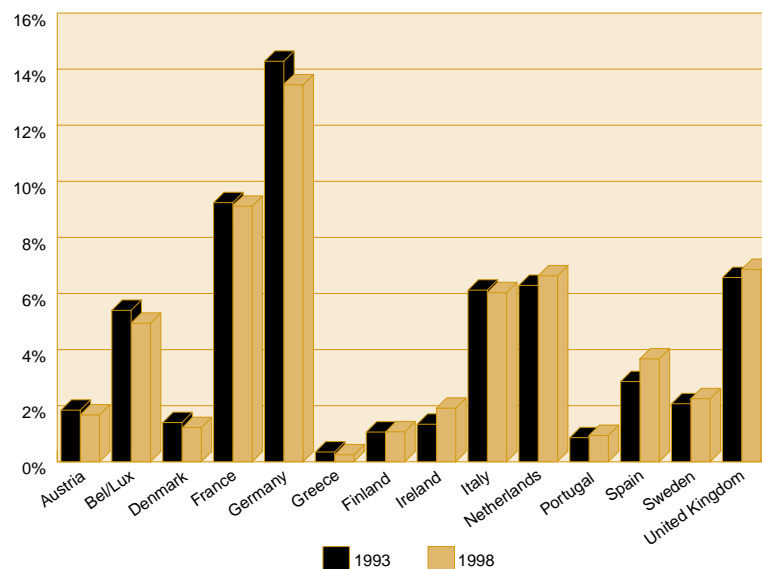
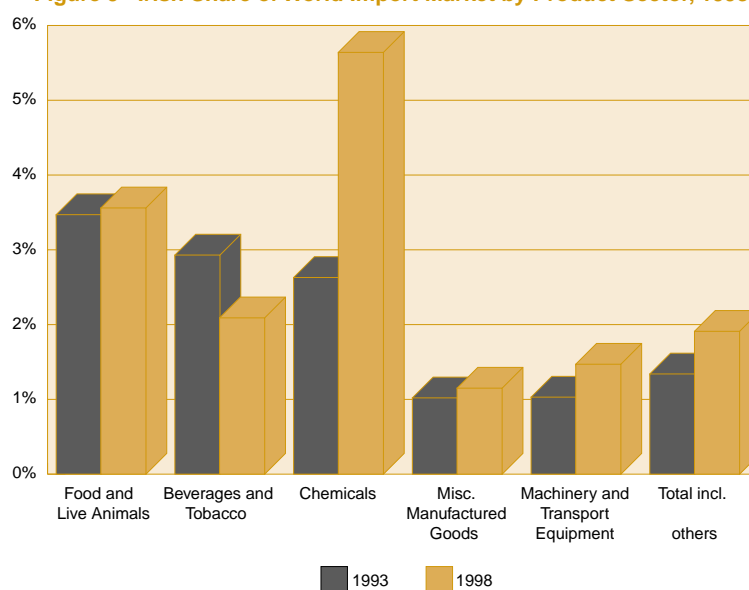


Figure 8 charts the shares of Ireland and other EU countries of the global market for merchandise imports for the years 1993 and 1998. During the period in question, Ireland's share of the world's import market grew from 1.34 per cent in 1993 to 1.91 per cent in 1998, an improvement of 43 per cent – greater than any other EU country. To put this into context, of the IR£32.2 billion in increased Irish goods exports over this period, higher export penetration and rising market share in world markets accounted for IR£13.7 billion, while the remaining IR£18.5 billion increase was accounted for by rising global import demand, i.e. Ireland maintaining its slice of a “growing pie”. In comparison, the UK has increased its share of the global import market by a modest four per cent over the period in question (from 6.57 per cent to 6.86 per cent). Other small EU countries, including, Belgium/Luxembourg, Austria, Denmark, Greece and Finland all recorded static or falling shares of the global market for merchandise imports over the same period. By 1998, Ireland enjoyed a greater share of the world import market than Austria, Denmark, Greece, Finland and Portugal.

Figure 9 Irish Share of World Import Market by Product Sector, 1993-98



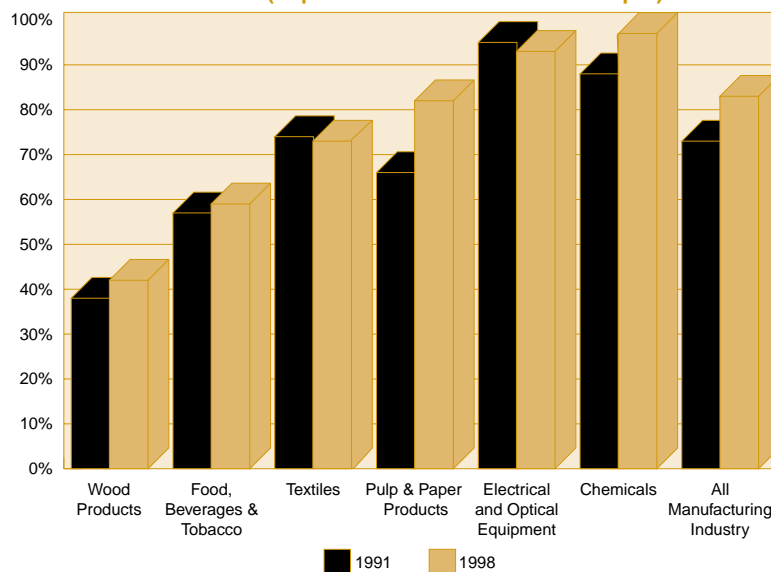
Source: OECD, *OECD Trade Statistics*

The dramatic growth in Irish chemicals exports was the main contributor to the overall growth in Ireland's share of world markets. Between 1993 and 1998, the share of world chemicals imports sourced in Ireland more than doubled from 2.63 to 5.64 per cent. Ireland's share of world imports of machinery and transport equipment (mainly computers and computer equipment) and miscellaneous manufactured goods (including packaged software) also rose significantly over this period. In contrast, Ireland's share of world imports of beverages and tobacco declined from 2.93 per cent in 1993 to 2.09 per cent in 1998, while Irish exports of food and live animals enjoyed a modest increase in world import share from 3.47 per cent in 1993 to 3.56 per cent in 1998.

2.8 Export Propensity of Irish Industry

The export propensity (export sales as a proportion of gross output) of Irish manufacturing industry rose steadily over the course of the 1990s, from an average of 73 per cent in 1991 to 83 per cent in 1998. This means that by the end of the decade only a small, and falling, proportion of Irish industrial output was destined for the home market. By 1998, export propensity was highest in the chemicals and electronic and optical equipment sectors (including computers) at 97 and 93 per cent respectively – industries dominated by high-technology export-oriented multinationals. Even in lower technology industries with a bigger representation of Irish-owned firms, a high proportion of output was exported. In the pulp and paper products sector, for example, 82 per cent of output in 1998 was exported, up from 66 per cent in 1991. Similarly, export sales as a proportion of total output in the food, beverages and tobacco industry rose from 57 per cent to 59 per cent over the same period, and remained at 73 per cent for the textiles industry. Of all the major industrial sectors, only the wood and wood products industry produced more than half of its output for domestic consumption, and even in this industry export propensity rose from 38 to 42 per cent in the 1991-98 period.

Figure 10 Export Propensities in Selected Manufacturing Industries, 1991-98 (Export Sales as a % of Gross Output)



Source: CSO, *Census of Industrial Production*

2.9 Multinational vs. Indigenous Exports

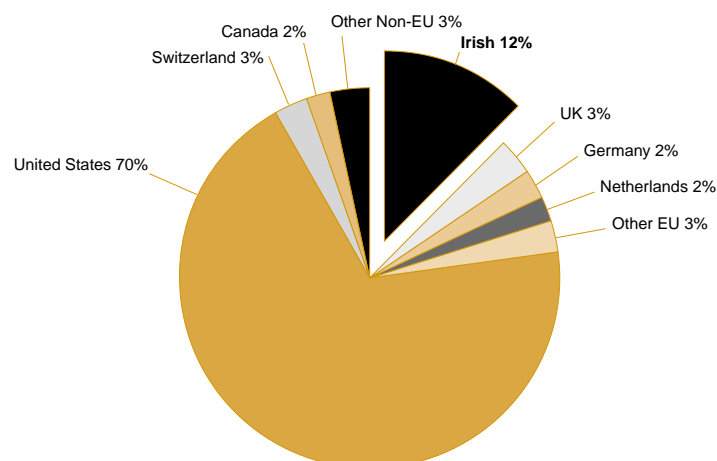
According to the CSO's 1998 Census of Industrial Production (CIP)⁶, Irish-owned firms accounted for IR£4.6 billion, or 12 per cent, of the IR£36.7 billion in industrial exports in that year. Correspondingly, foreign-owned companies accounted for IR£32.2 billion (88 per cent) of industrial exports – a situation without parallel in any other advanced economy. U.S.-owned firms alone exported IR£25.3 billion in industrial goods in 1998, or 70 per cent of the total. As shown in Figure 11, companies from other foreign countries recorded significant shares of Irish industrial exports, including UK firms (three per cent), Swiss (three per cent) and German (two per cent).

The CIP measures only exports by industrial firms employing more than three people. According to other CSO sources, the value of total merchandise exports in 1998 (including non-industrial goods exports and industrial exports from firms employing less than three people) came to IR£45.1 billion. The IR£8.4 billion difference between the two export measures relates mostly to indigenous non-industrial exporters involved in agriculture and other primary industries, as well as some small indigenous industrial firms not surveyed in the CIP. Even assuming that the whole IR£8.4 billion is accounted for entirely by indigenous exporters, which is unlikely, exports by Irish-owned firms in 1998 still accounted for only 35 per cent of total Irish exports in that year.

