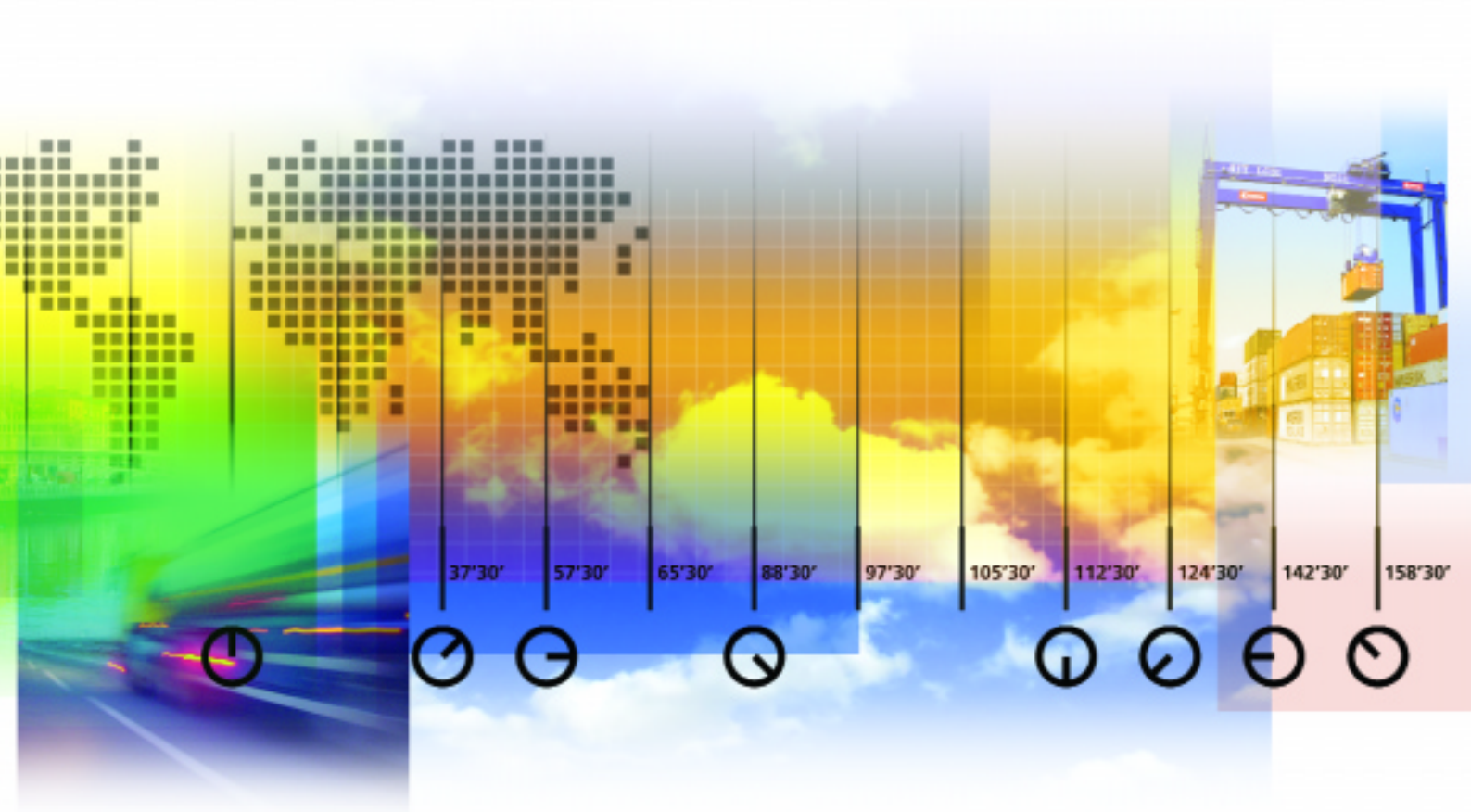


International Trade & Investment Report, 2005



Forfás 

THE NATIONAL POLICY AND ADVISORY BOARD FOR
ENTERPRISE, TRADE, SCIENCE, TECHNOLOGY AND INNOVATION

International Trade and Investment Report, 2005

**A report by Forfás to the
Minister of Enterprise, Trade and Employment**

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Preface

This paper presents an analysis of Ireland's trade and investment performance in the context of international developments. It is the latest in a series that has been published annually since 2000 and the analysis contained therein supports the development of trade policy in Ireland.

In recent years Ireland has displayed a very distinct economic structure, making it unusual amongst developed economies. On the one hand it has a strong export-orientated manufacturing sector, leading to Ireland having a huge merchandise trade surplus relative to the size of the economy. On the other hand it is the ninth biggest importer of services in the world, and consequently runs a considerable services trade deficit. As a result Ireland is one of the most open economies in the world in trade terms.

Its profile in terms of FDI is also atypical and is more akin to that of a country in an earlier stage of economic development. While Ireland has had average outward direct investment flows for a developed country, it has been the recipient of exceptionally large inward direct investment flows. Ireland has attracted significant FDI inflows, particularly throughout the nineties and early part of this decade, and the stock of FDI invested in Ireland is over three times the amount of FDI that Ireland has invested abroad. These are remarkable figures for a developed economy, which in general tend to be net exporters rather than importers of FDI.

If the trends identified in 2004 persist however, perhaps a turning point in the development of the Irish economy has been reached. The merchandise trade surplus, although it remains extremely large by international standards, declined for the second year running. This reflects both slower export growth, due in part to the slowdown in manufacturing experienced in many developed economies, allied to a surge in imports. The rise in imports was driven by buoyant consumer import demand and the reliance of Ireland on imported fuels (which contributed 27 per cent of the rise in imports). Services exports continued to expand rapidly, particularly in computer, financial and insurance services, leading to a narrowing of the services deficit. The importance of internationally traded services exports to the economy, measured as a percentage of GDP, now surpasses that of many other developed economies.

The continuing evolution of the Irish economy is also reflected in FDI flows. For the first time Ireland became a net investor overseas as outward FDI rose to its highest ever level in 2004. Ireland still attracts a disproportionate share of global FDI inflows, although this fell significantly in 2004 as exceptionally large dividend payments by multinationals reduced net inflows by 60 per cent.

If these trends continue into 2005 and beyond, it will support the contention that Ireland is moving into another stage of economic development. Once seen as a relatively low cost manufacturing base, Ireland has become a higher cost economy. This places a greater emphasis on value added activities such as high-skill manufacturing and internationally traded services as the key to Irish economic growth. In tandem with this shift, Ireland may follow the path of other wealthy developed economies by increasing its direct investments abroad, suggesting that Ireland is set to remain a net investor overseas in the coming years.

1. Executive Summary

1.1 Merchandise Trade

- ▶ World merchandise trade grew by over 10 per cent in euro terms in 2004. Driven by global economic growth of four per cent, the increase in world trade was more than double that of 2003, and the best since 2000. Asia, and in particular China, recorded above average trade growth. The USA experienced below average trade growth in 2004, but since imports grew over twice as fast as exports the trade deficit continued to grow, reaching seven per cent of world trade. Europe in general also experienced below average trade growth.
- ▶ Irish exports returned to growth in 2004, rising in value terms by 2.6 per cent to €84.3 billion, but still below the peak achieved in 2001. In the rankings of the world's largest exporters, Ireland has fallen from 19th in 2002 to 23rd in 2004. The USA was the destination for 20 per cent of Ireland's exports, making Ireland the US's 12th largest import source in 2004, with a market share of 1.9 per cent of total US imports. Exports to the UK and the rest of the world were steady in 2003 while exports to the EU rose by 5.6 per cent.
- ▶ In 2004, 71.6 per cent of total exports came from two sectors, pharmachem (chemicals and pharmaceuticals) and ICT/machinery. Pharmachem exports expanded 4.8 per cent in 2004, and have witnessed dramatic growth since 1999, expanding in aggregate by 77.6 per cent. Machinery, which includes ICT products, continued its decline in 2004 with exports falling by 2.8 per cent. This is in line with the trend in recent years, with the value of exports falling by 12.7 per cent between 1999 and 2004.
- ▶ The foreign-owned sector accounted for 87.6 per cent of Irish exports in 2004 with the indigenously owned sector accounting for the remainder. The indigenously owned sector is much less export orientated, exporting less than 40 per cent of its output. Much of the increased output from the indigenous sector over the last decade has been destined for the growing domestic market rather than export markets. However, in terms of their direct expenditure in the Irish economy, the contribution of indigenous exporters is similar to that of foreign-owned exporters. Foreign firms spent €17.8 billion on payroll and Irish goods and services in 2004, while Enterprise Ireland supported indigenous firms spent €16.2 billion.¹
- ▶ Imports to Ireland rose by 6.6 per cent in value terms in 2004, to reach €51 billion. The rise in volume terms was nine per cent, and import prices fell by two per cent. While imports have risen by 15.1 per cent since 1999, they remain considerably below the high posted in 2000, with the result that Ireland fell from 28th in 2003 to 30th place in 2004 amongst the world's leading importers.
- ▶ 'ICT/Machinery' remains by far the largest import category, at €21.9 billion, accounting for 43 per cent of imports in 2004. It rose by six per cent on 2003, after two consecutive years of decline. The category containing petroleum, although comprising only 5.5 per cent of imports, contributed 27 per cent of the rise in the import bill in 2004.
- ▶ The UK remains Ireland's largest import source, accounting for 31 per cent of Ireland's imports. UK-sourced imports grew nine per cent from 2003 to reach €16 billion. China has seen a cumulative increase of 323 per cent since 1999 and now provides 5.4 per cent of total imports, comprising mainly 'office and data processing machines'.

¹ Source: Annual Business Survey of Economic Impact, Forfás.

Ireland's merchandise trade surplus fell for the second consecutive year, declining by 2.8 per cent to €33.2 billion in 2004. Ireland still has the highest per capita merchandise trade surplus in the OECD. Prior to 2003 Ireland experienced 12 years of expanding merchandise trade surpluses.

1.2 Services Trade

According to the WTO, world trade in commercial services rose to €1,540 billion in 2004, an increase of seven per cent on the previous year. The enlarged EU (EU-25) accounts for almost half of global exports. The USA is both the world's largest importer and exporter of services. However its services trade surplus has declined consistently every year since 1999, and now stands at only 60 per cent of what it was in 1999. Asia is a net importer of services, with most of this deficit due to imports of transportation services.

2004 was another impressive year for Irish services exports. In 2004, CSO figures recorded a 13.7 per cent increase in Irish exports to €42.2 billion. According to the WTO, Ireland had a 2.2 per cent market share of world services exports in 2004.

Computer services continue to dominate services exports, accounting in 2004 for 35.5 per cent of total service exports. They increased by 19 per cent from 2003 to 2004, making up almost half of the total rise in services exports in 2004, and have jumped by 183 per cent since 1999. Business services exports grew by 17 per cent in 2004 to €8.1 billion and by 283 per cent between 1999 and 2004.² Tourism and travel's contribution to total service exports continues to decline in importance, down from 15 per cent in 1999 to eight per cent in 2004.

Between 1999 and 2004, the breakdown of Irish services exports by destination has remained relatively constant. The RoW (Rest of the World) purchases 37.4 per cent of our services exports, the eurozone 33.5 per cent, the UK 27.9 per cent and the EU 10 accession countries 1.2 per cent.

According to WTO data, Ireland was the ninth largest importer of services globally in 2004, consuming 2.8 per cent of global imports. CSO figures show an increase of 7.7 per cent in services imports from €48.2 billion in 2003 to €51.9 billion in 2004. Between 1999 and 2004 services imports doubled from €26 billion.

The bulk of the total services import bill is accounted for by business services, at €21.3 billion (41 per cent of the total) in 2004. Its value rose by nine per cent from 2003 and has doubled since 1999. The second largest contributor to services imports is royalties and licenses, amounting to €14.8 billion in 2004. The growth rate in royalty imports, which are primarily derived from industrial production, has decelerated in line with the slowdown in industrial output growth.³

The share of services imports sourced from the eurozone has increased from 24.5 per cent in 1999 to 33 per cent in 2004. The share originating from non-eurozone EU countries (i.e. the UK, Sweden and Denmark) has fallen to 18.3 per cent from 21 per cent in the same period. In 2004 the EU 10 accession countries accounted for less than one per cent of services imports and the RoW accounted for the largest part of services imports, at 48 per cent.

The continued success of the IFSC (Irish Financial Services Centre) and its importance to the economy is emphasised by the net trade surplus of €4.9 billion in IFSC activities in 2004. The growth in IFSC exports, comprising mainly insurance, financial services and business services exports, has been 234 per cent since 1999.

The services trade deficit fell for the second consecutive year in 2004, by €1.4 billion to €9.7 billion, the lowest services deficit since 1998. The overall trade surplus (merchandise and services) now stands at over €22 billion.

² Business services include trade-related services, leasing, professional fees such as legal and accounting charges and also inter-affiliate management fees. For more detail please see Chapter 3.

³ Services imports are significantly affected by payments from Irish subsidiaries of multinationals to their parent operations.

1.3 Foreign Direct Investment (FDI)

- ▶ The relevance and international comparability of FDI flows as they are currently measured is debatable and must be treated with caution. FDI flows are volatile and changes in each category result as much from the internal financial transactions that take place within firms as from actual physical investments in production facilities (see Chapter 4 for a more detailed discussion of this). These flows often have little relationship to the concept of FDI as a direct "one-to-one" greenfield investment.
- ▶ After three consecutive years of decline, outflows of foreign direct investment from OECD countries rose by 3.7 per cent in 2004 to €538 billion. Despite this return to growth, the figure still represents only 40 per cent of the all time peak in FDI of €1,340 billion, recorded at the height of the global investment boom in 2000. This modest rebound in FDI flows was supported by a stronger global economic growth rate of four per cent in 2004.
- ▶ The USA is both the largest foreign investing country (€203 billion) and the largest recipient (€86 billion) of FDI in the world. Inward FDI into China keeps hitting new records, reaching over €44 billion in 2004, up from €42 billion in 2003. From 1994 to 2003 the cumulative stock of FDI in the CEECs (Central and Eastern European Countries) rose almost tenfold to almost €175 billion, with inflows reaching €20 billion in 2004. FDI inflows into Russia have continued to recover strongly, reaching €9 billion in 2004, with the energy sector being the main attraction for investment.
- ▶ Ireland remains an attractive location for FDI. Ireland attracted 2.1 per cent of total OECD outflows in 2004. However, 2004 represents a decline from 2002 and 2003, when Ireland was the destination for almost five per cent and 4.5 per cent of OECD FDI outflows respectively. The cumulative stock of FDI invested in Ireland stands at 125 per cent of GDP, which is still the highest ratio of any of the OECD countries, bar Luxembourg.
- ▶ In absolute terms, FDI inflows of €9.1 billion in 2004 were the lowest since 1999, less than half the inflow for 2003 and less than one third of the record inflow achieved in 2002. In 2004 the majority of direct investment into Ireland went into IFSC related companies while non-IFSC FDI, at €1.5 billion, was at its lowest level since 1998.
- ▶ Consistent with the trend of recent years, US owned holding companies based in the eurozone are the immediate source of most of inward Irish FDI, with inflows reaching nearly €6 billion in 2004. Counterparty data from the USA indicates that investment flows from that country were up from €7 billion in 2003 to over €8 billion in 2004.⁴ The cumulative stock of US FDI invested in Ireland, measured on a historical cost basis, stood at around €59 billion in 2004, equivalent to 7.6 per cent of all US investment in the EU and 3.5 per cent worldwide. Analysed at a sectoral level, Ireland is the biggest location worldwide for US FDI in the information sector and 4th worldwide in chemicals.
- ▶ According to national data, FDI outflows were €12.7 billion in 2004. This is the largest total ever recorded and would suggest that for the first time Ireland is a net exporter of FDI as outflows exceeded inflows by €3.6 billion. This excludes investments by Irish investors in commercial and residential property abroad which are classified as portfolio investments. Many Irish companies were active in the area of mergers & acquisitions (M&A) in 2004, with overall activity increasing significantly on 2003.

⁴ Due to the nature of FDI flows and data collection methods FDI statistics from different countries are not always comparable. Inflows that Ireland records receiving may not always match outflows recorded by senders of these outflows to Ireland.

- ▶ The RoW was the recipient of the largest share of Irish outward FDI in 2004. However, US counterparty data indicates that there was disinvestment from the USA by Irish investors in 2004, suggesting that significant direct investment by Irish companies in the RoW was destined for countries outside the USA. Outflows to the Eurozone more than doubled from 2003. Outflows to the UK in 2004 were at the highest level they have been since 1999, in part driven by strong M&A activity.
- ▶ According to the OECD, 1.7 per cent of total global FDI in 2004 originated from Ireland. The cumulative stock of FDI invested by Irish residents abroad was around €60 billion, equal to 41 per cent of Irish GDP in 2004, which is a similar ratio to that of the EU as a whole.

1.4 Conclusion

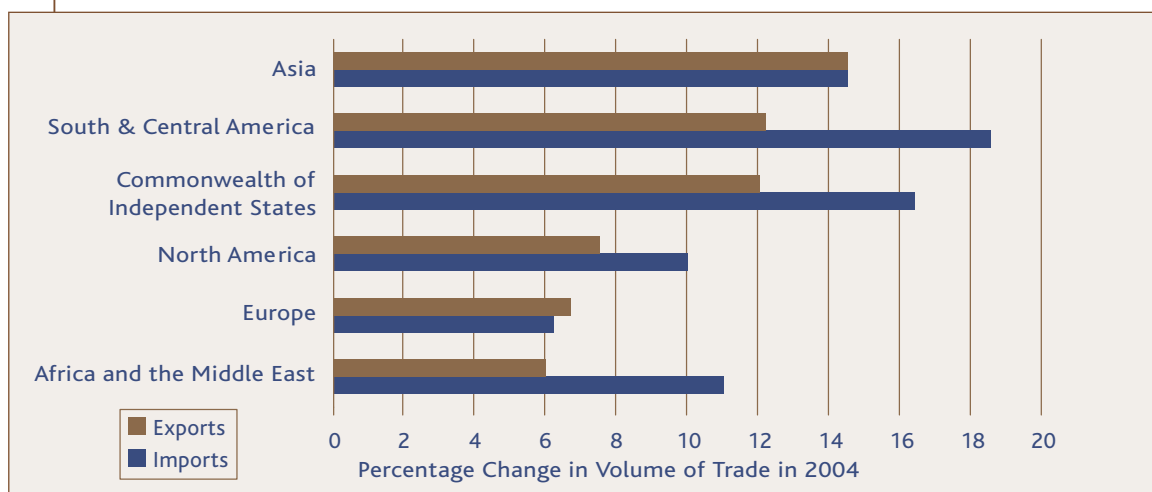
- ▶ Merchandise exports returned to growth in 2004 after two consecutive years of decline, albeit with a slower rate of growth than in services exports. Pharmachem and ICT/machinery account for 71.6 of merchandise exports. Pharmachem exports grew strongly in 2004 while ICT/machinery exports continued their decline of recent years.
- ▶ Strong growth in merchandise imports in 2004 was mainly driven by demand for consumer goods and the higher cost of fuel imports.
- ▶ Internationally traded services have become the main source of Irish export growth. Rapidly rising IFSC exports and computer services exports have been the drivers behind Ireland gaining a 2.2 per cent share of global services exports in 2004.
- ▶ Ireland remains the ninth largest importer of services in the world, due in part to the presence of the large foreign-owned sector of the Irish economy.
- ▶ The merchandise trade surplus declined for the second year running, while the services trade deficit also declined for the second year running. Ireland's overall trade surplus stood at €22.1 billion in 2004, a three per cent rise from 2003.
- ▶ FDI inflows into Ireland were half the level of 2003, while outflows were the highest ever recorded. As a result, Ireland was a net exporter of FDI for the first time in 2004. Given the volatility of FDI flows, it is too early to tell if this trend will continue, but it indicates that Ireland may be adopting the profile of a more typical developed economy, in that is becoming more important as a source rather than as a destination of FDI.