In the period 1991-98, industrial exports increased from IR£13.0 billion to IR£36.7 billion. With industrial exports by Irish-owned firms increasing by IR£1.2 billion over the same period, exports by foreign-owned firms accounted for 95 per cent of the total increase. As a result, the share of industrial exports by Irish-owned firms in the total fell from 26 per cent in 1991 to just 12 per cent in 1998. The relatively small measured contribution of indigenous enterprise to total merchandise export growth over this period in part reflects a movement of firms from indigenous to foreign ownership, both through acquisitions and equity sales to foreign investors. This is given some credence by a net movement of firms from the portfolio of Enterprise Ireland to IDA Ireland⁷. Nonetheless, the industrial export data provide compelling evidence that Ireland's merchandise export boom in the 1990s is owed almost entirely to foreign owned manufacturing companies.

6 The CIP provides details of the value of 1998 output of industrial local units that was exported. These results are presented for major industrial sectors for local units classified by nationality of ownership and number of persons engaged. These analyses are based on respondents' replies to questions asking about the ultimate beneficial ownership of the company, the percentage of the value of production (or turnover) which was exported and a breakdown by destination.

7 Enterprise Ireland is the state agency responsible for the development of Irish-owned industry. IDA Ireland is responsible for attracting and supporting foreign-owned industry in Ireland. In the period 1995-99, 25 companies moved into IDA's portfolio as a result of ownership changes, usually take-overs by foreign companies. Over the same period, 17 companies moved out of the IDA portfolio as a result of Irish take-overs, usually through management buy-outs (MBOs).

Figure 11 Irish Industrial Exports by Country of Firm Ownership, 1998

Source: CSO, *Census of Industrial Production*

This observation is reinforced by data from the Forfás 1998 Irish Economy Expenditures (IEE) survey⁸. According to the IEE, exports by Irish-owned manufacturing industry grew from IR£3.9 billion (1998 prices) in 1993 to IR£4.1 billion in 1998, equivalent to average growth of 0.8 per cent in real terms. By contrast, exports by foreign-owned manufacturing industry grew from IR£11.1 billion in 1993 (1998 prices) to IR£21.1 billion in 1998, equal to average annual growth of 12.7 per cent in real terms.

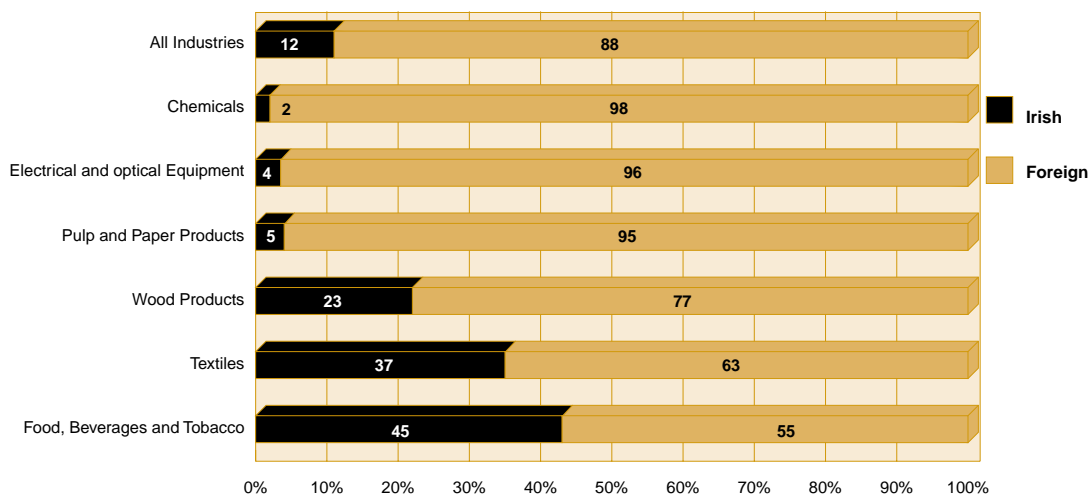
Comparing directly the export performance of the indigenous Irish-owned companies to that of the multinational sector is, of course, unfair, given the resources and intra-firm export linkages available to large foreign-owned firms. A more useful basis for comparison is the export performance of the indigenous sector in a previous period. In the five-year period between 1986 and 1991⁹, industrial exports by Irish-owned firms grew from IR£1.9 billion to IR£3.4 billion, equating to an average annualised growth rate of 12.3 per cent. In the subsequent seven-year period between 1991 and 1998, industrial exports by indigenous firms grew from IR£3.4 billion to IR£4.6 billion, equal to an average annualised growth rate of just 4.4 per cent – lower than the overall growth rate of the economy. As with comparisons with the multinational sector, the relatively poor measured export performance of the indigenous sector in the 1990s compared with the previous period may in part reflect the accelerating “internationalisation” of the Irish economy, with high numbers of Irish firms being acquired by foreign firms and investors. It may also be possible that indigenous firms have substituted domestic for export sales to exploit faster demand growth in the home market.

It is important to note that every IR£100 of exports by Irish-owned firms has a greater net positive impact on the domestic economy and the balance of payments than the same value of exports by foreign multinationals. According to Forfás’ IEE survey (see footnote 8), over 77 per cent of the value of total sales by Irish-based manufacturing multinationals in 1998 subsequently leaked out of the Irish economy through profit repatriations and imported goods and services (including payment for foreign royalties and licenses). Less than one-third of multinationals’ turnover went into Irish economy expenditures, in the form of wages and salaries, purchases of raw materials and Irish services, and profit distributions. The situation was reversed for Irish-owned manufacturing companies surveyed by Forfás, where two-thirds of turnover was spent in the Irish economy. Roughly applying these ratios to the CSO’s Census of Industrial Production suggests that the IR£4.6 billion in export sales by Irish-owned industry in 1998 added around IR£3.5 billion to domestic GDP, while the IR£32.2 billion in export sales by foreign multinationals added around IR£10.3 billion. While foreign multinationals still dwarf the indigenous sector even under this measure, the importance of growing export sales by the indigenous manufacturing sector becomes clearer from a policy perspective (see Section 5.3).

8 This annual survey by Forfás measures the economic impact of manufacturing and internationally traded services activities in the Irish economy, and is based on a survey of companies supported by IDA Ireland and Enterprise Ireland employing greater than 19 people.

9 Comparisons with years before 1986 are not meaningful because of methodological changes in the CIP.

Figure 12 Indigenous vs. Foreign Exports by Selected Industry Sectors, 1998



Source: CSO, *Census of Industrial Production*

Foreign dominance in industrial exports was most complete in the chemicals sector, in which foreign-owned firms accounted for a remarkable 98 per cent of overseas sales in 1998¹⁰. Not far behind was the electrical and optical equipment sector (including computers), in which Irish-owned firms accounted for only four per cent of exports. Even in lower-technology industries traditionally associated with strong indigenous enterprises, such as wood products, textiles, and food, beverages and tobacco, the majority of exports came from foreign-owned firms. Indeed, Irish-owned firms account for a minority of exports in almost every industrial sector¹¹.

10 It should be noted that included in the foreign-owned share are firms (particularly in the pharmaceuticals sector) that are Irish-managed and headquartered, but are majority-owned by non-Irish shareholders.

11 The one exception is in the manufacturing of non-metallic mineral products (excluding rubber and plastic products), in which Irish-owned firms accounted for IR£115 million of the IR£208 million in export sales.

Section 3 - Trade in Services

3.1 Global Developments in Trade in Commercial Services

After stagnating in 1998, the value of global commercial service exports recovered in 1999 to reach \$1,340 billion, a rise of two percent over 1998 levels. While growth in the value of services trade lagged behind that of merchandise goods in 1999 for the first time in several years, commercial services still accounted for just under 20 per cent of total global trade flows. This is up from less than fifteen per cent at the beginning of the decade. A number of factors drove the rapid expansion in global services trade during the 1990s. The inclusion of services in multilateral trade disciplines as part of the creation of the WTO in 1995 discouraged the erection of new barriers to international trade in services, and was followed by a number of notable services liberalisation initiatives (the WTO Basic Telecoms and Financial Services Agreements of 1997-98 being notable successes). Another factor driving services “internationalisation” over this period was deregulation and privatisation of utility industries across the globe, which spurred cross-border trade in telecoms, energy and financial services. The proliferation of information and communications technologies increased the tradability of previously non-tradable services such as health, education and information services. “Digitisable” media products such as software, music and even newspapers, previously traded in physical carrier form, increasingly crossed borders as “online services”. Rising disposable incomes across the world spurred consumer demand for travel, tourism and other traded leisure services. Finally, rapid growth in merchandise trade and cross-border investment sparked demand for business support services, such as trade facilitation, finance and technology transfers.