2. Merchandise Trade

2.1 Trends in Global Trade

According to the World Trade Organization (WTO), the value of world merchandise trade grew by over 10 per cent in euro terms in 2004. Driven by stronger than expected global economic growth of four per cent, the increase in world trade was more than double that of 2003, and the best since 2000. The increase in the volume of world trade was almost eleven per cent.

Figure 1 Growth in Volume of Merchandise Trade by Region in 2004



Of the main trading regions, Asia recorded real merchandise trade growth above the world average, with China, South Korea, Singapore and Japan leading the way. In particular, China recorded trade growth of over 20 per cent, leading to it to surpass Japan and become the third largest exporter in the world. Its economy is continuing its rapid growth of the last decade, posting an annual GDP growth rate of 9.5 per cent for the second year running, indicating that trade is helping drive the Chinese economic boom.

The US merchandise trade deficit, despite export growth of 2.7 per cent, continued to widen in 2004, as strong GDP growth of 4.4 per cent contributed to increased import demand by 6.4 per cent. In 2004, the US merchandise trade deficit grew by 24 per cent to reach €453 billion, equivalent to a record six per cent of US GDP and to seven per cent of world merchandise trade.⁵ This was in spite of the dollar's fall in value against the euro and most other major currencies, which should have helped narrow the deficit by making US exports more competitive abroad and imports more expensive domestically. However, many Asian central banks, including the Chinese, intervened to prevent their currencies from appreciating significantly against the dollar. This maintained their export competitiveness and helped them increase their exports to the USA and contributed to the growing US trade deficit. In July 2005 the Chinese central bank abandoned its policy of pegging the Yuan to the dollar and instead moved to a policy of a managed float. It is too early to tell what effect this monetary policy will have on the US trade deficit.

⁵ WTO Press Release April 2005.

In Europe, which accounted for 42 per cent of global merchandise trade in 2004, export growth exceeded import growth. In line with relatively slow economic growth of 2.3 per cent, the region experienced below average trade growth and as a result its share of world trade also fell. However, within the region there were significant differences. The new EU member states reported above average trade growth in both exports and imports as the increasing economic integration from EU enlargement in 2004 drove economic growth. Countries in the centre of Europe, with geographical and historical links to the EU 10 accession countries, also benefited, recording stronger growth in exports than in imports – Germany remains the top exporter in the world. The third group, comprising Western EU countries such as Ireland, France and the UK, posted weak export growth and slightly stronger import growth.

Strong global demand for fuels, metals and agricultural commodities resulted in strong export growth for the CIS (Commonwealth of Independent States), Latin America, Africa and the Middle East, whose exports are heavily weighted in these products. Rising export revenues in these regions helped fund increased imports. Latin America's particularly strong increase in imports was in part due to a rebound in import demand from Venezuela and Argentina, following domestic unrest and a financial crisis respectively in 2003.

2.1.1 Sectoral Trends in World Trade

Manufactured goods made up 76.9 per cent of world merchandise trade in 2003. In 2004, prices of manufactured goods are estimated to have remained relatively static on average but this headline figure masks differences among product categories. Of particular importance to Ireland, prices for computer and telecoms equipment fell, while those for chemicals, particularly organic chemicals and plastics, recorded significant price rises.

In recent years mining products have been increasing their share of world trade (10.9 per cent in 1999 to 13.6 per cent in 2003) due to strong global demand for raw materials. The data for 2004 suggests this trend is continuing. Commodities witnessed strong price rises, with fuels and metal recording price gains, in euro terms, of 20 per cent and 25 per cent in 2004 respectively. Prices for oil and many metals, including aluminum, copper, nickel and iron-ore, reached all-time highs, driven by strong Chinese demand.⁶

Agricultural products comprised nine per cent of world merchandise trade in 2003, down from 9.5 per cent in 1999. Within this category there has been a shift in recent years from unprocessed to more processed goods, with processed goods' share of world agricultural exports rising from 42.2 per cent in 1990 to 47.6 per cent in 2002.⁷

⁶ AIECE – Working Group on Commodity Prices April 2005.

⁷ World Trade Report 2004.

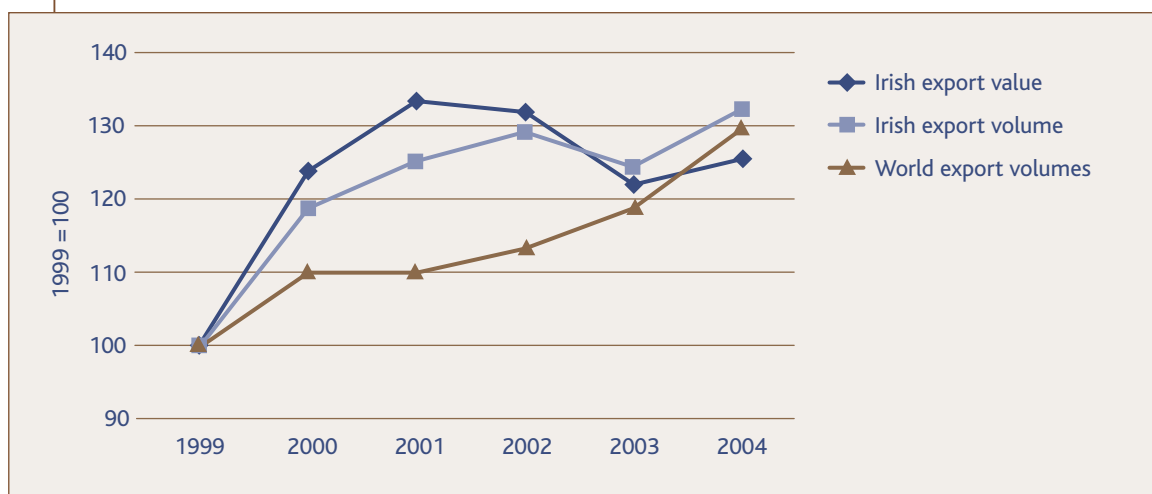
2.2 Ireland's Merchandise Exports

2.2.1 Trends in Irish Merchandise Exports

After the weak performance of 2003, which represented the second consecutive contraction in exports, Irish exports returned to growth in 2004.⁸ Overall exports in 2004 rose in value terms by 2.6 per cent to €84.3 billion, still considerably below the peak of €93.7 billion achieved in 2002. According to the WTO, this low export growth rate resulted in Ireland continuing its fall down the rankings of the world's top exporters, from 19th position in 2002 to 23rd in 2004. Ireland recorded the lowest growth rate in exports of the top 30 exporting nations and consequently its share of global exports declined to 1.1 per cent, down from 1.4 per cent in 2002. Preliminary data for 2005 indicates that this low growth rate has continued, with exports rising by just 1.9 per cent in the period January – August 2005, compared with the equivalent period in 2004. However, exports have risen by 26 per cent since 1999 as shown in Figure 2.

Ireland's merchandise export performance in 2004 was stronger in volume terms than in value terms (Figure 2). The volume of exports, up 6.5 per cent on 2003, reached its highest ever level in 2004. Since 1999, the volume growth in Irish exports has surpassed the global average, but as highlighted in Figure 2 the gap has been narrowing over the last few years.

Figure 2 Adjusted Merchandise Export Values and Volumes, 1999-2004



⁸ Note that adjustments have been made to compensate for distortions in the data (see Text box 1). The revised figures indicate that the peak in Irish exports was actually achieved in 2001, with 2002 and 2003 being two consecutive years of export decline.

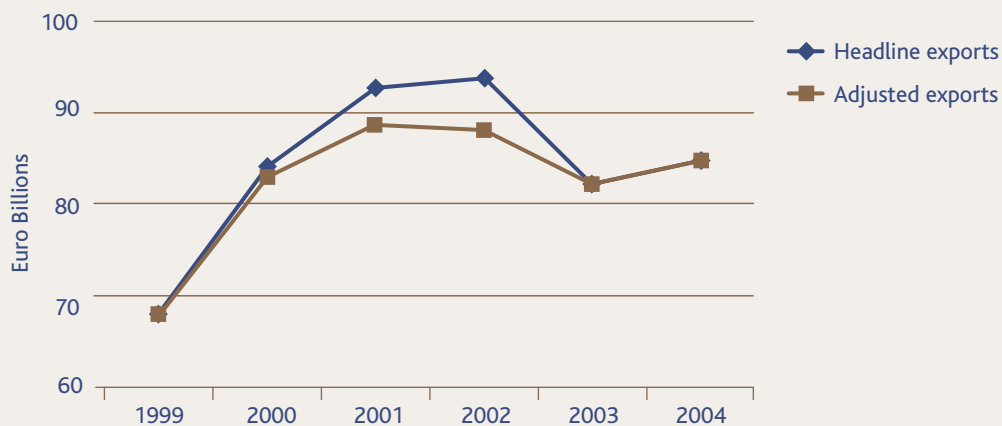
TEXT BOX 1: Adjustments to Merchandise Trade Data

While comparing trends in exports in recent years it is important to note that there were significant revisions to the data in 2003 when a VAT fraud was uncovered. The fraud, which was concentrated in the trade of electrical machinery to the UK, had been artificially inflating both imports and exports in the preceding years. The subsequent removal of the fraudulent data made the fall in exports in 2003 appear worse than it was in reality. The fraud mainly appeared in the sub-category 7764, 'integrated circuits etc'.

To compensate, exports to the UK in this category were assumed to have grown in a linear fashion between 1999 and 2004. The fraud had not yet started in 1999 and was discovered before 2004, so the trade statistics for these years were unaffected by the fraud. Any exports above this notional level were deemed as being affected from the fraud. These were then deducted from the headline CSO figures to create the Adjusted Exports line in the graph below.

While this crude method of compensating for the distortions can only give a broad outline of the effects of the fraud, it does show that exports were significantly overstated in 2001 and 2002 particularly. It indicates that the peak in Irish exports was actually achieved in 2001, with 2002 and 2003 being two consecutive years of export decline. The revised data is used throughout this paper and the same procedure is applied to the import data in later sections.

Exports Adjusted for Effects of Vat Fraud



With export volumes growing faster than export values, export prices were down almost by four per cent in 2004. This decline in export prices was due to a combination of factors. Firstly the dollar depreciated eight per cent against the euro in 2004. This made dollar receipts for Irish exports less valuable in euro terms, contributing to a 2.2 per cent fall in the value of Ireland's exports to the USA. Secondly, as outlined in section 2.1.1, world prices continued to decline for goods from the ICT sector. These form a disproportionately large share of Irish exports, thus helping to explain why the increased volume of ICT exports did not translate into higher export values.

2.2.2 Composition of Irish Merchandise Exports

The sectoral composition of Irish exports remains highly concentrated, with 71.6 per cent of total exports in 2004 coming from just two sectors, pharmachem, which includes organic chemicals and pharmaceuticals, and machinery and transport goods, which include ICT products. This level of sectoral concentration is quite high, even when compared to other small open economies.

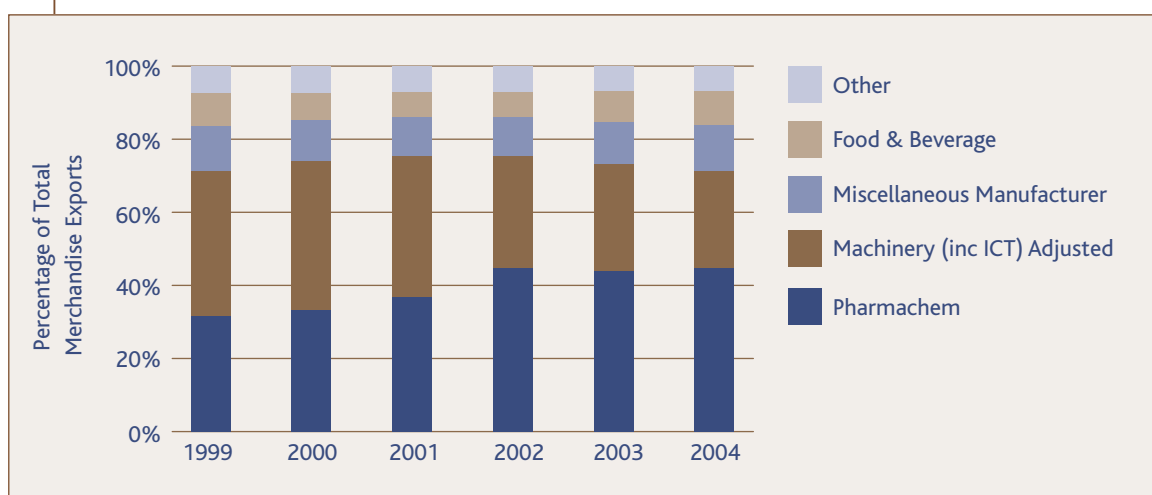
Only 55.7 per cent of New Zealand's exports, 54.4 per cent of Belgian exports and 50.7 per cent of Dutch exports come from the two largest export categories in these countries. Finland and Singapore are amongst the few countries that have more sectorally concentrated exports than Ireland, with over 73.2 per cent and 72.7 per cent of their exports respectively coming from their two main export sectors.

Table 1 Percentage of Exports from Two Main Industry Sectors – Selected Countries

	Food	Manufactured Goods	ICT/Machinery	Pharmachem	Combined Concentration
Finland		33.3 (2)	39.9 (1)		73.2
Singapore			61.0 (1)	11.7 (2)	72.7
Ireland			27.0 (2)	44.6 (1)	71.6
New Zealand	43.3 (1)	12.4 (2)			55.7
Belgium			26.7 (2)	27.7 (1)	54.4
Netherlands			33.4 (1)	17.3 (2)	50.7
Denmark	16.9 (2)		27.6 (1)		44.5

The pharmachem and ICT/Machinery sectors have had contrasting export performances over the last few years. Pharmachem exports have been expanding rapidly as new multinational production plants come on stream while the "hollowing-out" of ICT manufacturing appears to be continuing with multinationals increasingly moving production to locations in Eastern Europe and Asia.

Figure 3 Composition of Irish Merchandise Exports 1999-2004

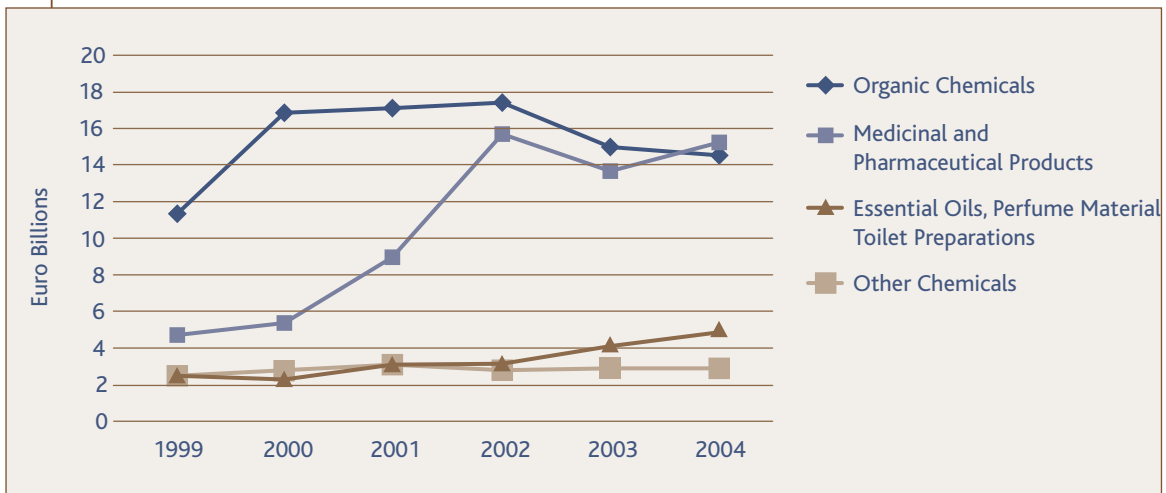


Pharmachem exports expanded 4.8 per cent in 2004, and have witnessed dramatic growth since 1999, expanding in aggregate by 77.6 per cent. Export growth remained strong in 2005, rising 4.9 per cent between January-August 2005 compared to the same period in 2004. Pharmachem exports are concentrated in two main sub-categories, 'organic chemicals' and 'medical and pharmaceutical products'.

Organic chemicals exports amounted to €14.7 billion in 2004, falling three per cent from 2003 but rising 29 per cent since 1999.⁹ 14.3 per cent of our total merchandise exports in 2004 came from one sub-category of organic chemicals, organo-inorganic compounds, in which Ireland had 23 per cent share of world exports in 2003.¹⁰ However exports from this category fell 29.2 per cent in 2004.

In 2004, Ireland's exports of medical and pharmaceutical products returned to growth, with a rise of 11.4 per cent to €15.2 billion, representing an increase of 215 per cent since 1999. Pharmaceutical exports are dominated by medicaments, which provided 14.9 per cent of Irish merchandise exports in 2004 and in which Ireland had a 9.9 per cent share of world exports in 2003.¹¹ Trade in pharmaceuticals has grown much more rapidly than world trade in recent years and Ireland has been at the forefront, due to substantial FDI inflows attracted by a well developed infrastructure and favourable tax conditions. The pharmaceutical industry employs 21,000 people in Ireland; the export orientation of the industry is evidenced by Ireland being the fifth largest exporter of pharmaceuticals in the world and having the largest pharmaceutical trade surplus in the EU. However, the industry in Ireland is heavily production focused; R&D expenditure makes up less than one per cent of turnover compared to an EU-15 average of 15 per cent.¹²

Figure 4 Irish Pharmachem Exports by sub-category 1999-2004



The other main export category, 'machinery and transport goods', continued to decline in 2004 with exports falling by 2.8 per cent. This is in line with the trend in recent years, with the value of exports falling by a cumulative 12.7 per cent between 1999 and 2004. The most important sub-category, 'office machines and automatic data processing machines', which includes computer products, accounting for €13.4 billion in exports, experienced a fall of ten per cent in 2004 despite a rise of three per cent in the volume of sales. Exports have declined by 11.7 per cent since 1999 and by 36 per cent from the high of €21 billion in 2001. This data is consistent with a recognised trend in production patterns, whereby relatively low-skilled computer assembly operations are increasingly moving to lower wage economies such as Eastern Europe or China.¹³

⁹ Much of Ireland's organic chemicals exports comprise of ingredients for pharmaceuticals that are finished in other countries such as the USA. This illustrates that Ireland does not have a significant basic chemicals industry and that the vast majority of our chemical exports are closely related to the pharmaceutical industry.

¹⁰ SITC Rev 3 515 – Organo-Inorganic Compounds, Heterocyclic Compounds, Nucleic Acids and their salts and sulphonamides.

¹¹ SITC Rev 3 5429 – Medicaments, nes, not in measured doses or retail form.

¹² EFPIA (European Federation of Pharmaceutical Industries and Associations) – 2003 figures.

¹³ Enlargement and the European Geography of the Information Technology sector – Barry F. and Curran C. 2004.

Ireland's third largest export sector, miscellaneous manufactures, showed a 4.8 per cent increase in 2004 and a six year increase of 29.7 per cent. Different categories experienced varying performances. All of the growth in 2004 is accounted for by 'professional, scientific and controlling apparatus' which is dominated by exports in 'medical instruments'. In this rapidly growing sector, Ireland is the world's third largest exporter with an 8.2 per cent share of world exports in 2003.¹⁴

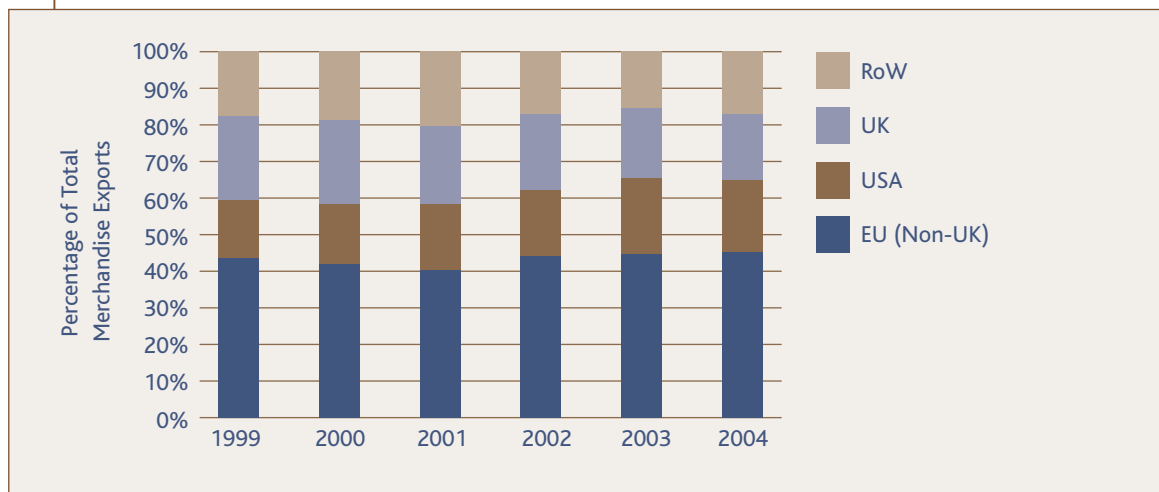
Exports of food and beverages, the fourth biggest category of Irish exports, rose by three per cent in 2004 and by 13 per cent since 1999. Their share of total Irish merchandise exports stood at eight per cent in 2004, a drop of one percentage point from 1999. Meat exports rose by 10.5 per cent in 2004 to reach the €2 billion mark for the first time. Particularly strong increases were recorded in beef, sheepmeat and prepared foods exports. The focus of beef exports has shifted dramatically in recent years towards a strong emphasis on the EU market (87 per cent). While beverage exports declined in 2004, mainly due to plant closures by multinationals, products such as whiskey, cream liqueurs and spring waters produced by indigenous companies enjoyed strong export growth.¹⁵

2.2.3 Destination of Irish Merchandise Exports

The USA remains Ireland's largest single export market, at €16.6 billion, despite exports falling by 2.2 per cent from 2003. The USA accounted for 20 per cent of Irish exports, while Ireland was the US's 12th largest import partner in 2004, with a market share of 1.9 per cent of total US imports, down from two per cent in 2003.¹⁶ The top Irish exports to the USA are, in descending order, 'organic chemicals', 'medical and pharmaceutical', 'professional and scientific apparatus', 'miscellaneous manufactures', 'essential oils, perfumes (chemicals)' and 'office machinery'. In 2004 exports to the USA of the largest category, 'organic chemicals', fell by over a quarter while exports of 'professional and scientific apparatus', which include medical devices, rose by 74 per cent or by almost €1 billion.

The UK lost its position as Ireland's largest export market in 2002 but still remains important in second place. Ireland's merchandise exports to the UK have stabilised, rising by 1.9 per cent in value terms in 2004, and now account for 18 per cent of total exports. As recently as 1994 27 per cent of all Irish exports went to the UK. ICT products are the largest export to the UK, followed by organic chemicals, meat products, pharmaceuticals and miscellaneous manufactures. Food and beverages comprise over 22 per cent of Irish exports to the UK, compared to only eight per cent of overall exports. As shown in section 2.2.4, food and beverage exports remain dominated by indigenous industry, and these export figures suggest that the UK remains a disproportionately important market for indigenous exporters.

Figure 5 Destination of Irish Merchandise Exports 1999-2004



¹⁴ Latest available data from UN (Comtrade).

¹⁵ Bord Bia – Food/Drink/Horticulture Export review 2004/05.

¹⁶ Comtrade UN Trade Statistics Database.

The rest of the EU accounts for 44 per cent of Irish exports. Exports to countries in the eurozone increased by 5.2 per cent in 2004, and have increased by 29 per cent since 1999, the year of the creation of the euro. Over 32 per cent of Ireland's trade with the eurozone is in pharmaceuticals, with the vast majority of this going to Belgium.¹⁷ Indeed most of the increase in exports to the rest of the EU in 2004, and all the increase between 1999 and 2004, is accounted for by increased pharmaceutical exports. Non-pharmaceutical exports to the eurozone have actually fallen by 6.4 per cent since 1999. While this can mainly be explained by the sluggish economic performance of the mainland European economies, it suggests that removal of currency risk, due to monetary union, has not led to any significant trade creation. Exports to Sweden and Denmark accounted for 1.8 per cent of exports in 2004 and have been falling in recent years. In addition, exports to the new member states comprise less than one per cent of total exports and remain virtually unchanged since 1999, indicating that Ireland has not fully benefited from the expansion in trade brought about by EU enlargement.¹⁸

After a steep fall in 2003, exports to the Rest of the World (RoW) stabilised. Exports to Pacific Rim countries grew strongly in 2004, with impressive increases in Australia (14 per cent), China (nine per cent), Japan (11 per cent), South Korea (15 per cent), Hong Kong (21 per cent) and Singapore (18 per cent) particularly, while others such as Malaysia, Mexico and Norway showed steep year-on-year declines.

2.2.4 Indigenous Merchandise Exports

Much of Ireland's economic growth in recent years has been attributed to the presence of a strong export-orientated multinational sector. However, the indigenous sector is of particular interest to policymakers, as indigenous enterprises, relative to their size, tend to be labour intensive and source more of their raw materials in Ireland than multinational companies. In terms of their direct expenditure in the Irish economy, foreign firms spent €17.8 billion on payroll and Irish goods and services in 2004, while indigenous Enterprise Ireland supported firms spent €16.2 billion.

According to Forfas 2004 data, the foreign owned sector dominates Irish merchandise exports, accounting for 87.6 per cent of Irish exports.¹⁹ Ireland's two major export categories, namely pharmaceuticals and ICT/Machinery are almost completely foreign owned as are medical instruments. The foreign-owned sector is highly export oriented, with exports accounting for 93 per cent of output. In contrast the indigenously owned export sector is much smaller, and less export orientated, exporting only 40 per cent of its output. The only major export sector which is majority Irish-owned is the food and drink sector.

Between 2000 and 2004 indigenous exports were estimated to have grown by only 1.6 per cent. All of this increase came from the food and drink sector, which grew by eleven per cent in the same period. Indigenous exports from the modern manufacturing sector (defined as chemicals, electronic equipment and professional goods) and other traditional sectors (mainly low-medium technology manufactured products) fell by 19.7 per cent and 7.2 per cent respectively between 2000 and 2004. The breakdown of indigenous merchandise exports in 2004 was 62.9 per cent from the food and drink sector, 10.4 per cent from modern manufacturing and 26.7 from other traditional sectors.

While this analysis shows indigenous export growth as relatively static in recent years, a comparison of Irish industrial output to that of the EU in the period 1991-2001 indicates that indigenous industry, despite low export growth, has been expanding its share of EU output. Overall, Ireland's total manufacturing exports increased from 1.6 per cent to 3.5 per cent of the EU total in the period 1991-

¹⁷ In 2004, Belgium was Ireland's 3rd largest export destination, with exports growing by 19 per cent in 2004 to €12.3 billion and a phenomenal 258 per cent since 1999. Two sub-categories, 'organic chemicals' and 'medicinal pharmaceuticals' account for 91 per cent of exports to Belgium in 2004. This suggests that the export figures may have been hugely influenced by some multinationals' distribution decisions. This is supported by the Irish Exporters Association who state that in 2002 Belgium became the EMEA (Europe, Middle East, Africa) distribution centre for many Irish-based pharmaceutical producers. EFPIA (European Federation of Pharmaceutical Industries and Associations) figures also show that in pharmaceuticals in 2003 Belgium produced €4.2 billion but exported €22.6 billion, suggesting that it is a major distribution centre for the industry.

¹⁸ WTO Trade Report 2005.

¹⁹ ABSEI – Annual Business Survey of Economic Impact, produced annually by Forfas.

2001, but in the same period indigenous exports as a proportion of the EU total fell from 0.4 per cent to 0.3 per cent.²⁰ However, in the same period Irish-owned production as a proportion of EU output also rose from 0.41 per cent to 0.44 per cent, meaning that the increased output of indigenous industry must have been destined for the Irish market. Therefore, moderate indigenous export performance can be partially explained by Irish manufacturers focusing on supplying their domestic market, one of the fastest growing economies in the world, at the expense of export markets.

2.3 Ireland's Merchandise Imports

2.3.1 Trends in Irish Merchandise Imports

Imports to Ireland rose by 6.6 per cent in value terms in 2004, to reach €51 billion. The rise in volume terms was nine per cent, and import prices fell marginally by two percent. While imports have risen by 15.1 per cent between 1999 and 2004, they remain considerably below the high posted in 2000.

Figure 6 Values and Volumes of Irish Merchandise Imports 1999-2004



Figure 6 shows the evolution of imports over time. In volume terms, notwithstanding the rise in 2004, Irish import growth has not kept pace with world import growth. However, the rise and subsequent decline of import values and prices must be interpreted in the light of currency movement, with euro weakness initially inflating the value of Irish imports and its subsequent strength having the opposite effect. According to the WTO, Ireland fell to 30th place amongst the world's leading importers, a fall of two places from 2003 as growth in world trade exceeded growth in Irish imports. Preliminary data for the period January-August 2005 shows that import growth has picked up, with imports rising by eight per cent compared to January-August 2004.

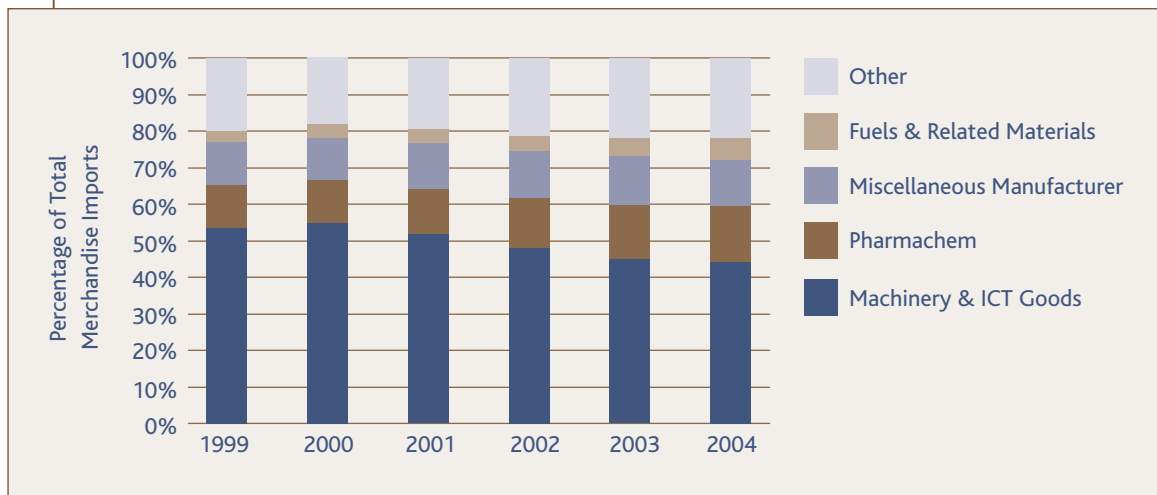
The growth in imports in 2004 can be attributed to several different factors. Firstly, the major development on world markets was the surge in commodity prices, particularly for metals and petroleum. According to the IMF 'Indices of Primary Commodity Prices' the price of metals and petroleum (in euro terms), rose by 25 per cent and 20 per cent respectively, in 2004. For Ireland, which must import most of its needs in these product areas, this represented a considerable rise in import costs. Although comprising only 5.5 per cent of total imports, fuel imports (petroleum, gas, coal) contributed 27 per cent of the rise in imports in 2004. Secondly the sustained strength of the euro, as it appreciated by two per cent in trade-weighted terms in 2004, continued to make many imports more affordable for Irish consumers and producers.

²⁰ *Competitive Performance in Irish Industry – Eoin O'Malley – 2004.*

The renewed strength of the Irish domestic economy would also be expected to lead to increased consumer demand for imports. Evidence in this area was mixed however. Despite benign economic conditions and a strong rise in consumer sentiment, reflected in the ESRI Consumer Sentiment Index, consumer spending was relatively muted, rising by just over five per cent, the lowest annual rate of increase since 1999. In addition lower industrial output meant that import demand from manufacturers was subdued in 2004. A feature of the Irish economy is the import-intensity of the manufacturing sector (57 per cent of total imports are inputs for further production). According to CSO figures industrial production grew by only 0.7 per cent in 2004, the lowest growth rate since 1982.

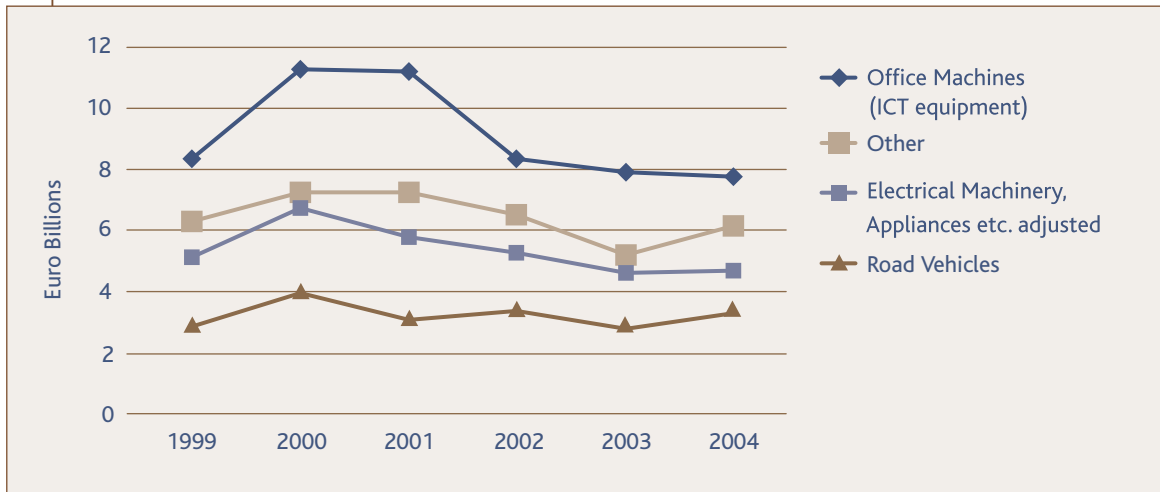
2.3.2 Composition of Irish Merchandise Imports

Figure 7 Composition of Irish Merchandise Imports 1999-2004



ICT/Machinery remains by far the largest import category at €21.9 billion, accounting for 43 per cent of merchandise imports. In 2004, it rose by six per cent, after two consecutive years of decline. This increase was due mainly to rises in 'road vehicles' (17 per cent) and 'telecommunication and sound equipment' (20 per cent), and 'other transport equipment' (89 per cent). The increase in 'other transport equipment' was mainly due to a sharp increase in imports of large aircraft, rising by €0.7 billion to €1.1 billion. Computer and computer parts imports have fallen dramatically to €7.8 billion, from a high of €11.4 billion in 2000, reflecting the decline in the ICT industry globally and the shifting of some production away from Ireland (much of Irish ICT imports are used as components by ICT manufacturers in Ireland).