	Exports				Imports			
	Value	Annual Change (%)			Value	Annual Change (%)		
	1999	1997	1998	1999	1999	1997	1998	1999
World	1,340	4	0	2	1,335	3	1	3
United States	252	9	2	5	182	11	8	10
Latin America	54	7	9	-2	60	13	4	-9
EU	565	1	5	1	555	0	7	2
Asia	267	5	-15	4	337	2	-11	5

Source: World Trade Organisation, *Annual Report 2000*

Preliminary data by major service categories indicate that all service categories recorded positive growth in 1999. The value of transportation services is estimated to have expanded by around 1.2 per cent in value terms. Travel services and the residual grouping of “Other Business Services” both expanded by two to three per cent in value terms. Price data for U.S. commercial services point to a moderate increase in prices for internationally traded services. This implies that the expansion of exports of commercial services has probably also lagged behind merchandise export growth in volume terms.

As with merchandise trade, commercial services trade data by region show that the most dynamic import and export growth in 1999 was in North America and Asia. While North America’s services import growth exceeded its export growth, thereby reducing its traditional large surplus in commercial services, Asia’s imports and exports expanded at about the same rate (4-5 percent). In contrast to the developments in North America and Asia, Western Europe’s services trade expanded by less in 1999 than in preceding years. With commercial service exports of \$252 billion in 1999, the United States accounted for 18.8 per cent of world service exports, indicating that the United States enjoys a considerable comparative advantage in the provision of services. This advantage was especially apparent in the large U.S. surplus in royalties and license fees – payments for intellectual property rights, such as rights to use computer software, rights to industrial processes, and rights to sell a product under a

particular trademark. In second place, lagging well behind the United States, was the United Kingdom, with 7.6 per cent of global service exports, followed by France (5.9 per cent) and Germany (5.7 per cent). In total, the EU-15 accounted for 42 per cent of global service exports in that year. The United States is also the largest importer of commercial services by country, followed by Germany, Japan and the United Kingdom. In contrast to merchandise trade, Ireland was not among the top 30 importers or exporters of commercial services in 1999.

3.2 Growth in Irish Service Trade

Balance of payments statistics for 1998-99 published by the CSO in May 2000 contain a more detailed breakdown of Irish service exports and imports than ever published before. Under the new reporting system, services trade is broken down into 11 sectors, compared with just four in the previous series. There is also, for the first time, a limited breakdown of Irish trade in services by geographic region. As with all international reporting of services trade, however, the CSO data is beset by conceptual and measurement problems, partly reflecting the intangible nature of services, as well as different classification systems across countries. As the Irish data is compiled through a mixture of enterprise inquiries, analysis of bank transactions and estimation techniques, it must be treated with caution, particularly with regard to international comparisons. The data on the new classification is available for only 1998 and 1999 and this prevents growth analysis over a reasonable period. Moreover, even with the recent improvements, the data on international trade in services remains limited compared with that available for merchandise trade. This inhibits analysis of the structure, volumes and market orientation of trade in services, as well as an examination of the export propensity in the services industry and a breakdown of service exports between multinational and indigenous Irish firms. There is also no reliable data source of the sales of services in Ireland through majority-owned affiliates of multinational companies, or the overseas service sales of Irish-owned affiliates in other countries, which is the main overseas delivery mechanism for many business, professional and technical services.

As throughout the 1990s, the services account of the Irish balance of payments was in substantial deficit in 1999. At IR£19.3 billion, imports of services were almost twice the level of service exports (IR£10.9 billion), resulting in a services trade deficit of IR£8.4 billion. This is up from a deficit of IR£7.1 billion in 1998 and from just IR£513 million in 1990. At just over 12 per cent, Ireland in 1999 had a larger services trade deficit as a proportion of GDP than any other country in the industrialised world. Altogether, total Irish services trade (imports and exports) accounted for just over 27 per cent of Ireland's total international trade (goods plus services).

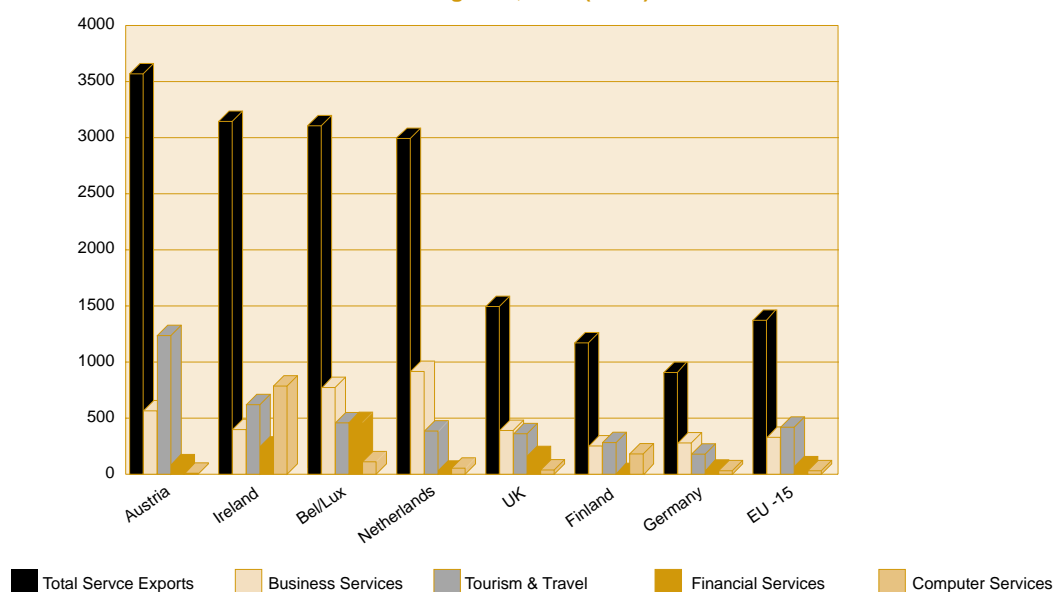
	Service Exports	Service Imports	Balance of Trade
Total	10,877	19,302	-8,425
Transport	1,019	1,761	-742
Tourism & Travel	1,898	1,829	69
Communications	264	154	110
Insurance	736	1,050	-314
Financial Services	1,232	933	299
Computer Services	3,770	230	3,540
Royalties/Licences	307	5,134	-4,827
Business Services	1,520	8,125	-6,605
- Merchanting	92	3,498	-3,406
- Leasing	531	71	460
- Misc. Bus. Services	898	4,557	-3,659
Other Services	132	85	47

Source: Central Statistics Office, *International Balance of Payments*

This large and widening services trade deficit is, to a large degree, a mirror image of the growing surpluses in merchandise trade, as there is a direct link between the many high-technology goods exports and payments by Irish-based companies for overseas royalties/licenses and other business services. In 1999, foreign-owned companies accounted for an estimated 90 per cent of Irish industrial exports. The industrial technologies and processes behind the manufacturing operations of foreign-owned factories in Ireland originate mostly from their overseas parents – a fact reflected by the huge outward payments from Ireland for royalties and licenses and inter-affiliate management fees (included in miscellaneous business services). International tax agreements between Ireland and our overseas trading partners often require foreign manufacturing operations in Ireland to pay a certain proportion of their turnover to their parent companies in the form of royalty payments in order to increase their home country tax liability. As high-technology exports by foreign-owned manufacturing operations in Ireland surge ahead, so do service imports. Accordingly, the large services deficit is a reflection not of poor Irish competitiveness in the provision of internationally traded services relative to the rest of the world, but rather of foreign dominance in Irish manufactured exports.

A related explanation for Ireland's large services deficit, as well as the huge goods surplus, is the distortion caused to Ireland's industrial structure by the preferential corporate tax treatment historically afforded to manufacturing companies. Partly resulting from this, manufacturing activities account for a much higher proportion of total economic activity than in most advanced economies, while the development of the services industry in Ireland has been stunted. As a result, a higher proportion of services consumed in Ireland need to be imported than in most other industrialised countries. The move towards a single rate of corporation tax over the coming years may see these large imbalances in Ireland's trade relationship with the rest of the world unwind.

Figure 13 Per Capita Service Exports by Selected EU Countries and Service Categories, 1998 (Ecus)



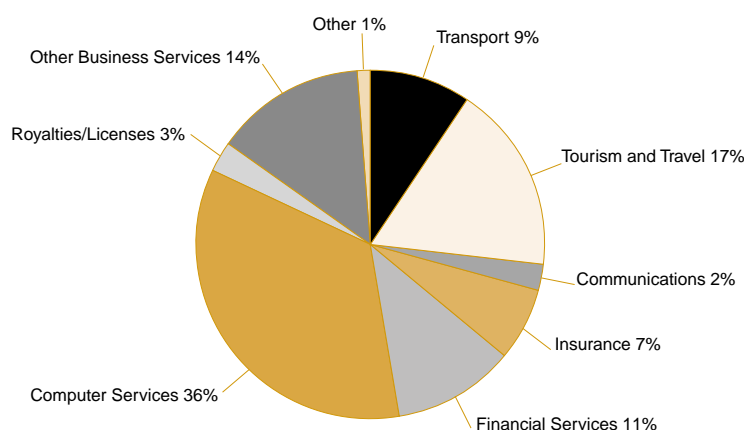
Source: Eurostat, *International Trade in Services*

The value of total Irish service imports in 1999 was IR£19.3 billion, up 18.4 per cent from IR£16.3 billion in 1998, and equivalent to just under 39 per cent of total Irish imports. Ireland's two largest service imports in 1999 were royalties and licenses and miscellaneous business services, measuring IR£5.1 billion and IR£4.6 billion respectively. As discussed earlier, the high level of outward royalty payments reflects foreign dominance in Ireland's manufacturing industry. Similarly, imports of miscellaneous business services include inter-affiliate management fees charged by parent companies to their Irish subsidiaries for head office services, such as finance, administration and marketing. Irish imports of other miscellaneous business services are also significant, including legal, management consulting, advertising and marketing and other professional and technical services. Irish imports of merchanting services, at IR£3.4 billion in 1999, comprise wholesaling and other services by foreign trade agents. A significant part of this is related to commissions earned by non-resident agents in relation to Irish exports. Anecdotal evidence of a movement away from the practice of Irish located

branch plants selling to affiliates which then arrange distribution, to one of using foreign distribution companies and paying them directly, partly accounts for the scale of this item. At a total of IR£3.6 billion, Irish imports of transportation and tourism and travel services were also significant and rising, reflecting demand growth for overseas business and leisure travel.

While the service imports are affected by the size and structure of the manufacturing sector, service exports are more directly related to domestic capacity and international competitiveness. Using this measure, Ireland performs reasonably well by international standards. Total Irish service exports in 1999 measured IR£10.9 billion, up from 18 per cent from 1998 (comparisons with years before 1998 are not meaningful due to a revision in the series). As shown in Figure 13, in 1998 Ireland had the second highest level of service exports on a per capita basis of any EU country, behind only Austria. In that year, Ireland exported Ecu 3,145 (IR£2,472) of services per capita, compared with Ecu 3,569 for Austria, Ecu 3106 for Belgium, Ecu 1,495 for the UK, Ecu 907 for Germany and an average of Ecu 1,372 for the EU-15¹². Even mass tourism destinations such as Greece, Portugal and Spain did not perform as well as Ireland using this measure. As with merchandise trade, of course, the relatively high degree of export intensity in Irish services activity is not surprising given the small size of Ireland's domestic market.

Figure 14 Irish Service Exports by Category, 1999
Total = IR£10.9 Billion



Source: CSO, *Balance of International Payments*

At a sectoral level, Ireland performed particularly well relative to other EU countries with regard to per capita exports of computer services, which measured Ecu 786 compared with an EU average of just Ecu 31 per capita. This mostly reflects the high levels of computer software sales by foreign multinationals in Ireland delivered electronically to overseas customers. Indeed, Ireland accounted for over a fifth of total EU computer service exports in that year. On a per capita basis, Ireland also enjoyed above average performances in exports of financial services, business services and tourism and travel services.

As shown in Figure 14, exports of computer services (as defined for balance of payments purposes), at IR£3.8 billion, was Ireland's largest service export in 1999, accounting for 35 per cent of total service exports in that year¹³. Following this was tourism, which generated IR£1.9 billion in foreign earnings and made up 17 per cent of total service exports, while exports of transport services and miscellaneous business services each contributed a tenth of total receipts. Altogether, six service categories contributed surpluses to Ireland's balance of payments in 1999. These were tourism & travel, financial services, computer services, communications, leasing and "other services". Activities related to the Dublin's International Financial Services Centre (IFSC)¹⁴, which span a range of service categories, contributed IR£2.6 billion, or 24 per cent, of total service exports in 1999, and 11 per cent of imports. Accordingly, the measured services trade surplus generated by the IFSC activities in 1999 was IR£452 million.

¹² The data for Ireland are drawn from the new CSO Balance of Payments series first published in May 2000, which revised Ireland's measured service exports substantially upwards. The data for other EU countries are drawn from less recent Eurostat sources, and may also be subject to upward revision.

¹³ Trade in computer software that is embedded in hardware or carried in other physical form is classified by the CSO under merchandise trade instead of computer services, in line with international norms. Software sales transmitted electronically and sales of software licences are classified under services.

¹⁴ Founded in 1987, Dublin's International Financial Services Centre has become one of Europe's most successful off-shore financial centres. With over 500 Irish and foreign companies engaged in a range of financial services including banking, treasury management, custodial services, insurance, leasing and back-office support, the centre now employs almost 8,500 people and manages funds worth over \$150 billion.

In terms of export growth, the most significant development in 1999 was the large increase in computer service exports, which rose by 42 per cent to reach IR£3.7 billion. This very rapid growth could be “real” in terms of new business or could be due to structural change in the delivery/distribution system, i.e. a move away from physical to electronic delivery of software, which changes the classification of the export from a merchandise good to a service. Another source of exceptional revenue growth was exports of royalties and licences, which jumped 154 per cent to reach IR£310 million, which is also largely a reflection of the current strength of the software industry in Ireland. Much of the growth in both of these sectors is accounted for by multinationals. Exports of financial services, which are more evenly balanced between indigenous and multinational firms, also grew strongly, from IR£710 million in 1998 to IR£1.2 billion in 1999, mostly reflecting an expansion in IFSC activities. Exports of tourism and travel services, transport services, and communications services, which are dominated by indigenous firms, were also up, although growth in these sectors was more modest. Exports of insurance, leasing and miscellaneous business services all fell in the 1998-99 period, although it is inadvisable to read too much into just two years data.

3.3 Indigenous vs. Multinational Service Exports

IR£ millions	Foreign	Indigenous	Total
Service Exports	6,660	265	7,925

Source: Forfás, *Irish Economy Expenditures 1998*

Unlike exports of industrial goods, data on service exports as provided by the CSO balance of payments series cannot be broken down by indigenous and non-indigenous economic entities. While surveys by the Irish development agencies allow some limited analysis of service export performance by nationality of company ownership, there are significant problems regarding their comparability and scope. The surveys are the Forfás Irish Economy Expenditures (IEE) Survey, the Enterprise Ireland Annual Business Survey (ABS) and the National Software Directorate Annual Survey.

The most recent Forfás IEE survey data relates to 1998. The target population for the IEE are companies on the Forfás database employing more than 19 people. According to this survey, exports of non-IFSC internationally traded services by agency supported companies totalled IR£7.9 billion in that year. This does not include service exports from non-designated sectors such as tourism, most transport services and most financial professional services. Significantly, the IEE survey estimates that indigenous companies accounted for only IR£265 million, or three per cent, of total exports of internationally traded services in the non-IFSC designated sectors in 1998. It seems likely, however, that the IEE substantially underestimates service exports by indigenous enterprises, even in the designated sectors. This reflects the fact that a cut-off point of 19 employees is high for internationally trading service firms, as SMEs in the services sector tend to be smaller and have a higher export propensity than SMEs in the manufacturing sector.

This point is reinforced by the fact that Enterprise Ireland’s Annual Business Survey suggests a higher level of export activity among Irish-owned service firms. The revamped ABS recorded service exports by its client base of IR£652 million in 1998, rising to IR£791 million in 1999. As with the IEE survey, this figure does not include service exports by Irish firms in non-designated sectors, such as transport (although some logistics & associated haulage companies are Enterprise Ireland clients), travel and tourism and most financial and professional services. As mentioned above, the large difference between the estimates of service exports in the two surveys partly stems from the fact that the target population was larger for the Enterprise Ireland survey¹⁵. Even using the ABS estimates, however, it is clear that indigenous firms accounted for not much more than one-tenth of total service exports in the designated sectors, with the remainder accounted for by multinationals.

15 The IEE survey for 1998 was confined to companies employing more than 19 people on the former Forbairt database. The Enterprise Ireland survey had a wider coverage, combining former Forbairt and An Bord Trachtala clients, and included all Enterprise Ireland client firms regardless of size.

Table 6 Enterprise Ireland Client Service Exports 1998-2000					
	1998 IR£M	1999 IR£M	Growth 1998/99 (%)	Projected Growth 1999/00 (%)	1999 Export Propensity
Information and telecommunications	52.1	84.6	62.4	104.5	72.3
Financial, healthcare, training etc.	257.7	328.9	27.6	68.3	63.8
Design, entertainment and others.	341.6	377.9	10.7	24.7	58.3
Total	651.4	791.4	21.5	51.4	61.8

Source: Enterprise Ireland, *Annual Business Survey*

Table 6 from the ABS categorises indigenous service exporters into three groups: Information and telecommunications services and software; financial, healthcare, training software and services; and design, entertainment and other services. The export propensity is high for all three sectors ranging from 58.3 per cent for design and entertainment to 72.3 per cent for information and telecommunications. The overall export propensity for these services was 61.8 per cent – only slightly below the estimate in the Forfás 1998 IEE survey. This result also compares favourably with an export propensity of 39.3 per cent among Enterprise Ireland-supported manufacturing companies.

Section 4 – Direct Investment Flows

4.1 Global Developments in Foreign Direct Investment Flows

International flows of foreign direct investment (FDI) surged to around \$800 billion in 1999, an increase of around 25 per cent over 1998 levels. The main factor behind the large increase in global FDI flows was the exceptional wave of cross-border mergers and acquisitions. These were driven by a number of factors: further liberalisation of trade, investment and capital markets (including the relaxing of controls on mergers and acquisitions); deregulation and privatisation of service industries; and increased competitive pressures stemming mainly from globalisation and technological change, thereby increasing the need to achieve economies of scale through overseas expansion. In addition, favourable economic conditions in the United States, Europe and Canada, and improved economic conditions in the Asia-Pacific region, enhanced the profit potential of foreign direct investments and boosted the earnings of existing affiliates and their parent companies, which in turn provided a ready source of financing for further FDI flows.