Figure 8 Irish Imports of Machinery, Transport and ICT Goods 1999-2004

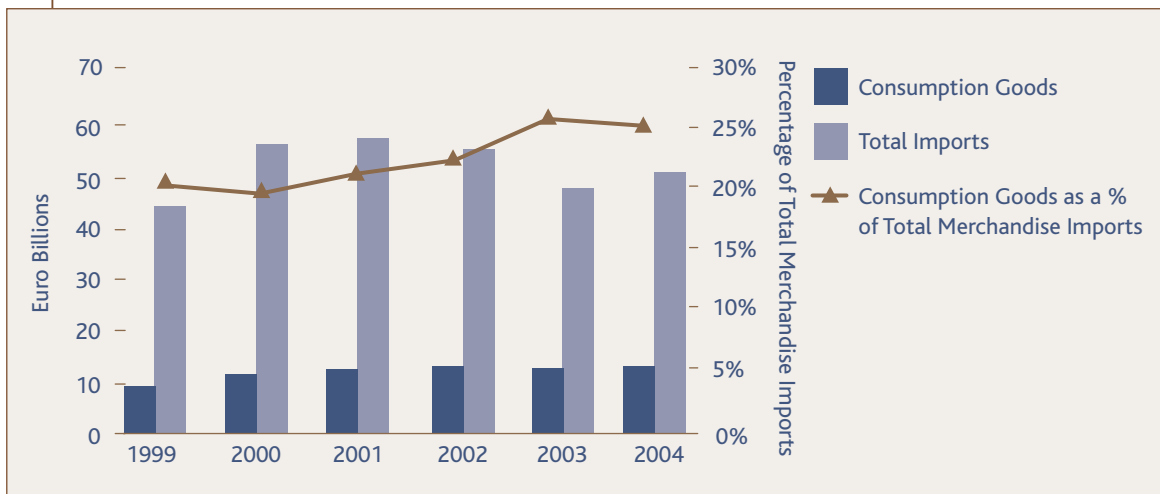


Although comprising only 5.5 per cent of total imports, fuel imports (petroleum, gas, coal) contributed 27 per cent of the rise in imports in 2004. In particular, imports of petroleum related products surged upwards by 43 per cent to €2.3 billion, on the back of a rise in world oil prices from \$34 a barrel in January 2004 to \$43 a barrel by the end of 2004. Ireland's fuel import quantities have been largely static, signifying that price rises are responsible for increased imports.

The two remaining significant import categories are chemicals and miscellaneous manufactures. Pharmachem imports have risen by 45 per cent since 1999. Imports of miscellaneous manufactures, which includes clothes, professional equipment, optical goods etc, have risen by 29 per cent since 1999, with furniture imports in particular growing by 63 per cent.

Imports can be further classified by their final use. Capital goods and intermediate goods are destined for use by industry, while the majority of 'consumption goods ready for final use' can be assumed to be intended for use by households. Notwithstanding a marginal decline in 2004, consumption goods have been slowly increasing as a share of total imports, from 21.2 per cent in 1999 to 25.8 per cent in 2004, reflecting in part buoyant demand from Irish consumers (Figure 9).

Figure 9 Irish Imports of Consumption Goods



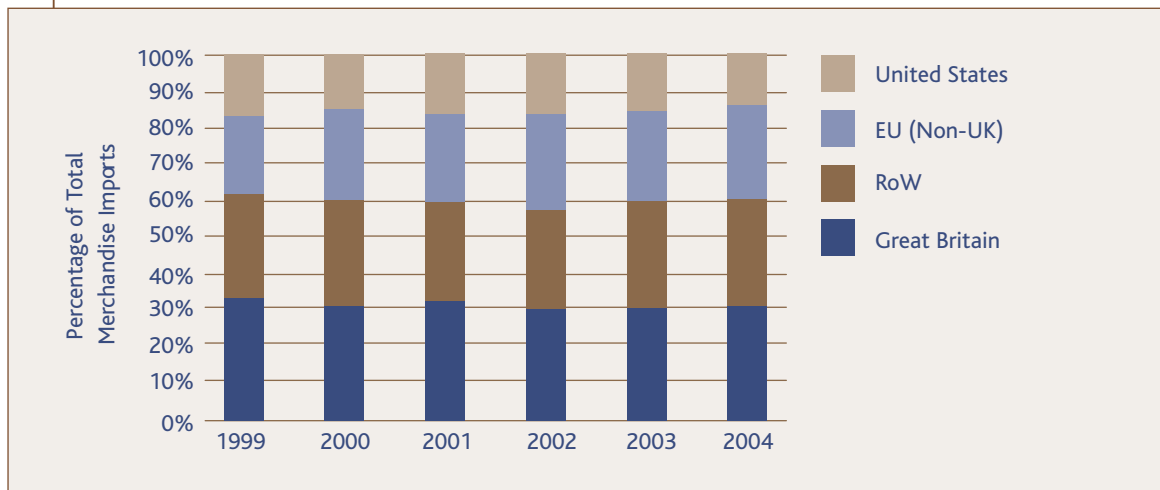
2.3.3 Origin of Irish Merchandise Imports

Merchandise imports from the UK grew by nine per cent in value terms to €16 billion in 2004. The UK was Ireland's largest source of merchandise imports with 31.4 per cent of the total in 2004, compared to 33 per cent in 1999. Electrical machinery, and petroleum are the largest import categories from the UK.

The share of Ireland's merchandise imports from non-UK EU countries rose from 22.1 per cent in 1999 to 26.3 per cent in 2004, increasing by 10.5 per cent in value terms in 2004 to reach €13.4 billion. In contrast, merchandise imports sourced from the USA continued to decline in 2004, falling by six per cent to €7 billion. Its share of total imports has fallen to 13.7 per cent, down from 16.7 per cent in 1999. Imports from the RoW rose by 7.5 per cent in 2004 to €14.6 billion, and now represent 28.7% of total imports compared to 28.3 per cent in 1999.

At an individual country level, Ireland's top five import partners in descending order are the UK, the USA, Germany, China and France. Imports from China and France recorded particularly impressive growth in 2004, rising by 25.2 per cent and 22 per cent from 2003 respectively. Imports from China have increased by 323 per cent since 1999 and at €2.8 billion represented 5.4 per cent of total Irish merchandise imports in 2004. China is the source of 23 per cent of Ireland's computer and computer parts imports, reflecting China's emergence as an important source of components for Ireland's ICT industry.

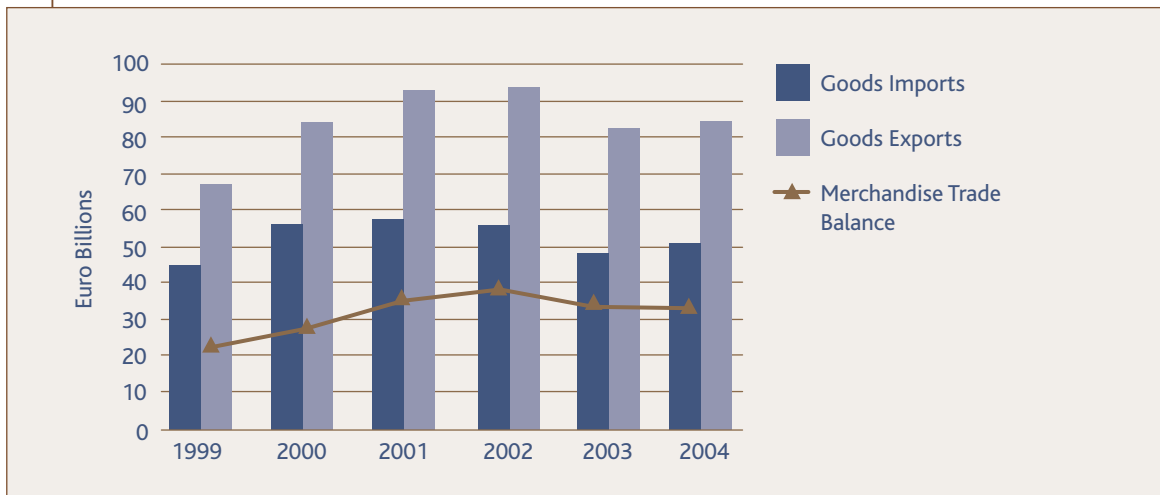
Figure 10 *Origin of Irish Merchandise Imports 1999-2004*



2.4 Ireland's Merchandise Trade Balance

Ireland's merchandise trade surplus fell for the second consecutive year in 2004, declining by 2.8 per cent to €33.2 billion. Exports rose by 2.6 per cent in 2004, but this was outweighed by faster import growth of 6.6 per cent, albeit from a lower base. Prior to 2003 Ireland had experienced 12 years of expanding merchandise trade surpluses. Overall, Ireland's trade surplus stands at 22.4 per cent of GDP (26.7 per cent of GNP), down from 24.6 per cent (29.4 per cent of GNP) in 2003, but it remains the largest per capita merchandise trade surplus in the OECD.

Figure 11 Irish Merchandise Trade Balance 1999-2004



On a sectoral basis the main changes were in pharmachem and ICT and transport equipment. In 2004 the surplus in pharmachem trade resumed its upward path, after a decline in 2003, representing over €30 billion out of the total merchandise surplus of €33 billion. However, this growth was outweighed by the continued decline in the ICT/machinery trade surplus. Rising fuel costs also contributed to the declining trade surplus. Preliminary data for 2005 indicates a further narrowing of the merchandise trade surplus, which has fallen by around €1.6 billion in the period January-August 2005, compared with the same period in 2004.

In 2004, Ireland ran significant trade surpluses with Belgium (€11.4 billion), the USA (€9.6 billion) and France, Germany, Italy, the Netherlands and Switzerland (in the region of €2-3 billion with each). The only countries with which Ireland ran considerable deficits were China (over €2 billion) and the UK (under €1 billion).

3. Services Trade

3.1 Global Developments

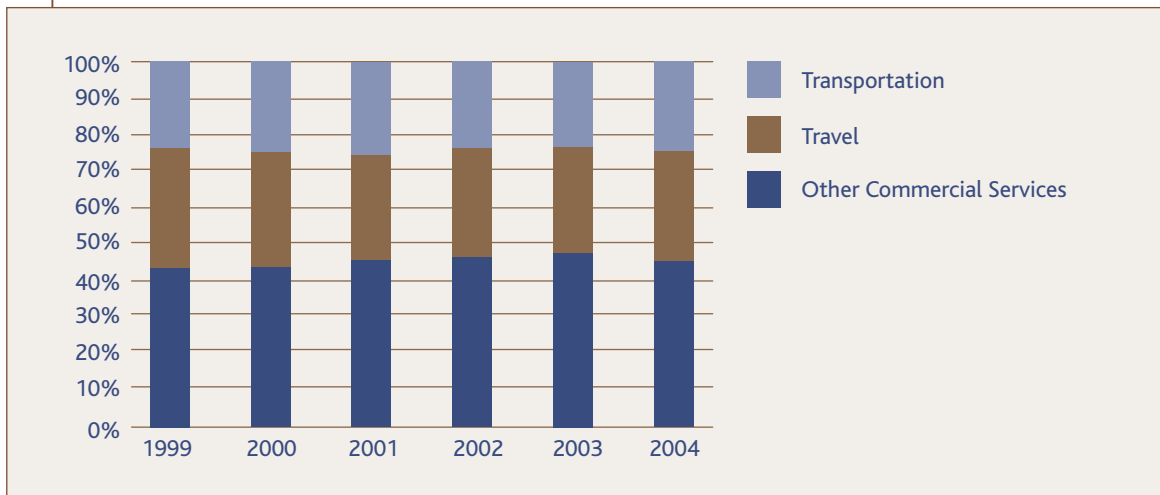
According to the WTO, world trade in commercial services rose to €1,540 billion in 2004, an increase of seven per cent on 2003, although in most regions growth in merchandise trade outstripped that of trade in commercial services. The enlarged EU (EU-25) remained the most important region globally in services trade, accounting for almost half of global exports and recording a modest surplus in recent years. Its three biggest exporters, the UK, Germany and France, together made up over 19 per cent of world services exports in 2004. However, the USA remained both the world's single largest importer and exporter of services, and ran a surplus in 2004 in services trade, particularly in business services. This surplus declined consistently every year between 1999 and 2004, and stood at €40 billion in 2004, only 60 per cent of what it was in 1999. Asia continued to be a net importer of services, with most of this deficit due to imports of transportation services.

Table 2 *Regional Breakdown and Growth in World Services Trade*

	Share of exports in 2004	Percentage change since 1999	Share of imports in 2004	Percentage change since 1999
Asia	21%	1	24%	-1
EU-25	48%	3	46%	2
North America	18%	-4	16%	-1
ROW	13%	0	14%	0

The WTO divides services trade into three broad categories, tourism and travel, transportation (trade-related services) and other commercial services (business services). Tourism's share of global services trade remained steady at 29.6 per cent in 2004, but prior to this it had been declining in importance, falling from a 32.7 per cent share in 1999. The share of transportation services stood at 23.6 per cent in 2004, similar to its level of 23.2 in 1999. While prior to 2004 this category was declining as technological changes reduced transportation costs, this trend was halted in 2003 and reversed in 2004, as strong merchandise trade growth created more demand for transportation services. Business services trade, as a percentage of world services trade, has been increasing in recent years mainly at the expense of tourism. This trend was reversed in 2004, as its share fell to 46.7 per cent, but this is still higher than its share in 1999 of 44.1 per cent.

Figure 12 Composition of World Services Trade

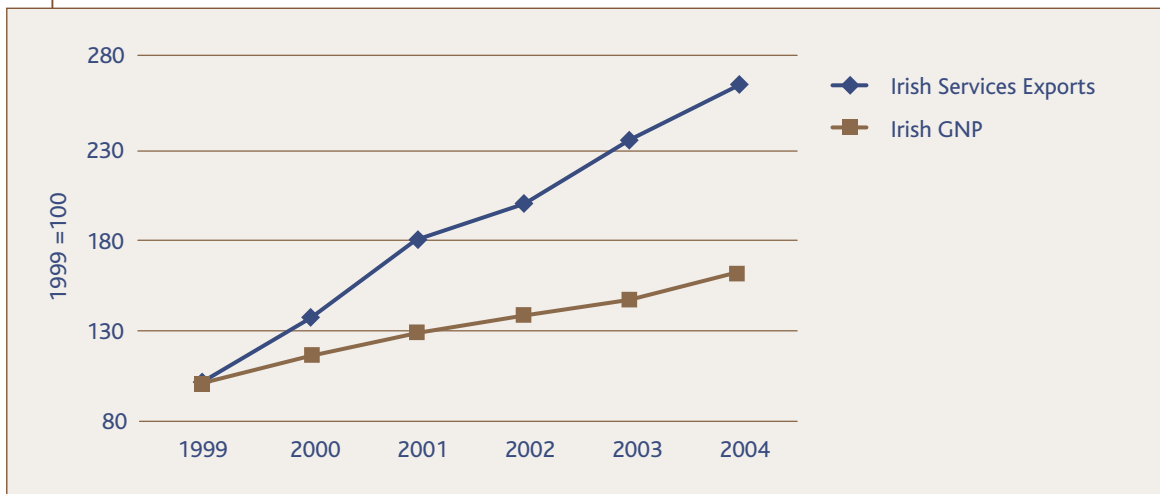


3.2 Irish Services Exports

3.2.1 Irish Services Exports by Value

2004 was another impressive year for Irish services exports. According to the WTO, world services trade in euro terms grew by seven per cent, while Irish services trade grew by 12.5 per cent. This strong growth placed Ireland in 14th position in the league table of services exporters for the second year in a row. Ireland had a 2.2 per cent share of world services exports in 2004. In comparison, Ireland's share of the world economy was around 0.32 per cent, underlining the openness of the Irish economy to world trade, particularly in services trade.

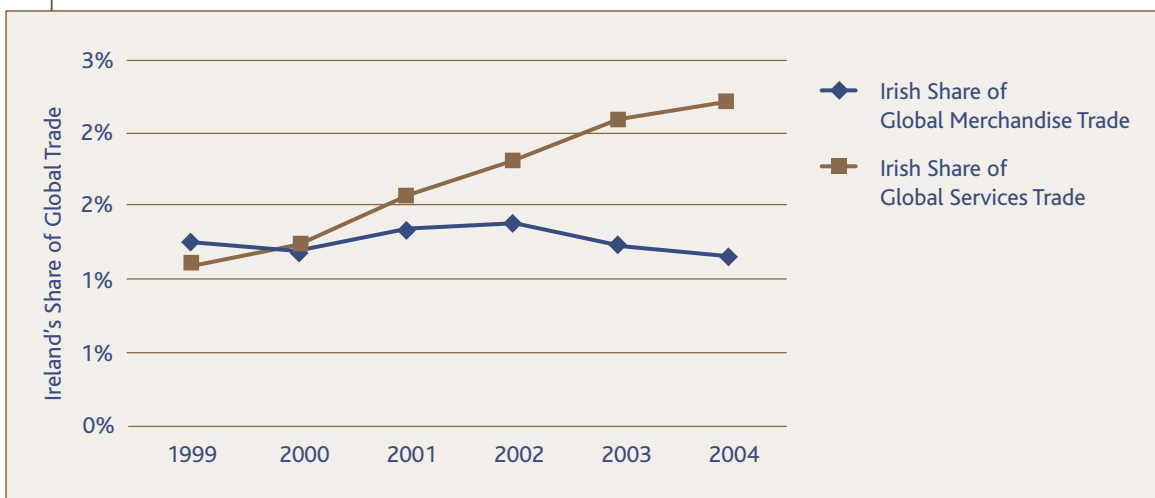
Figure 13 Irish GNP v Irish Services Exports 1999-2004



According to CSO data, services exports rose by 13.7 per cent in 2004 to reach 42.2 billion, which represents an increase of 167 per cent from 1999. In 2004, computer and general business services accounted for most of this gain.²¹

In contrast to the slowdown in merchandise export growth in recent years, services exports continue to grow rapidly. While service exports have increased by 167 per cent since 1999, merchandise exports have only posted a 25 per cent gain in the same period. As a result, services exports comprise a growing percentage of total exports, rising to 34 per cent in 2004 from 20 per cent in 1999. At 34 per cent the importance of the internationally traded services sector in Ireland is comparable to that of other developed economies, the share of services in total exports stands at 34 per cent in the UK and 30 per cent in the USA. Figure 14 underlines how the export performance of the services sector has outpaced that of manufacturing. Ireland's share of global services trade has been rising steadily since 1999, exceeding that of merchandise trade in 2000, which reached its peak in 2002.