The United States was the single largest destination for FDI, taking in \$271 billion in direct investment inflows in 1999, mostly from EU countries. Despite the surging dollar, investors were attracted to the U.S. market by strong economic growth, favourable business conditions and the prospect of exceptional returns offered by the “new economy”. The UK was the world’s largest source of FDI flows in 1999, spending over \$148 billion on overseas acquisitions, mostly in the United States. The EU countries as a group spent \$461 billion dollars in overseas direct investments, but received just \$282 billion dollars in inward FDI flows (a deficit of \$179 billion in FDI flows compared with a \$130 billion surplus for the United States). While the United States attracted an unprecedented level of capital inflows, which helped to finance its widening current account deficit, this came partly at the cost of stagnation in FDI flows to the major emerging markets, which measured around US\$150 billion in 1999.

4.2 Inward Investment into Ireland

Balance of payments statistics published by the CSO in May 2000 provide, for the first time, data on FDI flows between Ireland and the rest of the world. The data are, however, available only for 1998-99, and the geographical breakdown on the sources and destinations of FDI flows is limited. According to the available CSO data, total FDI flows into Ireland measured IR£14.0 billion in 1999¹⁶. Of this, IR£4.8 billion comprised traditional “industrial” direct investment by foreign-owned firms. This covers not only foreign investment in new “greenfield” operations in Ireland, but also foreign purchases of existing Irish companies, as well as all subsequent capital flows from foreign parents to their affiliates in Ireland, whether in the form of equity capital, debt or reinvested earnings (the undistributed profits of their Irish affiliates). The remaining IR£9.2 billion of inward direct investment in 1999 went into companies associated with the International Financial Services Centre in Dublin (see footnote 14). This mostly entails large movements of capital by foreign-owned companies to their treasury, fund management and other financial subsidiaries at the IFSC, mostly to be reinvested in overseas assets¹⁷. In this sense, inward flows of direct investment into IFSC companies are roughly matched by outward flows of portfolio investment, and have little impact on the productive potential of the domestic economy.

16 In line with international norms, the CSO defines FDI as the value of financial flows (including the value of in-kind assets) from “home” countries to foreign affiliates in “host” countries. A direct investment enterprise is an unincorporated or incorporated enterprise in which a direct investor owns ten per cent or more of the ordinary shares of the company or voting power (for an incorporated enterprise) or the equivalent for an unincorporated enterprise. Most data on FDI flows take into account only the acquisition or establishment of foreign affiliates involving the use of so-called foreign direct investment funds, consisting of equity, intra-company loans and re-invested earnings. FDI financed through equity or debt issues in the domestic capital market of the host country or in international capital markets, or through equity contributed by local partners in non-wholly owned foreign affiliates, is not included.

17 Overseas investment by IFSC-related enterprises covers mostly the acquisition and disposal of foreign equities, bonds and other money market instruments in the form of portfolio investment, and is not direct investment in overseas enterprises.

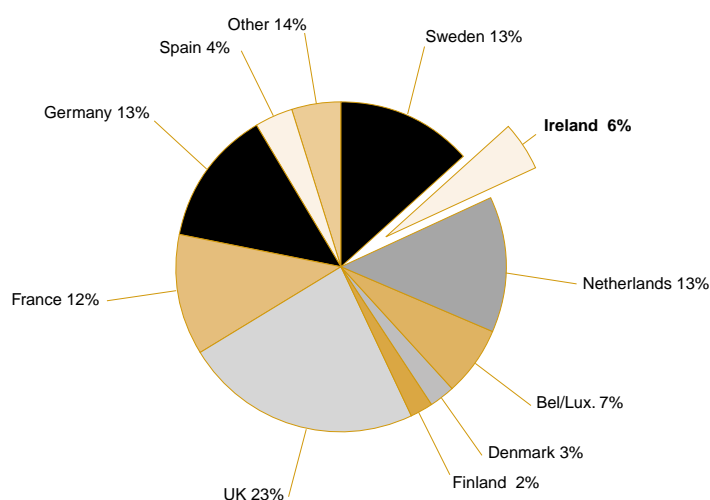
Table 7 Inward Direct Investment into Ireland, 1998-99 (IRE Millions)		
	1998	1999
Total	6,226	14,013
Equity	4,615	6,209
Reinvested Earnings	3,463	5,767
Other Capital	-1,852	2,037
IFSC	3,412	9,230
Non-IFSC	2,814	4,783
EU	3,654	4,767
Non-EU	2,572	9,246

Source: Central Statistics Office, *Balance of International Payments*

As the table above shows, both IFSC and non-IFSC related FDI inflows grew substantially from 1998 levels, although it is inadvisable to read too much into just two years' data as FDI flows (particularly IFSC-related) tend to be highly volatile. Non-IFSC (industrial) FDI inflows rose from IR£2.8 billion in 1998 to IR£4.8 billion in 1999, while IFSC-related FDI inflows rose from IR£3.4 billion to IR£9.2 billion. Altogether, FDI inflows rose from IR£6.2 billion in 1998 to IR£14.0 billion in 1999.

Of the 1999 total FDI inflows, equity inflows, at IR£6.2 billion, contributed the single largest element, followed by reinvested earnings (IR£5.8 billion) and other (mostly debt) capital, at IR£2.0 billion. Unpublished CSO data indicate that nearly all the equity and debt capital inflows went into IFSC-related companies, while non-IFSC related "industrial" FDI inflows were mostly financed out of retained earnings. These undistributed profits of foreign-owned companies were often used, in turn, to finance plant expansions in Ireland. Over IR£9.2 billion, or two-thirds, of total inward FDI flows in 1999 originated in non-EU countries. According to unpublished CSO data, most of this comprises Canadian direct investment into IFSC-related enterprises, with most of the remainder originating in the United States. Of the EU-15, only Ireland and the UK receive most of their inward investment flows from outside the Union. Of the IR£4.8 billion in inward FDI flows into Ireland from other EU countries in 1999, IR£3.8 billion came from other euro-zone countries, with the remaining IR£1.0 billion originating from the four non-euro participants, presumably mostly from the UK.

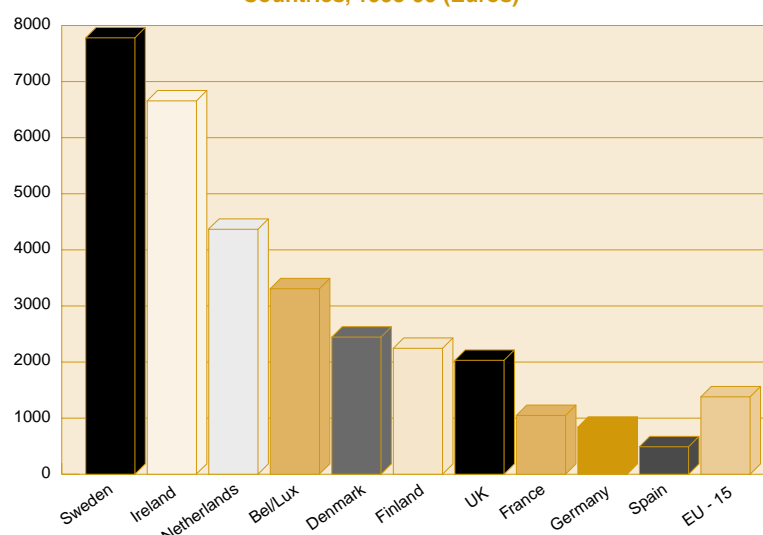
Figure 15 Share of 1998-99 EU Inward FDI Flows by Member States



Source: Eurostat, *European Union Direct Investment*

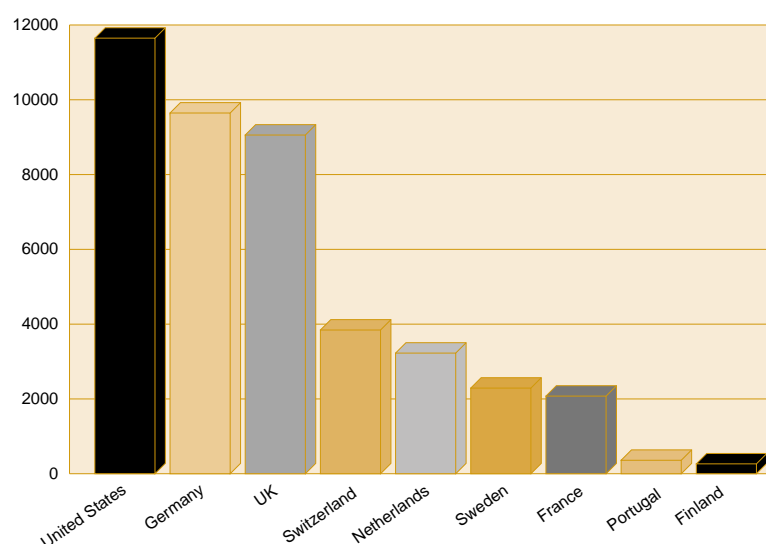
Ireland attracts a disproportionate share of FDI inflows into the EU relative to its small population and economic weight. While accounting for just over one per cent of EU GDP in 1999, Ireland took in over 5.7 per cent of total inward FDI flows into the EU in that year. Inward FDI flows into Ireland in 1999 were greater than those into other much larger EU countries, including Finland, Austria, Greece, Italy, Spain, Denmark, Portugal and Belgium/Luxembourg. Ireland was one of only three EU countries in 1999 to record a surplus in FDI flows (inflows exceeding outflows), the other two countries being Italy and Sweden. As with previous years, the UK was the largest single destination for FDI flows into the EU, taking in €65.4 billion in FDI, or 23 per cent of the total.