Figure 14 Global Trade Share of Irish Services and Merchandise Exports

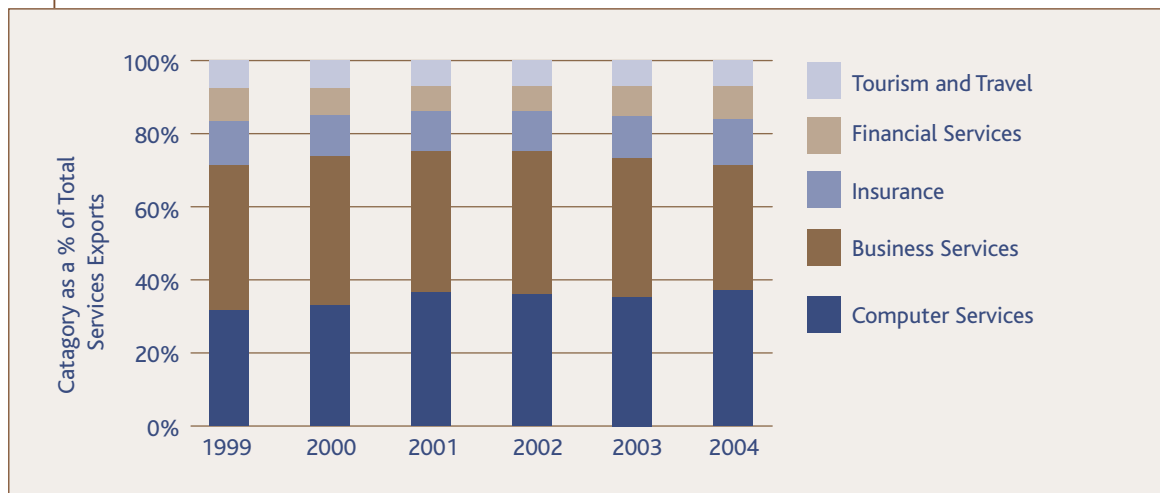


3.2.2 Irish Services Exports by Composition

Computer services remain Ireland's largest services export category. Ireland is the base for many multinational ICT companies and our strength in this area is reflected both in our manufacturing and services exports. Financial, insurance and general business services exports, of which the International Financial Services Centre (IFSC) is the main source, are another major contributor to services exports, while more traditional sectors such as tourism and travel have declined in relative importance.

²¹ Business services covers receivables and payables for (a) merchanting and other trade-related services, (b) operational leasing and (c) miscellaneous business services. Merchanting consists of the sales net of purchases by Irish merchants of foreign goods bought from and sold to non-residents without entering or leaving Ireland. Other trade-related services consist of commissions earned by resident agents or paid to non-resident agents in connection with imports or exports. Operational leasing covers leasing (other than financial leasing) and chartering, of aircraft, ships and other transport or other equipment and plant. Miscellaneous business services covers legal, accounting, management consulting, public relations, advertising and marketing, research and development and other professional and technical services as well as agricultural services. It also covers inter-affiliate management fees.

Figure 15 Composition of Irish Services Exports 1999-2004



Computer services continue to dominate services exports, accounting in 2004 for 35.5 per cent of total service exports, up from 33.5 per cent in 1999. Exports of computer services increased by 19 per cent in 2004, making up almost half of the total rise in services exports in that year, and increased by 183 per cent between 1999 and 2004. Computer services exports overtook computer merchandise exports for the first time in 2004. This growth reflects both Ireland's continued strength and skill base in ICT and the changes in the structure of the ICT industry, which include:

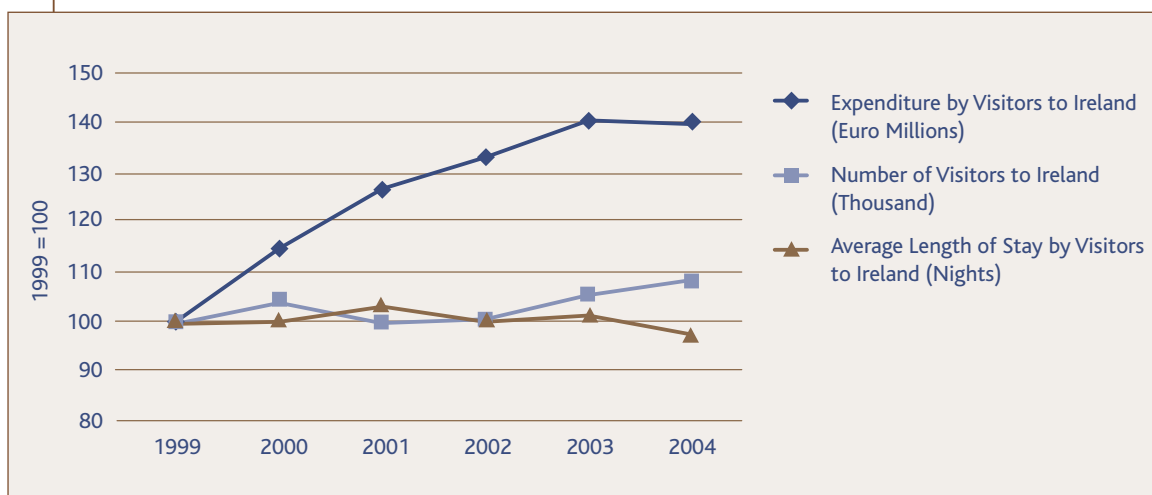
- A change in the medium of software delivery has boosted computer services exports. Previously software delivered in physical formats such as CD ROM was counted as a merchandise export, but as technological change has allowed software to be delivered electronically, it is now recorded as a services export instead.
- Many computer companies operating in Ireland have shifted focus from manufacturing PCs to selling IT services and solutions. IBM, for example, now employs one-third of its Irish staff in its sales and support centre for the EMEA (Europe, Middle East and Africa) region.
- Indigenous ICT firms are increasingly specialising on providing niche and custom software solutions and are highly export-orientated, generating 85 per cent of their revenues from exports, compared with only one-third for UK software and computer services companies.²²

The second largest category, insurance exports, has increased by 310 per cent in value from €2 billion in 1999 to €8.2 billion in 2004. It now accounts for 19.4 per cent of services exports, up from 12.6 per cent in 1999. Business services is the third largest single category of Irish exports, growing by 17 per cent in 2004 to €8.1 billion and rising by 283 per cent since 1999. It now accounts for 19.3 per cent of total service exports, up from 13.5 per cent in 1999. The fourth major sector in Irish services exports is financial services. This rose by 20.3 per cent, from €3.4 billion to €4 billion, in 2004 and by 159 per cent since 1999. Exports from this sector now stand at 9.6 per cent of total services exports, marginally down from 9.9 per cent in 1999. Developments in these areas will be covered in greater detail in section 3.4.

²² *Services Offshoring into Ireland – Frank Barry 2005.*

Tourism and travel's share of total service exports continues to decline in importance, down from 15 per cent in 1999 to eight per cent in 2004. Although between 1999 and 2004 expenditure by visitors to Ireland increased by over 40 per cent, growth in tourism exports have been considerably below the overall growth in services exports and in 2004 tourism receipts were flat. Other tourism indicators demonstrate the relatively slow growth in the tourism industry – the average length of stay of visitors to Ireland fell from 7.77 days in 1999 to 7.45 days in 2004, while in the same period the overall number of visitors has increased by less than ten per cent to reach over six and a half million. These figures indicate that while visitor numbers to Ireland are holding up, tourists are increasingly taking shorter breaks.

Figure 16 Irish Tourism Exports Indicators



Included in the 'other' category in Figure 15 are communications, transport, royalties/licences, and services not classified elsewhere. Communications services exports have risen by 187 per cent since 1999 to €761 million, down from their peak of €1.1 billion in 2001. They account for around two per cent of total services exports. The activities of call centres are included under this heading. Exports of transport services rose by 11 per cent in 2004, and by 51 per cent since 1999, to reach €1.9 billion. Income from royalties/licences fell by 68 per cent since 1999 to €177 million.

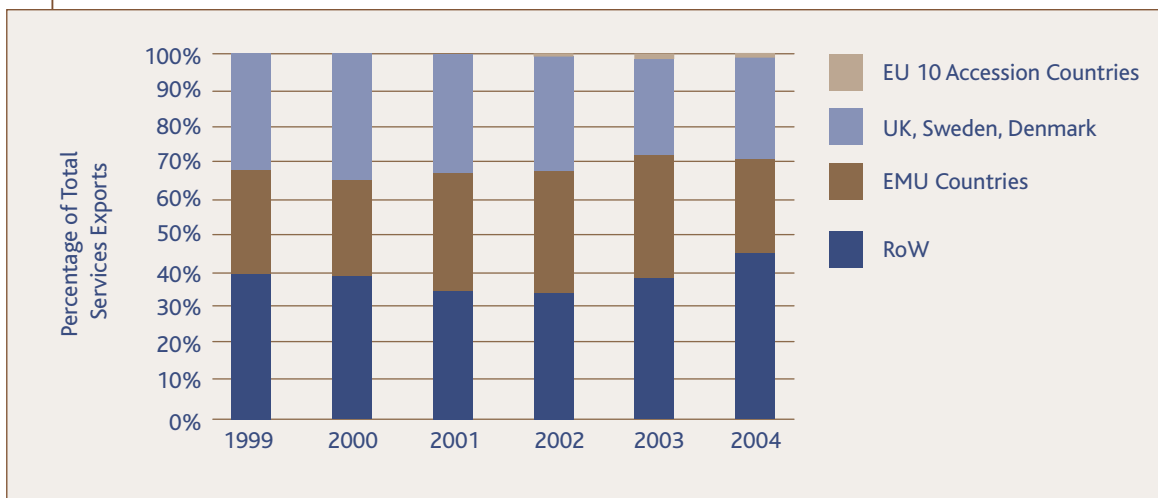
3.2.3 Destination of Irish Services Exports

Data on Irish services export and import markets can only be broken down into four regions, the eurozone, the EU 10 accession countries, a group comprising the UK, Sweden and Denmark and the RoW. In 2004,²³ the RoW purchased of 38 per cent of our services exports, the eurozone 33 per cent, the UK 28 per cent, and the EU 10 accession countries one per cent. The most notable change since 1999 has been that the eurozone has overtaken the UK to become Ireland's second most important export destination.

²³ CSO service data is limited to a breakdown based on EMU and non-EMU and a separate disaggregation: EU25 and non-EU. This breakdown offers a quite limited picture of the direction of services trade. In analysing this data it can be assumed that the difference between EU15 and eurozone trade is almost entirely accounted for by the UK, as Sweden and Denmark are the only other countries in this category (Ireland's merchandise trade with these countries is very small relative to trade with the UK). Since 2002 data is available for the ten new EU member states, so from that year onwards, the rest of the world excludes these countries. The CSO are currently changing the format of published services statistics, and greater breakdown by category and trading country is expected to be available soon.

Irish services exports to the RoW amounted to €15.8 billion in 2004, representing an increase of 13 per cent on 2003 and 151 per cent on 1999. Ireland's service exports to the eurozone rose to €14.1 billion in 2004, 212 per cent higher than in 1999 and 13.7 per cent higher than in 2003. Exports to the UK, Sweden and Denmark stood at €11.8 billion in 2004, an increase of 13.2 per cent and 136 per cent from 2003 and 1999 respectively. However, counterparty data from the UK tells a different story – according to British trade statistics our services exports to the UK amounted to only €3.9 billion in 2004.²⁴ The WTO suggests that in general services trade is likely to be better recorded on the export side rather than the import side as statistical agencies find it easier to collect data from a few large exporters rather than many small importers. Nevertheless a difference of this magnitude highlights the difficulty in comparing services trade statistics across countries. Exports to the ten new member states of the EU increased from €272 million in 2003 to €497m in 2004, an 82.7 per cent rise. However, they only account for a small fraction of total exports (0.7 per cent in 2003 and 1.2 per cent in 2004).

Figure 17 Destination of Irish Services Exports 1999-2004



3.3 Irish Services Imports

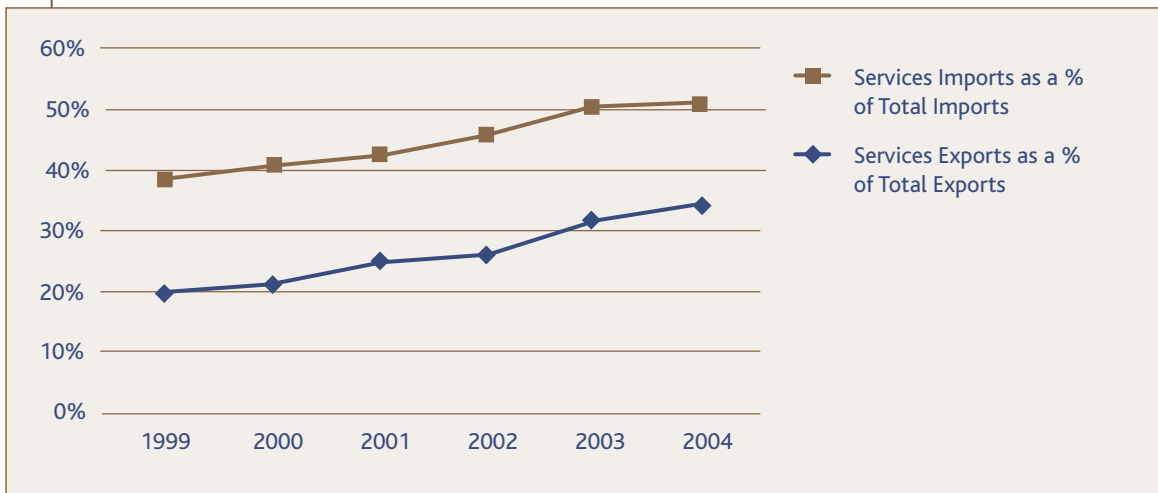
3.3.1 Irish Services Imports by Value

The value of Irish services imports grew 7.7 per cent in 2004 to reach €51.9 billion, up from €48.2 billion in 2003. Since 1999 imports doubled from €26 billion. Service imports as a percentage of total Irish imports have risen steadily since 1999, up from 38.5 per cent to 51.7 per cent in 2004.

According to WTO data, Ireland accounted for 2.8 per cent of imports of internationally traded services, making it the world's ninth largest importer for the second year running. The composition and large size of Ireland's services imports is due mainly to the presence of a large foreign-owned manufacturing sector. Much of the business services imports comprise of transactions between Irish subsidiaries and their foreign headquarters, such as inter-affiliate management fees. The same can also be said of royalties and licences imports, which primarily represent payments by foreign-owned companies in Ireland to their parent companies for the use of patented processes and technologies.

²⁴ Information on services is gathered from Balance of Payments data. Unlike merchandise trade data which has a standardized classification system, the difference in classification approaches towards services can make comparisons between national data sources difficult. In addition services trade is likely to be better recorded on the export side rather than the import side as statistical agencies find it easier to collect data from a few large exporters rather than many small importers.

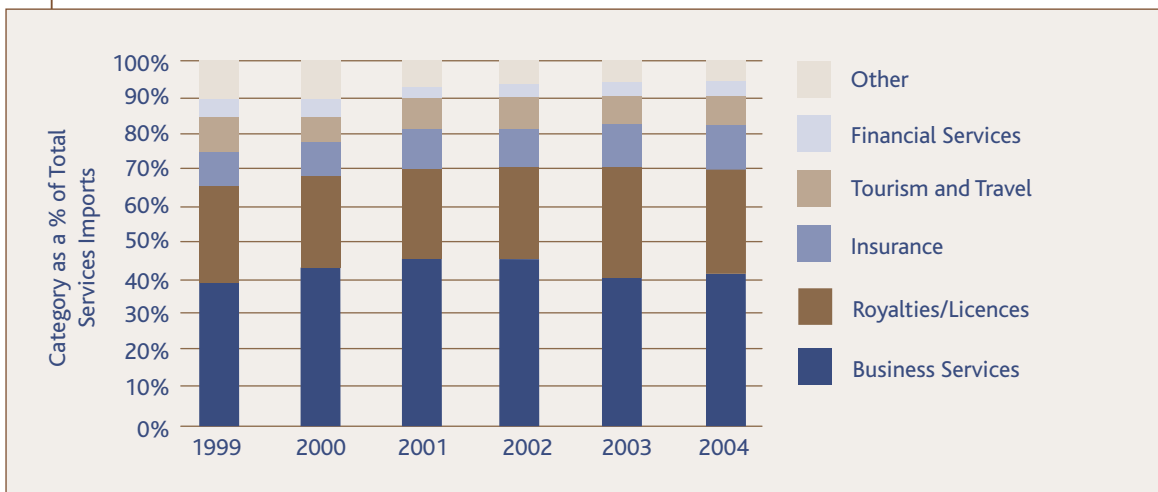
Figure 18 Evolution in Irish Services' Share of Total Irish Trade



3.3.2 Irish Services Imports by Composition

Business services account for 41 per cent of the total services import bill is accounted for by business services, which totalled €21.3 billion in 2004. Its value rose by nine per cent in 2004 and has doubled from €10.2 billion in 1999. Business services imports are divided approximately half and half between miscellaneous business services, which include inter-affiliate charges, and trade-related services.²⁵ The sharp rise in business services imports in 2004 was mainly due to a 17.7 per cent rise in miscellaneous business services imports.

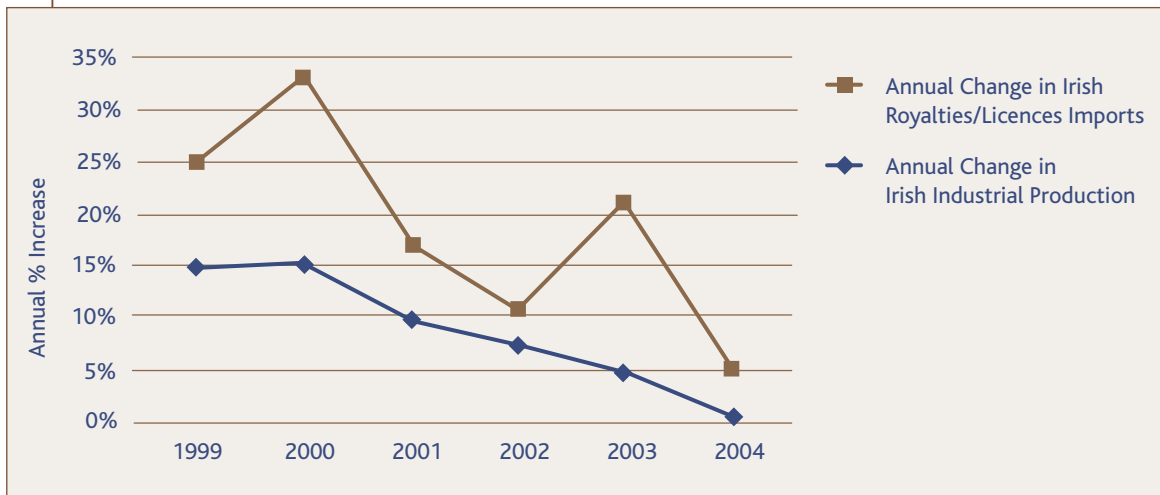
Figure 19 Composition of Irish Services Imports 1999-2004



The second largest contributor to services imports is royalties and licenses, amounting to €14.8 billion in 2004. They rose by 4.5 per cent in 2004 and by 118 per cent between 1999 and 2004. The bulk of royalty imports are essentially patent payments by foreign-owned manufacturers to their parent companies abroad and as such would be expected to change in tandem with Irish industrial production. Figure 20 shows how the growth rate in royalty imports has decelerated, except for a temporary deviation in 2003, along with the slowdown in industrial output growth in the same period.