Figure 16 Per Capita Inward FDI Flows by Selected EU Countries, 1998-99 (Euros)



Ireland's performance in attracting inward investment on a per capita basis is impressive (Figure 16). In the two-year period 1998-99, Ireland received €6,656 in inward direct investment for every person in the country. This compared with an EU average of just €1,380 over the same period, and put Ireland into second place out of the EU-15 on this measure, behind only Sweden. Surveys of multinational companies operating in Ireland attribute Ireland's success in attracting high levels of inward direct investment to a number of factors, including the special ten per cent rate of corporation tax, a skilled and flexible labour force, improving transport and communication links with the UK, continental Europe and the United States, the external economies stemming from the existing base of multinationals with regard to the availability of key suppliers and skilled personnel, and the pro-business attitude of the Irish government and its agencies. Another important factor has been the "demonstration effect" of other large multinationals operating here successfully. In this sense, Ireland has managed to develop self-reinforcing industrial clusters, particularly in the electronics, software and pharmaceuticals sectors.

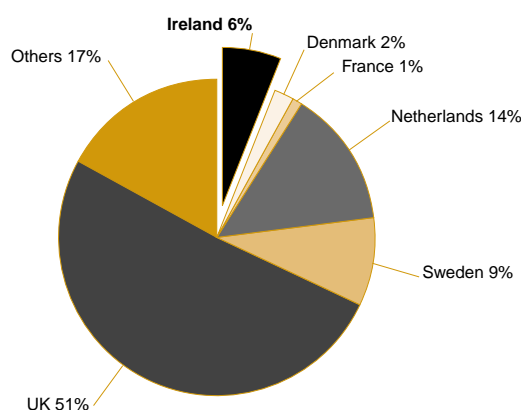
Figure 17 Stock of FDI in Ireland by Source Countries, 1997 (Euro Billions)



Although the CSO has not published, at the time of writing, data on Irish FDI stocks (as opposed to flows), it is possible to build up a picture of the situation using data from the statistical agencies of Ireland's main investment partners (Figure 17). Using this approach, we estimate that U.S. companies owned €11.6 billion in FDI assets (on a historical cost basis) in Ireland in 1997, confirming the United States as Ireland's largest cumulative source of FDI flows in recent years. This was followed by Germany, whose companies owned €9.6 billion of FDI assets in Ireland, the UK (€9.1 billion) and Switzerland (€3.8 billion). According to the counter-party data, companies from the Netherlands, Sweden, France, Finland and Portugal also owned significant FDI assets in Ireland. While no data is available, Canadian companies are also likely to be owners of significant FDI stocks in Ireland, particularly in IFSC-related activities.

A surprising feature of this data is that U.S. companies appear to have owned less than 30 per cent of FDI assets in Ireland in 1998, given that they accounted for 70 per cent of industrial exports in the same year. A number of explanations may exist, including the possibility that FDI by U.S. companies has been concentrated in industrial assets to a greater degree than that of companies of other nationalities. For example, anecdotal evidence suggest that much of German and Canadian FDI into Ireland in recent years has comprised IFSC-related financial flows, while UK direct investment in Ireland has been traditionally concentrated in the services sector (particularly retailing). Even still, these data offer evidence that FDI by U.S. companies in Ireland has been more efficiently and profitably put to use than FDI in Ireland by companies of other nationalities.

Figure 18 Share of 1999 U.S. FDI Flows into the EU by Member States



Source: U.S. Department of Commerce, *International Investment Data*

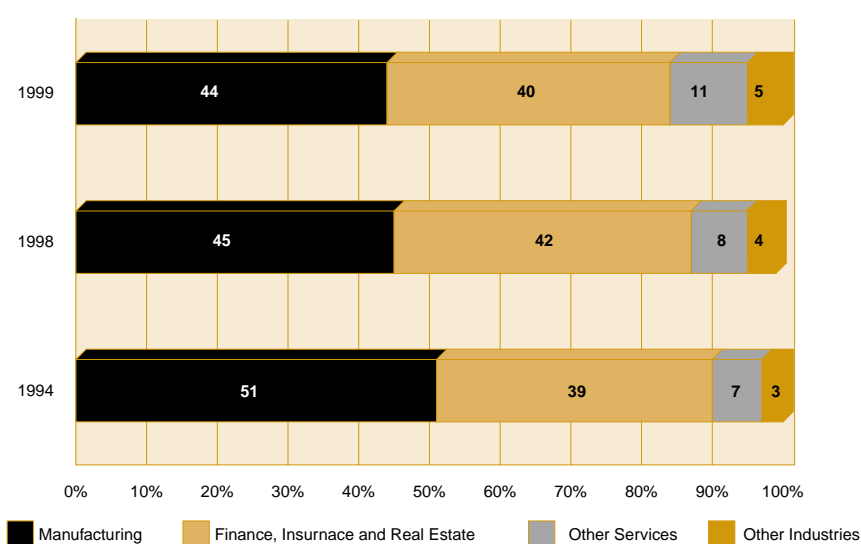
Among the small EU economies, Ireland has been by far the greatest beneficiary of the large and rising levels of U.S. FDI into Europe over the course of the 1990s. According to data from the U.S. Department of Commerce, the stock of U.S.-owned FDI assets in Ireland in 1999 measured \$19.8 billion on a historical cost basis, equivalent to over four per cent of total U.S. FDI assets in the EU at that time. In comparison, the share of U.S. FDI assets in the EU at the end of 1999 was less than one per cent each for Finland, Austria and Denmark. By far the biggest destination for U.S. FDI in Europe in the 1990s was the UK, with 41 per cent of total U.S. FDI assets in the EU at the end of 1999, followed by the Netherlands (21 per cent) and Germany (ten per cent). Ireland's early success in luring high profile U.S. investment projects has become self-reinforcing. In 1999, U.S. companies invested a further \$3.4 billion here, equivalent to over six per cent of total U.S. FDI flows into the EU (Figure 18). Of the EU-15, only Germany, the UK, the Netherlands and Sweden received more U.S. FDI flows in that year.

As well as being the greatest destination for FDI flows within the EU, the UK is also by far the greatest source of FDI flows, both within the EU and indeed in the world. In 1999, UK companies spent over €158 billion in overseas direct investments, of which €105 billion was destined for the United States and nearly all of the remaining €53 billion for other EU countries. According to CSO statistics, Ireland

received only €1.3 billion from non-euro EU sources. Even if all of these FDI flows originate in the UK, this implies that Ireland received less than 2.5 per cent of UK FDI flows into the EU in 1999, and less than one per cent of total UK global FDI flows. In contrast, Ireland absorbed almost seven per cent of total UK goods exports in the same year. The low level of FDI into Ireland from the UK relative to the United States partly reflects provisions of UK tax law that reduce the incentive for UK companies to invest in low tax jurisdictions. In addition, UK companies do not need to invest overseas to access the single European market.

According to U.S. statistics, U.S. companies spent over \$3.4 billion on direct investments in Ireland in 1999. While this was down from \$5.6 billion in 1998, Ireland's share of U.S. FDI in Europe remained steady at around six per cent, reflecting a fall in overall U.S. direct investment levels in Europe in 1999. At \$1.8 billion, most U.S. FDI in Ireland in 1999 was in the form of reinvested earnings, reflecting the large profits generated by existing U.S.-owned affiliates in Ireland. By reinvesting the profits earned by their Irish operations in Ireland or most other non-U.S. locations, U.S. companies can defer payment of U.S. corporate taxes. Of the remaining \$1.6 billion in FDI inflows from the United States, \$917 million was in the form of equity capital (mostly into the services industry), and \$697 million was in the form of debt capital (mostly to manufacturing and IFSC-related companies).

Figure 19 Composition of U.S. FDI in Ireland by Industry Sector, 1994-99



Source: U.S. Department of Commerce, *International Investment Data*

The composition of U.S. FDI flows into Ireland has shifted to some extent in recent years (Figure 20). Between 1994 and 1999, the share of total U.S. FDI assets in Ireland in the manufacturing industry declined from 51 per cent to 44 per cent. Correspondingly, there were increases in the shares of U.S. FDI assets in finance, insurance and real estate (mostly IFSC-related activities), which rose from 39 to 40 per cent, in other services (from seven to 11 per cent) and other non-defined industries (from three to five per cent). Indeed, while non-financial services made up just 11 per cent of the stock of U.S. FDI assets in Ireland in 1999, this sector absorbed 32 per cent of U.S. FDI inflows in that year, or \$1.1 billion. Within the manufacturing sector, the chemicals sector accounted for the greatest single proportion of U.S. FDI assets, followed by "other" manufacturing, electronic equipment and food products. Altogether, Ireland hosted just under six per cent of total U.S. manufacturing assets in the EU.