²⁵ See footnote 21.

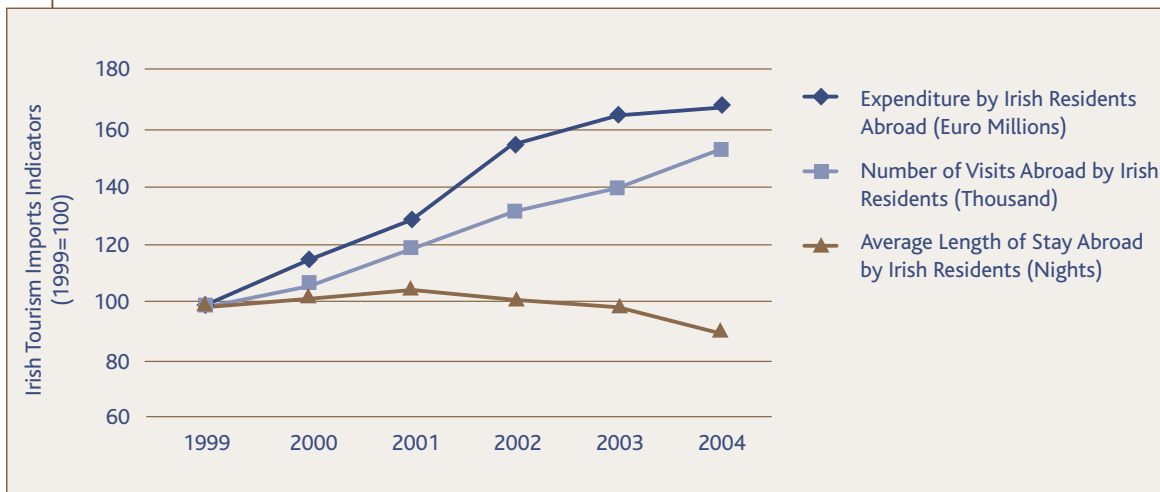
Figure 20 Annual Changes in Irish Industrial Production and Royalties Imports



Insurance services imports of €6.3 billion and financial services imports of €2 billion combined comprised 16.1 per cent of Irish services imports in 2004 and have risen 164 per cent and 71 per cent respectively since 1999 and 14 per cent and 12.3 per cent respectively from 2003. It is likely that much of the activity in insurance and financial services trade is generated by companies in the IFSC and this will be discussed in more detail in section 3.4.

In 2004, tourism and travel imports of €4.2 billion represented eight per cent of services imports, compared to 9.5 per cent in 1999. Figure 21 shows that while the average length of stay abroad has declined marginally, the number of visitors and their expenditure has increased from 1999 levels by around 52 per cent and 69 per cent respectively. In 2004, Irish people spent €736 million more on journeys abroad than visitors to Ireland spent here.

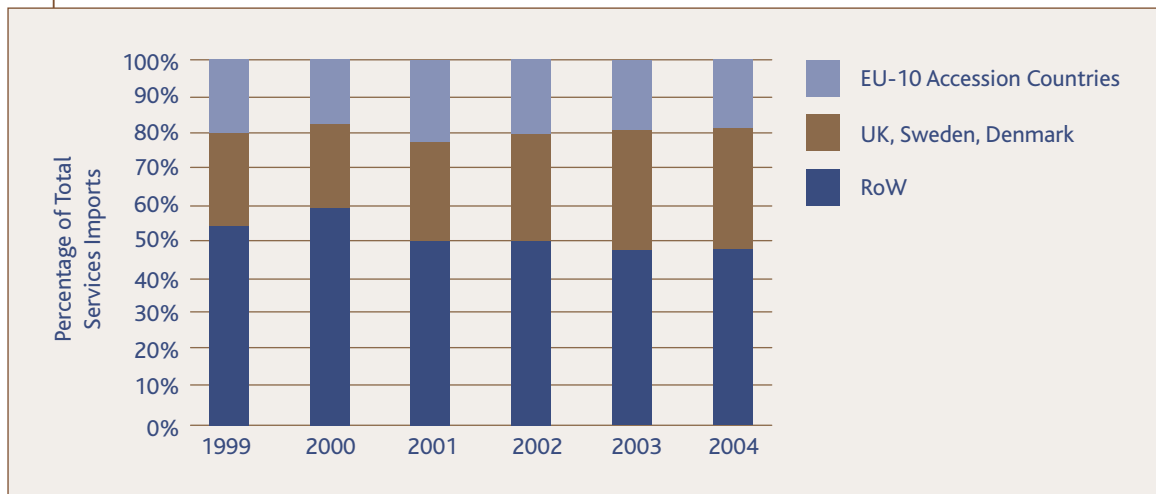
Figure 21 Irish Tourism Imports Indicators



The remaining service categories, included in 'others' in Figure 19, are transport, communications and computer services, together comprising just over six per cent of total services imports in 2004. Transport imports have fallen 22 per cent since 1999 to €1.8 billion while computer services imports have risen by 11 per cent to €293 million in the same period. Communications services imports increased 215 per cent from 1999, albeit from a low base, to just under €1 billion in 2004.

3.3.3 Origin of Irish Services Imports

Figure 22 Origin of Irish Services Imports 1999-2004



As is the case with services exports, the geographical breakdown of import data is limited to EU, the eurozone, the ten new EU member states and the rest of the world. Data on the new member states is only available since 2002, prior to which they were included with the RoW. The most notable trend since 1999 has been the rising share of services imports sourced from the eurozone, increasing from 24.5 per cent in 1999 to 33 per cent (€17,151m) in 2004. While imports originating from the UK, Sweden and Denmark have grown by 69 per cent to €9.2 billion since 1999, their share of total services imports has fallen to 18.3 per cent from 21 per cent in the same period. The EU 10 accession countries account for less than one per cent of services imports. The RoW continues to account for the largest part of services imports, due in part to the influence of US dominated sectors of the economy, whose companies import services from their affiliated firms.

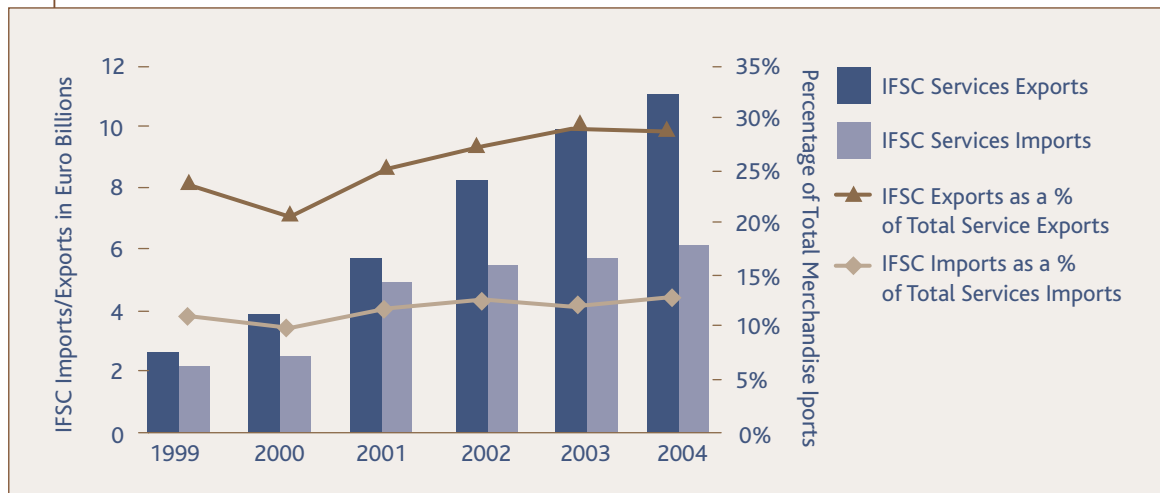
3.4 Ireland's Trade in International Financial Services

As outlined in section 3.2.2, exports from the IFSC have been one of the main drivers of Irish services export growth in recent years.²⁶ Companies based in the IFSC account for the majority of Irish insurance and financial services exports, which grew by 310 per cent and 159 per cent respectively between 1999 and 2004.²⁷ It is also likely that a considerable proportion of business service exports, which include accounting and legal services, are also accounted for by the IFSC.

²⁶ The CSO breaks down services trade into IFSC exports, relating mainly to financial service enterprises operating from the International Financial Services Centre in Dublin, and non-IFSC services trade.

²⁷ Ireland is a leading global centre in the area of funds, particularly in activities such as fund administration and asset management. Many of the world's leading banks and insurance companies have set up in Ireland, engaging in activities such as debt issuance, treasury management, securitisation, structured finance and asset financing. In insurance, Irish based life insurers wrote approximately €5.85 billion of premiums in 2002, making Dublin Europe's largest cross-border life centre. Source: Review of the Irish Financial Services Centre – Deloitte and Touche, September 2004.

Figure 23 Irish Financial Services Imports and Exports



Looking at the evolution of IFSC trade since 1999, growth in exports of 234 per cent has outpaced the growth in total Irish services exports of 167 per cent. Notwithstanding a slight fall in 2004, IFSC exports as a percentage of total services exports have risen from 27.5 per cent in 1999 to 34.5 per cent in 2004, amounting to €14.6 billion. IFSC imports have also grown since 1999 but at a slower rate of 156 per cent. In 2004 they stood at 18.1 per cent of total services imports.

This performance underlines the continued success of the IFSC and its importance to the economy, a point emphasised when we consider that there was a net trade surplus of €4.9 billion in IFSC activities in 2004. In addition, it is estimated that 17,600 people were directly employed in IFSC companies in 2004, representing an increase of seven per cent on 2003, with many more employed in supporting industries. In 2004 assets administered by IFSC companies amounted to €600 billion and the €663 million collected in tax represented 12.4 per cent of the corporation tax take in Ireland.²⁸

3.5 Ireland's Services Trade Balance

The services trade deficit fell for the second consecutive year in 2004, by €1.4 billion to €9.7 billion, the lowest services deficit since 1998. The overall trade surplus (merchandise and services) now stands at over €22 billion.²⁹ Several reasons can be advanced to support this trend, both on the export and import side.

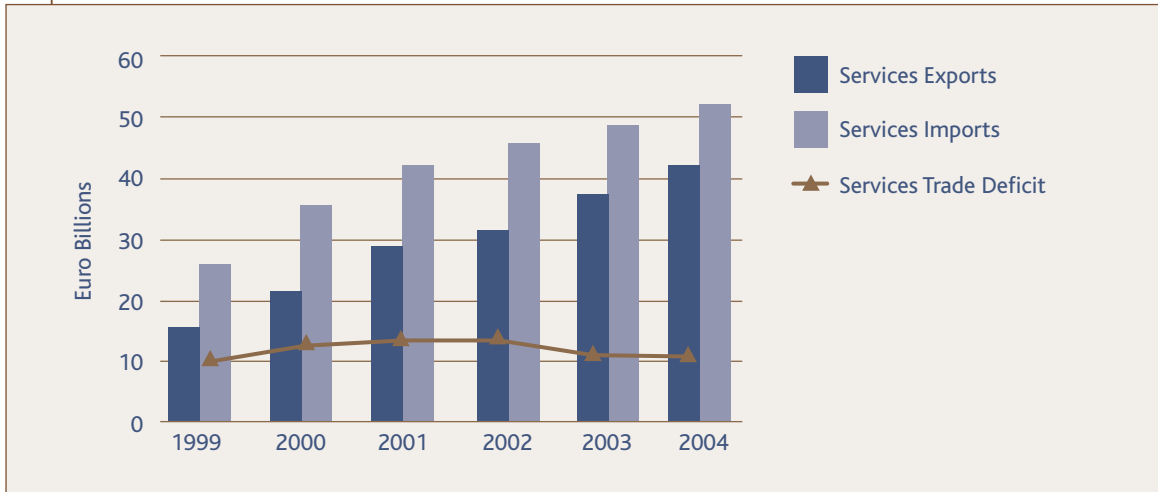
- The IFSC continues to thrive, with the activities of global financial companies generating a considerable surplus in IFSC services trade.
- A change in the medium of software delivery has delivered a boost to computer services exports. Previously software delivered in physical formats such as CD ROM was counted as a merchandise export, but as such products began to be delivered electronically they were recorded as services exports instead.
- The activities of many multinationals have evolved, particularly in the ICT sector; from simply being manufacturing locations to increasingly becoming providers of value added services for their affiliates or parent companies located elsewhere, which in turn contributes to Ireland's services exports.

²⁸ Finance Dublin website – July 2005.

²⁹ Taken from Balance of Payments data.

- The recent slowdown in industrial output has caused a deceleration in the growth of royalty payments and also in turn reduced the level of inter-affiliate management fees, thus reducing services imports.
- Irish-owned ICT services companies are specialising successfully, for example in the banking software sector, and thus increasing their exports.

Figure 24 Ireland's Services Trade Balance 1999-2004



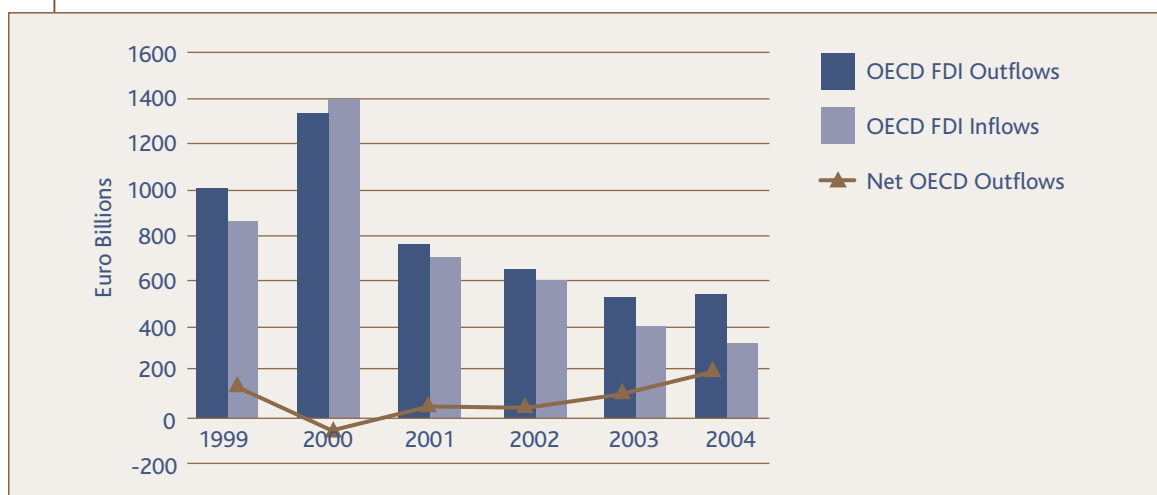
4. Foreign Direct Investment

4.1 Global Developments

After three consecutive years of decline, outflows of foreign direct investment (FDI) from OECD countries rose 3.7 per cent in 2004 to €538 billion.³⁰ Despite this return to growth, the figure still represents only 40 per cent of the all time peak in OECD FDI outflows of €1,340 billion in 2000. This rebound in FDI flows came at a time of stronger economic growth, as the global economy grew four per cent in 2004.

As one would expect from relatively rich developed economies, the OECD is a net investor in the rest of the world. The net outflow, the amount by which outflows exceed inflows, has generally been quite small compared to total OECD outflows, illustrating that the majority of OECD FDI outflows are destined for other developed OECD countries. However this net outflow has been rising sharply in recent years, at a time when overall FDI flows were declining, and reached a record high of €210 billion in 2004, indicating that developing countries are rapidly gaining a larger share of global FDI flows. In 2004 OECD net outflows amounted to 39 per cent of total OECD FDI outflows, a significant increase from 15 per cent in 1999.

Figure 25 OECD FDI Flows 1999-2004



The USA is both the largest foreign investing country and the largest recipient of FDI in the world, with outflows of €203 billion and inflows of €86 billion in 2004.

Inward FDI into China keeps hitting new records, reaching over €44 billion in 2004, up from €42 billion in 2003. Direct investment into Hong Kong, some of which is ultimately destined for mainland China, was over €27 billion in 2004. These inflows are helping to fuel the continuing economic boom in China, leading to continued concerns that the economy may be overheating. According to the OECD, much of the OECD FDI into China is aimed at setting up production facilities to service the local market, and not just at off-shoring production from high-cost OECD countries.

³⁰ Unless otherwise stated, the source for data on global FDI flows is the OECD 2005 report "Trends and Recent Developments in FDI". The outflow of FDI from the OECD is a suitable proxy for global FDI trends, since the OECD countries account for the vast majority of the world's economy - in recent years OECD outflows of FDI have averaged over 95 per cent of total global FDI, according to the United Nations Conference on Trade and Investment (UNCTAD). In 2004 OECD outflows were 92 per cent of UNCTAD estimate of global FDI flows.

The Central and Eastern Europe countries (CEECs) experienced significant inflows of FDI over the last decade.³¹ The cumulative stock of FDI in the CEECs rose almost tenfold from 1994 to 2003 to €175 billion, while inflows in 2004 alone reached €20 billion. FDI stocks as a percentage of GDP rose in the same period from seven per cent to 33 per cent. It is estimated that over the last decade, FDI has contributed, on an annual basis, two thirds of average annual regional growth of 3.5 per cent.³² FDI into Russia has continued to recover strongly, at €9 billion in 2004, with the energy sector being the main attraction for foreign investment.

A growing feature of global FDI flows in recent years has been the emergence of Research and Development (R&D) as a driver of multinationals' investment decisions.³³ Traditionally R&D, which requires close collaboration and exhibits cluster effects, was among the least internationalised segments of multinationals' value chain; functions such as production and marketing were moved abroad more quickly. However, multinationals are increasingly conducting their R&D operations outside their home economies, as they search for both the best scientific talent and lower costs. Multinationals are conservatively estimated to account for at least two thirds of global business expenditure R&D (BERD) spending, which totalled €362 billion in 2002.³⁴ The foreign affiliates of multinationals account for an increasing share of global BERD expenditure, rising from 10 per cent in 1993 to 16 per cent in 2002. According to UNCTAD foreign multinationals accounted for over 70 per cent of BERD expenditure in Ireland in 2003, which was the highest share in the world, suggesting that Ireland is an attractive location for R&D-related FDI.