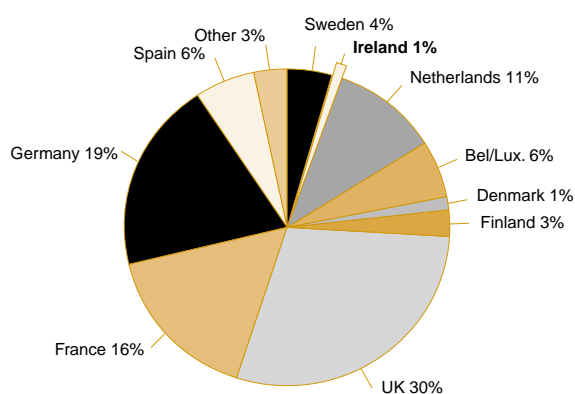
4.3 Outward Direct Investment

	1998	1999
Total	2,743	4,005
Equity	717	1,735
Reinvested Earnings	1,202	1,465
Other Capital	824	806
EU	885	1,189
Non-EU	1,858	2,817

Source: Central Statistics Office, *Balance of International Payments*

According to CSO balance of payments data, Irish resident companies made IR£4.0 billion in overseas direct investments in 1999, up from IR£2.7 billion in 1998 and from less than an estimated IR£1.0 billion in 1990. Of the 1999 total, IR£1.7 billion consisted of equity acquisitions, a further IR£1.5 billion comprised reinvested earnings and the remaining IR£806 million was made up of other, mostly debt, capital. Although well below total inward FDI in 1999 (IR£14.0 billion), outward FDI flows were only just below non-IFSC related “industrial” inward investment of IR£4.8 billion.

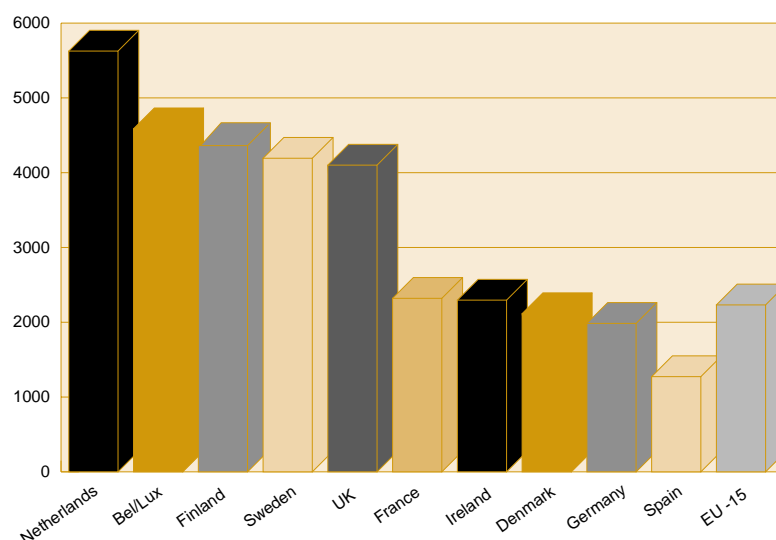
Figure 20 Share of Outward EU FDI Flows by Member States, 1998-99



Source: Eurostat, *European Union Direct Investment*

In euro terms, Irish outward investment flows measured €5.1 billion in 1999, and were higher than many larger EU economies including Italy, Austria, Portugal and Denmark (see Figure 20). On a per capita basis, however, outward direct investment from Ireland, at €2,296 in the two-year period 1998-99, remained well behind EU leaders Holland (€5,626), Belgium/Luxembourg (€4,587), Finland (€4,362), Sweden (€4,193) and the UK (€4,101). Moreover, the stock of Irish overseas direct investment is small compared with most other EU countries. According to data from the United Nations Conference on Trade and Development, the stock of Ireland’s outward FDI as a proportion of GDP in 1997, at just 7.9 per cent, was lower than every other EU country bar Austria, Greece and Portugal. While the position will certainly have improved in 1998-99, it likely remains well below that of other small EU countries such as Belgium/Luxembourg (40.7 per cent), the Netherlands (58.1 per cent), Sweden (34.7 per cent) and Finland (16.9 per cent). According to Eurostat data, in 1999 all EU countries bar Italy, Sweden and Ireland recorded greater outward than inward investment flows, as might be expected of “mature” slow-growing economies. No other country in the EU has as low a level of outward investment as a percentage of inward investment than Ireland.

Figure 21 Per Capita Outward FDI Flows by EU Member States, 1998-99 (Euros)



Source: Eurostat, *European Union Direct Investment*

Ireland's historical under-performance with regard to outward direct investment compared with other small EU countries reflects partly the fact that, with the exception of financial services, Ireland has few large corporations in the industries that generate the bulk of global FDI deals (oil, automobiles, telecommunications etc.). Other factors contributing to the low historic level of outward direct investment from Ireland include Ireland's relatively recent industrialisation, its geographic peripherality, the aggressive promotion of outward investment by some other EU governments, and the high proportion of output and employment in Ireland accounted for by foreign-owned companies. Also, many foreign acquisitions and investments by Irish companies are financed by non-FDI funds not recorded in the balance of payments, i.e. through finance raised not in Ireland, but rather in international capital markets or through loans in the local market of the acquired asset (see footnote 16). This may reflect limited development in Ireland's capital markets, as well as a desire by Irish outward investors to match foreign currency assets and liabilities. In this sense, the arrival of the euro may spur an increase in Irish-financed outward direct investments in continental Europe.

Unpublished CSO data indicate that around fifteen large Irish publicly-quoted companies have been responsible for the bulk of Irish outward direct investment in the recent past. These tend to be dominant home players in traditional non-traded industries that use their existing strong positions in terms of management expertise and finance in the domestic market to develop overseas. Indeed, anecdotal evidence suggests that these companies are active players in global mergers and acquisitions activity. Conversely, the evidence suggests that overseas investment by small- and medium-sized Irish enterprises is small compared with other EU countries.

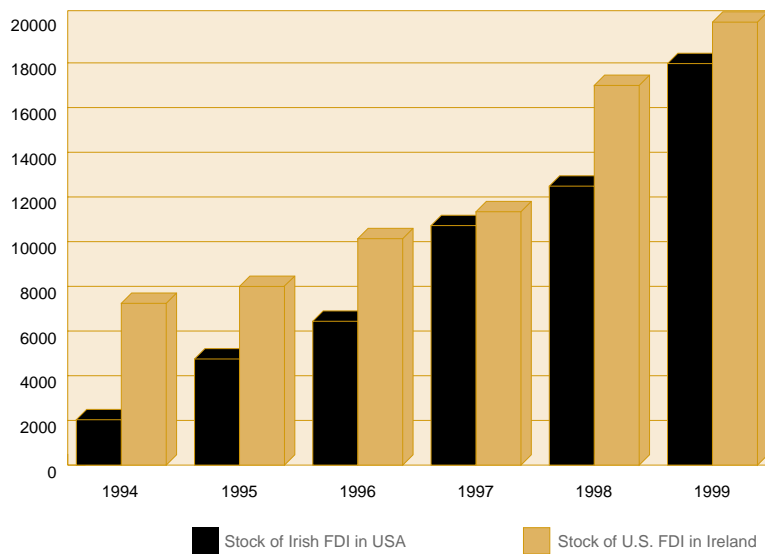
While not broken down by individual countries, CSO data for 1999 show that over 70 percent of Irish outward direct investment in that year went to non-EU countries, presumably mostly to the United States. Over 88 per cent of outward investment went to non-EMU countries, suggesting that the most Irish outward investment into other EU countries went to the UK. The historical concentration of Irish outward direct investment in the UK and the United States is also evidenced by statistics from UNCTAD compiled from counter-party sources. According to UNCTAD, these two countries alone received 85 per cent (UK 38 per cent, US 47 per cent) of Irish companies' total spend on overseas acquisitions in the period 1995-97. The rest was accounted for by Europe outside the UK (nine per cent) and the rest of the world (six per cent).

The importance of the United States as a destination for Irish FDI flows is also supported by data from the U.S. Department of Commerce, which show that the stock of Irish FDI assets in the United States (valued on a historical cost basis) almost caught up with U.S FDI assets in Ireland during the late 1990s (Figure 22). By 1999, Irish-owned FDI assets in the United States measured \$18.0 billion, only \$1.8 billion below the stock of U.S. direct investment assets in Ireland. This implies that since 1994 Irish

companies have invested considerably more in the United States than U.S. companies have invested here. By the end of 1999, Irish-owned companies in the United States employed almost 65,000 people, compared with 78,500 employed by U.S. companies in Ireland. Within the EU, only Luxembourg, the Netherlands, France, Germany and the UK have a larger stock of FDI in the United States than Ireland.

According to the U.S. figures, Irish FDI flows to the United States in 1999 measured \$2.5 billion, of which equity flows comprised \$1.6 billion and debt capital \$702 million. Reinvested earnings were \$206 million. The bulk of Irish direct investment in the United States comprises Irish acquisitions of existing U.S. companies. This is in contrast to U.S. FDI in Ireland, which tends to be largely dominated by “greenfield” investment projects. Irish FDI assets in the United States at the end of 1999 were concentrated in insurance, financial services, wholesale trade, building materials, food ingredients, software and other manufacturing industries.

Figure 22 U.S.-Irish Direct Investment Relations, 1994-99 (\$ Millions)



Source: U.S. Department of Commerce, *International Investment Data*

According to recent analysis, the narrowing gap between Irish outward and inward direct investment, particularly in relation to the United States, suggests that the Irish economy is moving up the “Investment Development Path”¹⁸. According to this concept, a country’s net outward investment position (outward direct investment less inward direct investment) is influenced by its level of economic development. With increasing economic development, a country evolves from being a net recipient of investment to being a net outward investor. As the domestic economy becomes more advanced, indigenous firms develop “firm-specific” assets, allowing them to become more internationally competitive and to exploit their advantages by investing overseas. Also rising labour costs in the home economy lead to a reduction in inward investment flows. Under these conditions, outward direct investment is likely to be beneficial to the home economy¹⁹.

¹⁸ “Irish Direct Investment in the United States: Evidence and Further Issues”, Holger Gorg, Centre for Research on Globalisation and Labour Markets, University of Nottingham

¹⁹ In October 1999, Forfás commissioned Public and Corporate Economic Consultants (PACEC) to examine outward direct investment from Ireland and its impact on company performance and the wider economy. The project involved desk research by the consultants of all relevant publications pertinent to outward direct investment from Ireland, an in-depth survey of 16 Irish companies that had engaged across a broad range of sectors, as well as discussions with key agencies and departments with regard to established economic and social objectives of Government.

Section 5 – Issues for Policy Consideration

5.1 Lack of Integration into the Euro-zone Economy

Ireland is unique among the 11 EU countries participating in European Economic and Monetary Union (EMU) in that its two largest trading partners, the UK and the United States, are outside the euro-zone. There has been little evidence, to date, that the arrival of EMU has caused a diversion of trade away from non-euro countries towards other euro-zone members. Indeed, high levels of bilateral direct investment between Ireland and the United States in recent years presage an intensification of U.S.-Irish trade relations, and the United States may become Ireland's largest trading partner within the next year. This leaves the Irish economy more vulnerable than any other euro participant to fluctuations in the external value of the euro, particularly against UK sterling and the U.S. dollar. While the recent weakness in the external value of the euro is a plus for Irish exporters to the UK and the United States, it has also left many Irish exporters to euro-zone countries vulnerable to rising import costs and declining competitiveness.

Any barriers preventing a deepening of Irish trade and investment relations with other eurozone countries need to be identified and addressed. In early 2000, the Chambers of Commerce of Ireland identified a number of measures to encourage Irish importers to source directly from euro-zone suppliers, and have received funding from the Department of Enterprise, Trade and Employment to finance a "Source Euro" campaign over the remainder of 2000. Consideration should be given to extending state financial assistance to this campaign into 2001.

5.2 Importance of the World Trade Organisation

While most Irish goods trade is still conducted within the Single European Market (SEM), and governed by EU rules, a growing share of trade is conducted outside the SEM, and is therefore governed by multilateral agreements under the auspices of the World Trade Organisation (WTO). Upcoming trade negotiations at the WTO will, potentially, have a major impact on the Irish economy.

With comprehensive WTO negotiations unlikely to restart until mid-2001, there now exists a new window of opportunity to re-examine Ireland's international trade and investment priorities. In conjunction with the Department of Enterprise, Trade and Employment, Forfás is planning a new industry consultation process to be completed by May 2001 to determine the trade priorities of Irish industry in the new round. The impact of the elimination of remaining barriers to cross-border trade and investment on Ireland's position in the global economy and Irish industrial policy generally will also need to be examined.

5.3 Growing Dominance of Foreign Companies in Exports

Foreign multinationals accounted for 88 per cent of Irish industrial exports in 1998 and for 95 per cent of the growth in industrial exports over the preceding seven-year period. The disproportionately large contribution of foreign enterprise to total export growth over this period may in part reflect a movement of firms from indigenous to foreign ownership, both through acquisitions and equity sales to foreign investors. Nonetheless, these data provide compelling evidence that Ireland's merchandise export boom in the 1990s is owed almost entirely to foreign owned manufacturing companies.

The measured export performance of indigenous Irish-owned manufacturing industry in the 1990s was modest compared with both the foreign-owned sector and with the performance of indigenous industry over the previous five-year period. As well as a movement of firms from indigenous to foreign ownership, the relatively small measured contribution of indigenous enterprise to total merchandise export growth over this period may reflect some substitution of export for domestic sales to exploit faster demand growth in the home market. It is also possible that for some indigenous industries, outward direct investment has replaced traditional exporting as the most efficient mechanism for exploiting foreign markets.

It is a valid question to ask whether the breakdown between foreign and indigenous contributions to total export growth is a useful variable for analysis. Possibly of greater significance for industrial policy is the degree of “embeddedness” of foreign-owned firms in the Irish economy through supply chain links, and the degree of autonomy in decision making that the local Irish management has vis-à-vis the parent company. Nonetheless, the reasons behind the modest performance of indigenous companies in overseas export markets require further exploration.

5.4 Potential of Services Trade for Indigenous Irish exporters

The share of trade in commercial services in total global trade rose steadily during the 1990s. Further liberalisation of services trade, together with the proliferation of advanced communications and information technologies will likely reinforce the “internationalisation” of global service industries over the coming years. Ireland is in a strong position to tap into the growing global market in tradable services. Earlier this year, Enterprise Ireland published its *Internationally Traded Services 2007 (ITS 2007)* strategy, which targets four high-potential service sectors for export support (Informatics, Digital Media, e-Business and Healthsciences). There may also be a need to develop a more broadly based strategy for the development of tradable service industries in Ireland.

5.5 Outward Direct Investment

Outward direct investment (ODI) is often the most efficient delivery mechanism for overseas sales of many business, professional, and technical goods and services. In 1999, direct investment overseas by Irish resident companies was only slightly below inward “industrial” investment. ODI is beneficial to the Irish economy across a range of indicators, including export performance and diversification, employment and pay levels at Irish parent companies, company profitability and growth, access to skilled labour and the development of globally minded management teams.

Ireland does not provide direct or indirect financial assistance to companies interested in investing overseas. Instead, the state currently facilitates outward investment by Irish companies at two levels: (1) Ireland’s network of Double Taxation Agreements (DTAs), which promote trade and investment between Ireland and other countries that might otherwise be discouraged by the possibility of double taxation; (2) Support from Enterprise Ireland and Ireland’s overseas diplomatic network. Enterprise Ireland recognises that for many Irish firms, overseas acquisitions and investment are crucial to long term sales and export growth. Accordingly, Enterprise Ireland assists, on a case by case basis, indigenous Irish companies seeking to make overseas direct investments and acquisitions. Support comes in the form of information, expert advice and networking services through its network of overseas offices and incubator facilities and in the form of overseas trade and investment missions.

It may be, however, that the continuing modest levels of outward direct investment from Ireland relative to our main trading partners, particularly from small- and medium-sized enterprises here, could constitute a source of competitive disadvantage in increasingly global markets. Government must address obstacles faced by Irish firms interested in investment opportunities overseas. At an international level, the issue of multilateral investment rules is an issue that requires deep consideration. As a general principle, Ireland supports the creation of a transparent, predictable and non-discriminatory business climate for international direct investment flows. The government is currently considering whether it is in our best interests to support efforts by other countries to negotiate binding rules at the WTO level to govern direct investment relations between WTO members. Domestically, Enterprise Ireland and the other development agencies should continue to support client firms interested in overseas acquisitions, mergers, alliances and greenfield investments through the provision of expert advice, information and other non-financial supports. The effectiveness of these services in facilitating Irish companies investing overseas should be kept under review.

5.6 The High Level of Intra-Firm Trade

Most trade by foreign firms comprises transactions between affiliated units of multinational companies. While multinationals have provided an effective training ground for Irish managers in finance, logistics and engineering – skills that can be later exploited by indigenous Irish industry – the high share of intra-firm trade in total Irish trade may have led to a situation where there are few workers in multinational companies skilled at export marketing. This may have future implications for the ability of indigenous companies to recruit skilled export marketing personnel. The large share of intra-firm trade in total Irish trade also makes it difficult to predict the impact of currency fluctuations and changing overseas market conditions on Irish trade patterns, and may mean that Irish trade is vulnerable to unforeseeable changes in business models, international tax developments etc. On the positive side, growing trade between foreign-owned firms in Ireland and affiliated units around of the world often opens up new distribution channels for Irish-owned exporters to previously untapped markets.

5.7 Ireland as a Hub for Trans-Atlantic Trade in Industrial Goods

Attracted by improved communications and transport links with the United States, the low corporate tax rate, a skilled English-speaking workforce and falling tariffs on trade in industrial goods between the EU and the United States, many U.S. multinationals are establishing in Ireland to sell not only into Europe and the Middle East, but also back into the domestic U.S. market. While Ireland accounts for only one per cent of total EU economic activity, Irish-U.S. trade makes up over five per percent of total merchandise trade between the EU and the United States – a share significantly larger than that of much bigger EU economies such as Belgium, Spain, the Netherlands and Sweden. It is clear that Ireland is at the centre of a fast-growing transatlantic market in industrial goods. This has important implications for how the IDA markets Ireland as a base for U.S. industry. It also highlights the importance of a healthy U.S.-EU trade and investment relationship to Irish economic prosperity.

5.8 High Degree of Internationalisation of the Irish Economy

While the “internationalisation” of the Irish economy is partly a reflection of the small size of the domestic market, the extreme openness of the Irish economy in terms of trade and investment, even compared with other small EU countries such as Finland, Austria and Denmark, suggests that market size is not a full explanation. It is clear that the “outward oriented” industrial policy pursued by Irish authorities since the 1960s, in the form of generous tax and grant incentives for export-oriented inward investors, has also contributed significantly to the globalisation of the Irish economy. This is reflected in the dominance of foreign-owned firms in the Irish manufacturing sector, and huge flows of goods and services between multinational giants and their Irish subsidiaries. This policy boosted economic growth and average real incomes, particularly in the late 1990s. But Ireland’s heavy dependence on FDI-based export growth also imposes constraints on domestic policy making. Keeping Ireland attractive to mobile technology industries searching the globe for cost advantages will require a constant commitment to improving the competitiveness of Ireland’s industrial policy framework across a range of indicators, including taxation, labour costs, infrastructure and innovation.