The outsourcing of R&D has not been just confined to developed countries – developing countries such as China and India are capturing more and more R&D-related FDI inflows. The stock of such FDI reached €3.2 billion in China in mid-2004. The relative abundance of qualified scientists and engineers, quality educational institutes, government incentives and of course lower costs contribute to both these countries being seen by multinationals as among the most attractive prospective R&D locations in the world, with China ranked first and India in third place.

31 CEEC countries include Albania, Bulgaria, Estonia, Croatia, Latvia, Lithuania, Macedonia, Poland, Romania, Slovakia, Slovenia, the Czech Republic, Hungary.

32 Marco Neuhaus, "The impact of Foreign Direct Investment on Economic Growth: An analysis for the Transition Countries of Central and Eastern Europe, doctoral dissertation, Mannheim University.

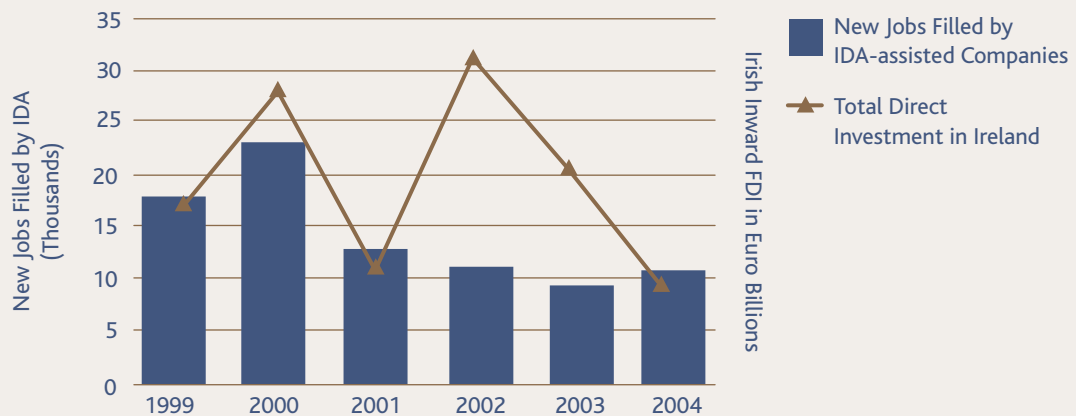
33 The information on R&D is taken from UNCTAD 2005 World Investment Report: Transnational Corporations and the Internationalization of R&D.

34 UK Department of Trade and Industry.

TEXT BOX 2: HOW TRUSTWORTHY ARE FDI STATISTICS?

While increased FDI inflows, as revealed in the statistics published by the OECD and others, have a strong relationship in the long term to trends in multinational employment growth, it is interesting to note that this relationship isn't always evident in the more short term data. The figure below charts the relationship between annual changes in inward investment flows and new jobs created each year by IDA Ireland supported companies. It shows that in 2002, the peak year for inward FDI into Ireland according to the OECD data, the number of new jobs created was lower than in the previous three years - in fact IDA Ireland backed companies suffered net job losses in that year. In 2004, although inward FDI dropped dramatically, the number of new jobs created rose slightly.

Jobs Created by IDA Ireland-assisted Companies and Inward FDI to Ireland



This discrepancy between FDI activity and actual economic performance is not unique to Ireland and has been the subject of much international discussion.^A

The concept of FDI at its core relates to "one-to-one" greenfield investments by one economy in another, which would be expected to increase the production capacity of the host economy. However from the 1970s onwards, capital market deregulation and the growing phenomenon of multinationals caused the nature of FDI flows to increasingly change to types of chain investments, with many indirect links between related enterprises. Major multinationals began to set up treasuries and holding companies, often in countries other than where the head office was based, and with limited real links to their host economy. These holding companies take advantage of operating efficiencies and different fiscal or regulatory environments, in order to optimize the financial performance of their parents. As a result FDI statistics now increasingly reflect "indirect" investment, or in another sense the financing operations of multinationals, which have caused FDI flows to multiply between countries and within companies. These flows have little relationship to the original concept of FDI as a direct "one-to-one" investment, raising doubts about their usefulness for economic analysis.

Work is currently being undertaken at the IMF to try and reach agreement for a reform of the collection procedures relating to FDI to take account of these issues.

A IMF Direct Investment Technical Expert Group (DITEG) - Frank E.M. Ouddeken, De Nederlandsche Bank

23 Data from national and US sources for 2000 are contradictory. According to national figures massive disinvestment was recorded by non-EU residents, while US data show almost \$10bn flowed into Ireland from that source.

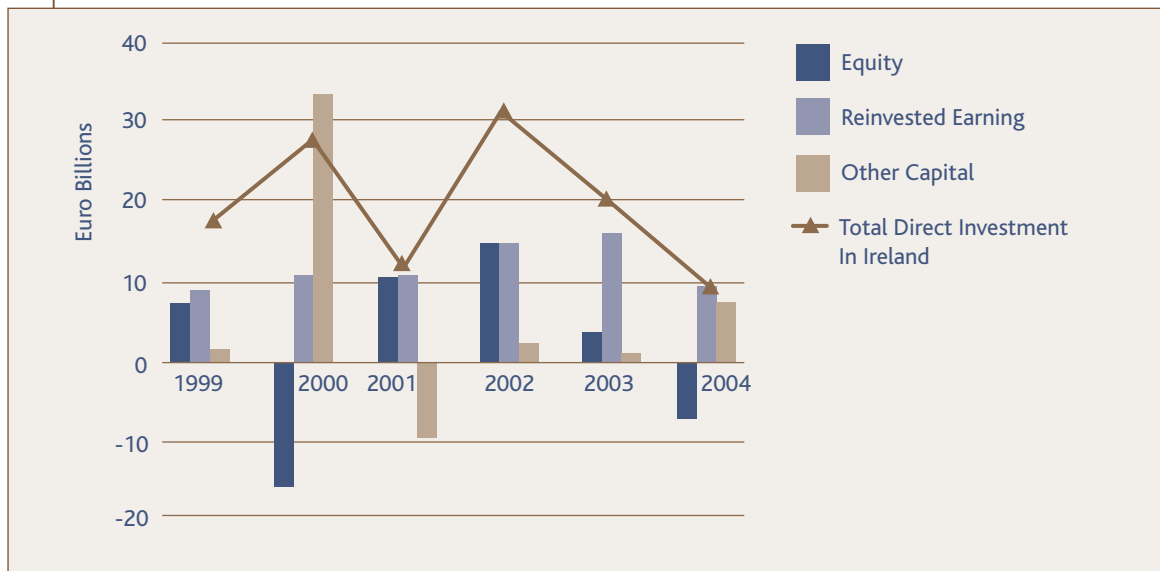
4.2 Irish FDI Inflows

CSO data shows that direct investment into Ireland declined significantly in the three years to 2004, with the 2004 inflow of €9.1 billion standing at less than half the inflow for 2003 and less than one third of the record inflow of €31.2 billion achieved in 2002.

The relevance of FDI statistics as they are currently measured is debatable and must be treated with caution. FDI flows are volatile and changes in each category result as much from the internal financial transactions that take place within firms as from actual physical investments in new production facilities (see Text Box 2 for a more detailed discussion of this). These flows often have little relationship to the original concept of FDI as a direct "one-to-one" greenfield investment.

The contribution of FDI to the Irish economy can be measured by criteria other than net inflows. In 2004 the number of new projects announced by IDA Ireland supported companies rose by 10 per cent, while the number of new jobs created rose by 18 per cent on 2003. The net level of employment in IDA Ireland backed companies rose slightly also. Increasingly it is the quality rather than the quantity of new jobs that matters. Reflecting this, over 48% (40% in 2003) of the new jobs in IDA Ireland supported projects announced in 2004 will pay salaries in excess of €37,000 when the projects become operational, compared to the average industrial wage of around €30,000 (Dec 2004).

Figure 26 Components of Inward FDI in Ireland

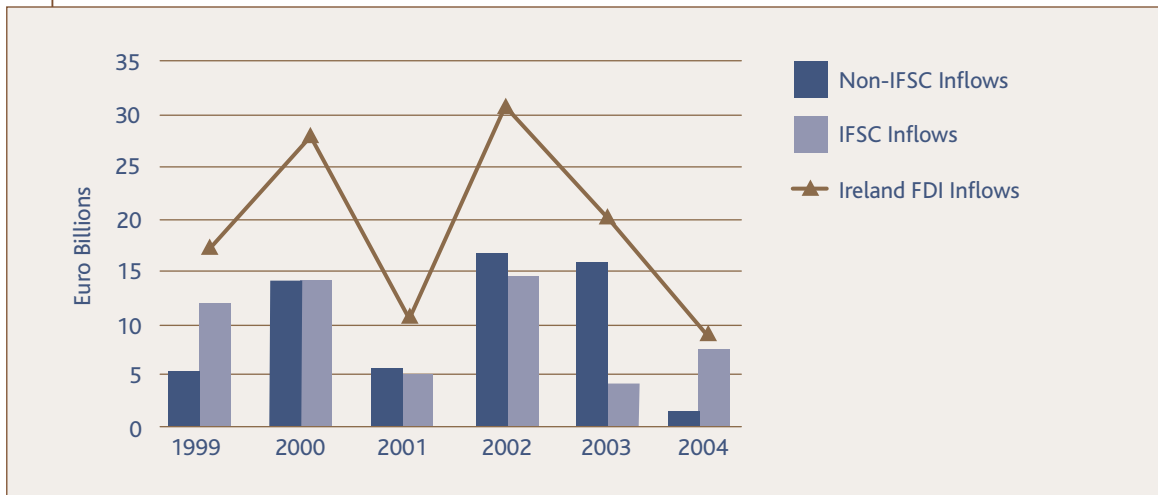


In line with international methodology, FDI is classified under three categories, namely equity, reinvested earnings and other capital.

- There was a negative flow of €7.2 billion in the equity category in 2004, indicating that transfers by Irish-based foreign owned companies to their parent companies outweighed equity investment flows into Ireland.

- Reinvested profits of foreign-owned companies into their Irish operations, which have generally been rising over recent years both in absolute terms and a percentage of overall FDI, fell 43 per cent to €9.1 billion in 2004. Much of this drop can be attributed to particularly large dividend payments by multinationals in 2004. Changes in US tax law are also expected to reduce FDI inflows from retained earnings even further. The Job Creation Act in October 2004 afforded American companies the opportunity to repatriate profits earned by their foreign affiliates at a special tax rate of 5.5 per cent instead of the normal rate of 35 per cent. This tax window lasts for one financial year and its effects on reinvested earnings are likely to continue throughout both 2005 and 2006. However this tax break is not expected to have any bearing on investment decisions by US multinationals in Ireland.
- The 'other capital' category contains, among other items, inter-affiliate financial transactions and it is usually through this category that financing for greenfield investments are channelled. Inward flows of other capital rose from €798 million in 2003 to €7.2 billion in 2004.

Figure 27 *Inward FDI in Ireland: IFSC and non-IFSC*

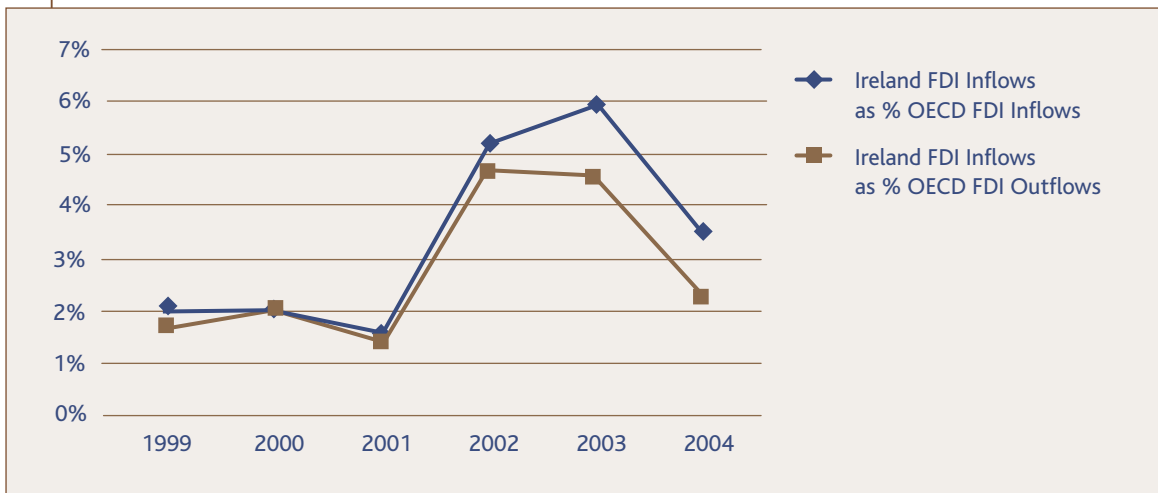


Inflows of FDI into IFSC companies form an important part of Ireland's total FDI inflows. In 2004 the majority of direct investment into Ireland went into IFSC related companies for the first time since 1999, while non-IFSC FDI was at its lowest level since 1998. Non-IFSC FDI inflows fell from €15.7 billion in 2003 to €1.5 billion in 2004, and IFSC inflows rose from €4.4 billion to €7.7 billion in the same period. The results of the success of the internationally traded financial services sector in attracting investment is reflected in rising employment and exports, as discussed in Section 3.4.

Despite these steep falls in inflows in 2004 Ireland still remains an attractive location for FDI according to OECD data. In 2004 Ireland attracted 2.1 per cent of total OECD outflows amounting to €11.3 billion, or approximately one out of every €48 euros invested.³⁵ However 2004 represents a decline from previous years, since in 2002 and 2003, Ireland was the destination for 4.7 per cent and 4.5 per cent of OECD outflows respectively. While still disproportionately large, Ireland's share has fallen from these peaks and now stands at the same level as it did back in 2000. As a result, in absolute terms, Ireland has fallen to 9th in 2004 from 6th place in 2003 in terms of inflows to OECD countries.

³⁵ OECD data is sourced from the CSO. However the CSO FDI data used in this paper is more recent (June 2005) than that used by the OECD and contains significant revisions not included by the OECD.

Figure 28 Irish FDI Inflows as a Percentage of OECD FDI Inflows and Outflows

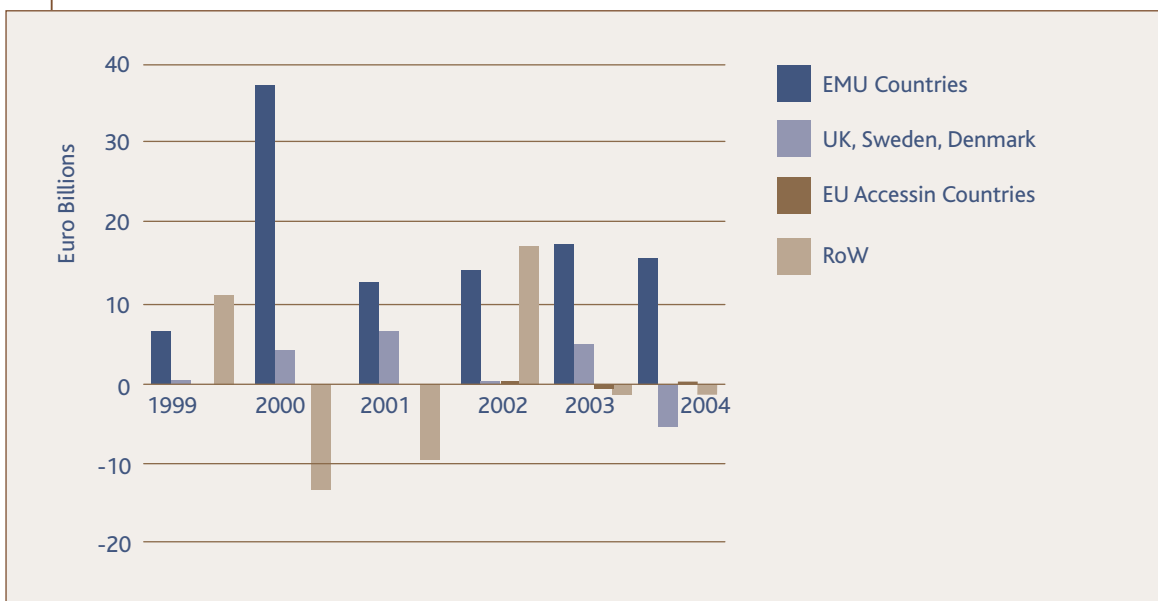


The importance of the foreign-owned sector in the Irish economy is clear. In terms of aggregate manufacturing turnover, the share of the foreign-owned sector was highest in Ireland and Hungary at 75 per cent, compared to less than three per cent in Japan. The share of foreign firms in total manufacturing turnover is also high in Canada, the UK, France, Poland and the Netherlands, exceeding 30 per cent. Using OECD data, the cumulative stock of FDI invested in Ireland in 2004 stood at 125 per cent of GDP.³⁶ This is by far the highest ratio of any of the OECD countries, bar Luxembourg.³⁷

4.3 Origins of Ireland's Inward FDI

As is the case with services data, the CSO Balance of Payments data on direct investment can only be broken out to four geographical areas: the eurozone, EU 10 accession countries, EU-15 countries not in the eurozone (UK, Sweden and Denmark) and the rest of the world.

Figure 29 Origin of Direct Investment into Ireland



³⁶ FDI stock invested in Ireland was calculated as position end 2003 plus inflow 2004 which totalled together \$231,231million. Ireland's 2004 GDP was converted to USD using the average USD/EUR exchange rate for 2004 of 0.80508 which gave \$184,523 and the ratio was thus derived.

³⁷ According to OECD data the stock of FDI in Luxembourg in 2002 was 162 per cent of GDP.

Consistent with the trend of recent years, the eurozone was in 2004 the immediate source of most of inward Irish FDI, with inflows reaching nearly €6 billion in 2004. According to 2003 data, the Netherlands is the largest investor into Ireland, accounting for over one third of total inflows in 2003.³⁸ Its stock of direct investment into Ireland stood at over €60 billion at the end of 2003, again over one third of the total and more than the UK's and the US position combined. While this seems at odds with the relatively small number of Dutch multinationals operating in Ireland, it is known that holding companies based in the Netherlands act as intermediaries for much of US direct investment into Ireland. Due to favourable tax treaties, directing FDI flows through the Netherlands offered considerable fiscal benefits for US companies in the past and many multinationals continue to use this channel. The EU 10 accession countries are not a significant source of FDI for Ireland.

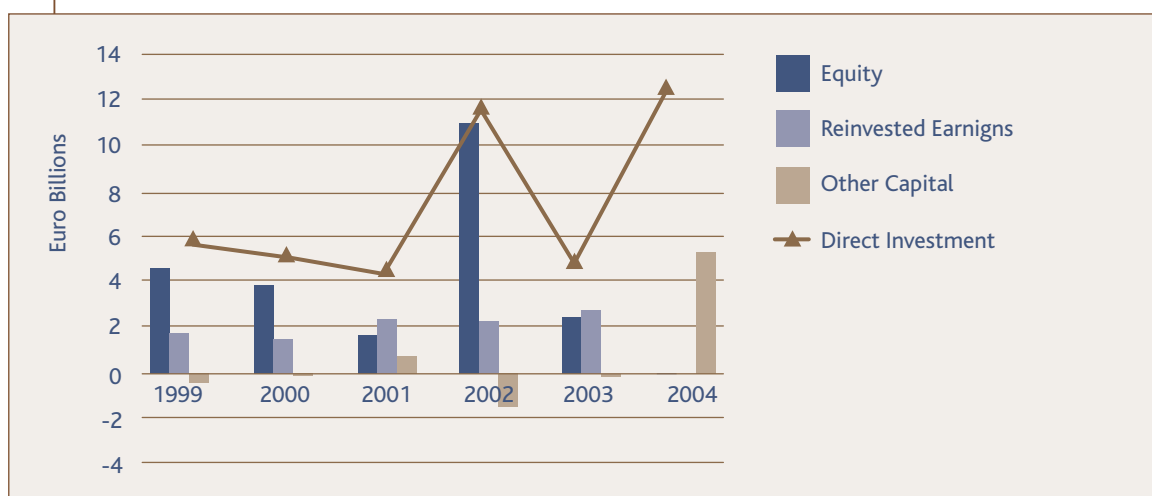
There has been disinvestment from the regions containing the USA and the UK, which are historically our main investment partners. The region 'UK, Sweden and Denmark', experienced negative flows of €5.4 billion.

The RoW, containing amongst others the USA, posted negative flows of €1.3 billion. While this seems unusual, as mentioned earlier, much US FDI into Ireland is channelled through the Netherlands. Counterparty data from the USA indicates that investment flows from that country into Ireland were up from €7 billion in 2003 to over €8 billion in 2004.³⁹ Ireland accounted for 12.5 per cent of US investment into the EU in 2004 and Ireland was the third largest EU destination for outward direct investment from the USA. The cumulative stock of US FDI invested in Ireland, measured on a historical cost basis, stood at around €59 billion in 2004, equivalent to 7.6 per cent of all US investment in the EU and 3.5 per cent worldwide. Analysed at a sectoral level, Ireland is the premier location worldwide for US FDI in the information sector and fourth worldwide in chemicals.⁴⁰

4.4 Irish FDI Outflows

FDI outflows in 2004 were the largest total ever recorded at €12.7 billion. Outflows were over two and half times higher than in 2003. For the first time Ireland was a net exporter of FDI, as outflows exceeded inflows by €3.6 billion.

Figure 30 Composition of Irish FDI Outflows 1999-2004



³⁸ CSO 2003 Foreign Direct Investment report.

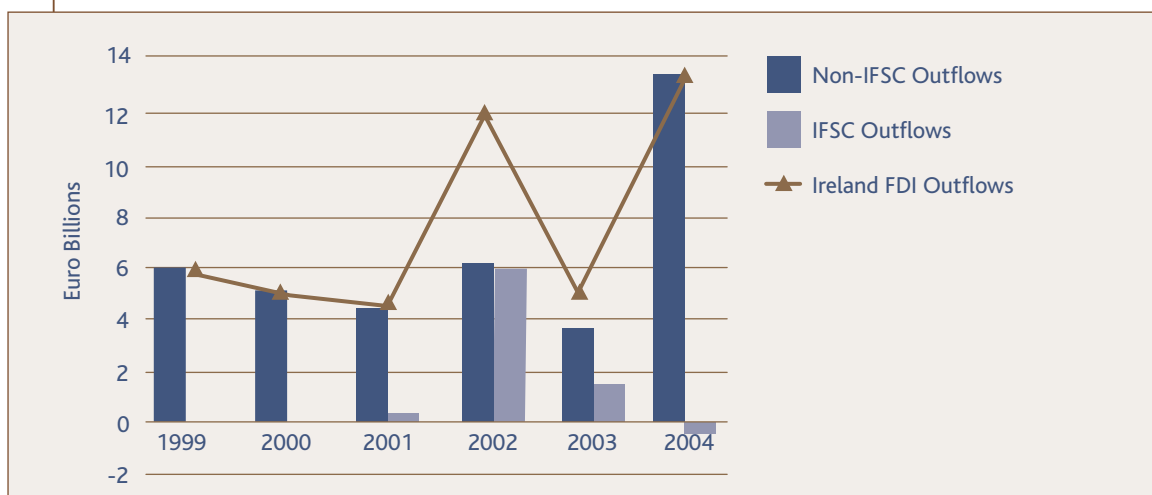
³⁹ US Bureau of Economic Analysis. Due to the nature of FDI flows and data collection methods FDI statistics from different countries are not always comparable. Inflows that Ireland records receiving may not always match outflows recorded by senders of these outflows to Ireland.

⁴⁰ According to the US Department of Commerce website the main components of Information sector are the publishing industries, including software publishing, and both traditional publishing and publishing exclusively on the Internet; the motion picture and sound recording industries; the broadcasting industries, including traditional broadcasting and those broadcasting exclusively over the Internet; the telecommunications industries; the industries known as Internet service providers and web search portals; data processing industries; and the information services industries.

Due to confidentiality reasons a breakdown by category is not available for 2004. However many Irish companies were active in the area of mergers and acquisitions (M&A) in 2004, with overall activity increasing significantly on 2003. The trend of Irish individuals and corporates being major net buyers of assets continues, further demonstrating Ireland's increasing wealth. FDI data excludes investments by Irish investors in commercial and residential property abroad which are classified as portfolio investments. Macroeconomic conditions in Ireland during 2004 were good and increasing confidence based on strong corporate results, persistently low interest rates and an abundance of private equity continued to fuel acquisitions by multinationals, indigenous companies and financial buyers. Some major deals by Irish companies abroad were in the hotel, construction, food and energy sectors.⁴¹

In 2004 the IFSC lost its position as being a significant source of Irish outward FDI. Indeed the outflows were negative which means that Irish resident IFSC companies repatriated more capital from their foreign affiliates than they invested abroad in 2004. As is clear from Figure 31, the IFSC as a source of outward direct investment is a recent phenomenon and likely to be a result of changes in the types of foreign assets that Irish-domiciled funds are purchasing.⁴²

Figure 31 Irish FDI Outflows – IFSC and non-IFSC FDI Outflows

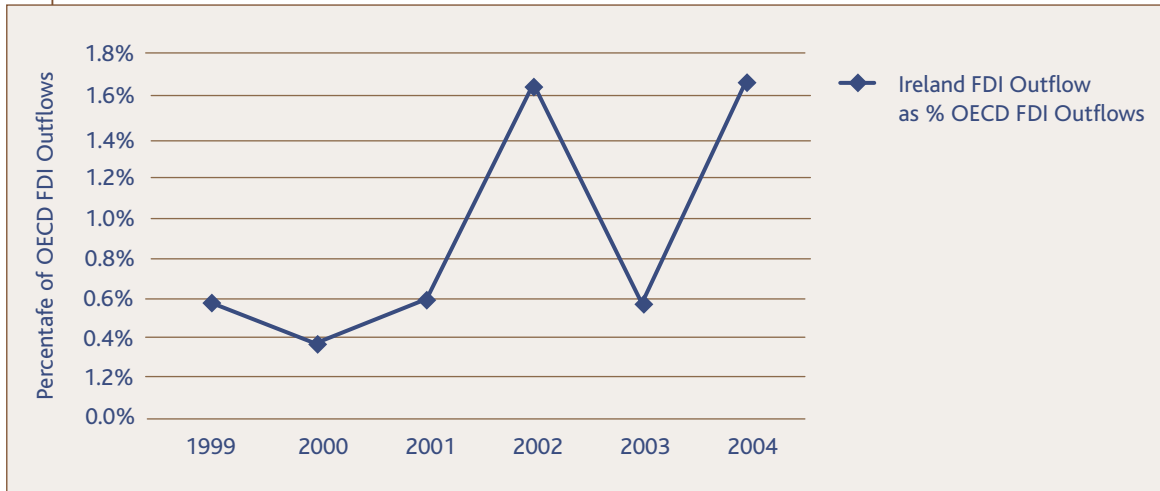


According to the OECD, in 2004 1.7 per cent of total OECD FDI outflows originated from Ireland. In absolute terms, Ireland was the eighth largest source of FDI outflows in the EU-15. As shown in Figure 32, Ireland's share of total OECD FDI outflows has generally been around 0.6 per cent, except for 2002 and 2004, when its share jumped to around 1.7 per cent in both of these years.

⁴¹ Ion Equity M&A Quarterly Tracker Surveys – 2005.

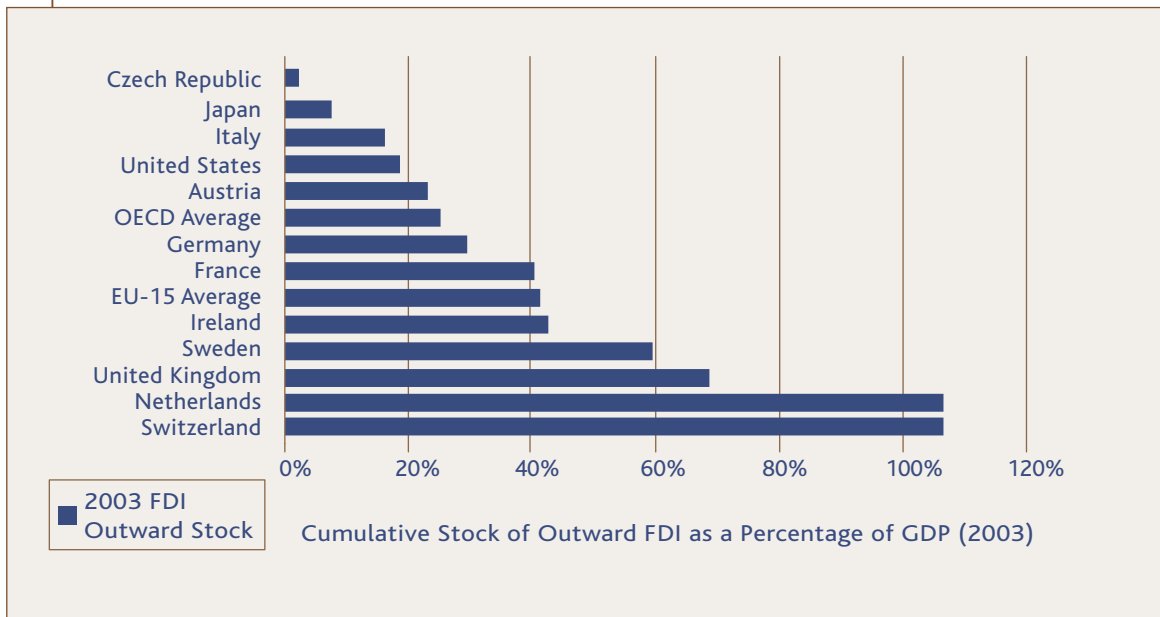
⁴² Foreign investment is classified as "direct" rather than "portfolio" when a stake greater than 10 per cent of a corporation is purchased. Given that IFSC outward portfolio investment has been growing very rapidly in recent years (in 2004 it stood at €110 billion, equivalent to 74 per cent of GDP), it is unsurprising that a portion of monies invested in foreign equities cross the definitional threshold of 10 per cent.

Figure 32 Ireland's FDI Outflows as a Percentage of OECD Outflows 1999-2004



Using OECD FDI stock data, the cumulative stock of FDI invested by Irish residents abroad is estimated to be €61 billion in 2004. This is equal to 41 per cent of GDP in 2004, which is similar to the ratio for the EU-15 as a whole.⁴³ Figure 33 illustrates how Ireland compares to a selection of OECD countries, using the latest available figures from 2003. It shows that the stock of Irish outward FDI as a percentage of Irish GDP is broadly in line with the average of other EU countries.

Figure 33 Outward FDI Stock as a Percentage of GDP – Selected OECD Countries 2003

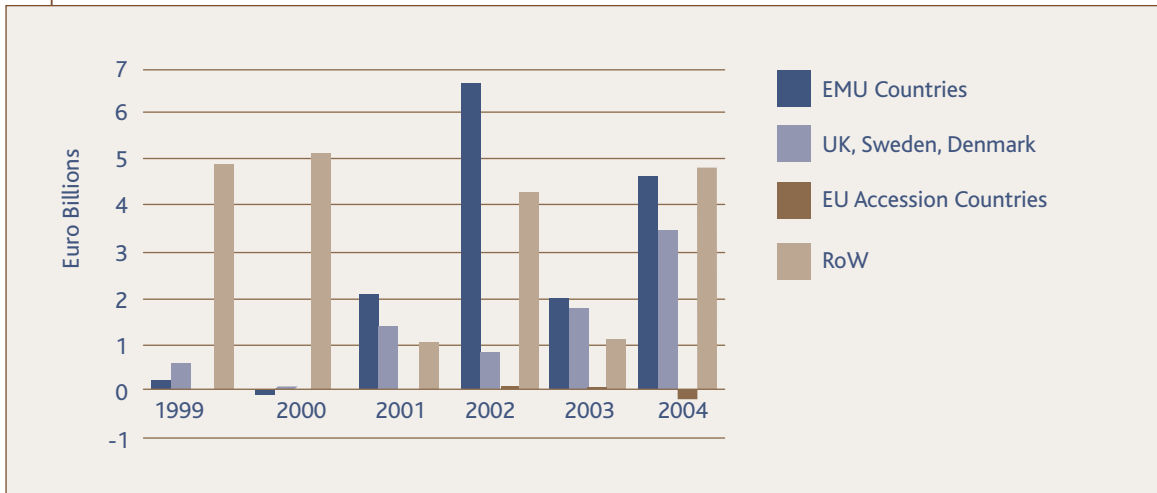


⁴³ UNCTAD World Investment Report 2005.

4.5 Destination of Ireland's Outward FDI

As noted previously, balance of payments data on direct investment for 2004 can only be broken out to four geographical areas: eurozone countries, EU 10 accession countries, EU 15 countries not in the eurozone (UK, Sweden and Denmark) and the rest of the world.

Figure 34 Destination of Irish FDI Outflows 1999-2004



Direct investment flows to most areas have rebounded strongly from 2003. The eurozone continues to be an important destination for Irish FDI. Outflows to the UK, Sweden and Denmark in 2004 were at the highest level they have been since 1999, in part driven by strong M&A activity in the UK. Outflows to the rest of the world were up strongly also. However counterparty data from the USA indicates that there was a negative inflow of direct investment there from Ireland of around €2.7 billion, suggesting that there was significant direct investment by Irish companies in countries outside the EU and the USA.

Outflows to the EU 10 accession countries are small in size and indeed were negative in 2003 and 2004. It would have been expected that interest in the markets of the EU 10 accession countries would accelerate as EU integration eased access to their economies and gave rise to further FDI opportunities for Irish companies. However the CSO data does not suggest that accession to the EU in 2004 membership has led to greater Irish investment in these countries.

Counterparty; FDI stock data from the two main destinations for Irish outward FDI, the USA and the UK underline the close economic relations they have with Ireland. According to the most recent (2003) figures from the UK's Office for National Statistics (ONS), the cumulative stock of Irish-owned FDI in the UK was estimated at around €6.5 billion, which was almost 12.5 per cent of Ireland's total outward FDI stock in 2003. US data reveals that the cumulative stock of Irish FDI in the USA stood at approximately €21.4 billion in 2003, which was 42 per cent Ireland's total outward FDI stock in that year. In 2004 it had fallen to €17 billion, although 40 percent of this decline is due to exchange rate movements. However counterparty data comparisons must be interpreted with caution, since UK and US figures differ significantly from the equivalent CSO figures. In 2003 the CSO calculated that the cumulative stock of Irish-owned FDI in the UK and the USA stood at €8.8 and €5.8 billion respectively, highlighting once again the difficulty in gathering consistent data on direct investment statistics.

5. Conclusion

The contraction in Irish merchandise exports of the last couple of years was reversed in 2004 as exports resumed growth, albeit at a slower rate than in 2000 and 2001. Irish merchandise exports remain dominated by foreign-owned sectors of the economy, with 71.6 per cent of Irish exports in 2004 coming from the pharmachem and ICT/machinery sectors combined, although the importance of these sectors is probably overstated by transfer pricing by multinationals. These two sectors had contrasting performances in 2004, with pharmachem exports increasing rapidly but with ICT/machinery exports continuing their decline of recent years. Exports of food and beverages, an area important to indigenous manufacturers, rose by three per cent in 2004.

Merchandise imports grew more strongly than exports in 2004 as buoyant consumer demand became increasingly important in the Irish economy. Consumer demand for imported goods such as cars and electrical equipment allied to the increased cost of imported fuels were the main drivers behind rising imports. As a result of these trends the merchandise trade surplus declined for the second consecutive year, although it still remains the highest per capita in the OECD.

The growing importance of internationally traded services to the Irish economy was highlighted by the continued rapid growth of service exports, which grew by 13.7 per cent in 2004. Financial, insurance and business services exports from IFSC companies and computer services and were behind this rapid growth, with tourism exports also contributing. Services have become the main source of Irish export growth, underlined by the fact that in 2004 the share of Irish services exports of global services exports rose to 2.2 per cent, compared to the Irish share of global merchandise exports of 1.1 per cent.

Ireland was the world's ninth largest importer of services for the second year running in 2004. The composition and large size of Ireland's services imports is due in part to the presence of a large foreign-owned sector, which imports services and pays royalties to head offices and affiliates based abroad. Services imports grew less rapidly than services exports in 2004 and consequently Ireland's services trade deficit fell for the second consecutive year. Ireland's overall trade surplus, comprising both merchandise and services trade, thus stood at €22.1 billion in 2004, an increase of three per cent from 2003.

From an FDI perspective Ireland was previously characterised by exceptionally high inflows and average outflows for a developed country. The trends of 2004 may signal a departure from this trend. Inflows of €9.1 billion in 2004 represented sharp decline from the peak of €31.2 billion achieved in 2002, even though inflows still remain high relative to other countries. Much of this decline was due to particularly large repatriation of profits by multinationals in 2004. This trend is likely to continue in 2005 and 2006, as temporary changes to US tax law subject earnings by US companies based in Ireland to considerably lower tax rates in these years.

In contrast Ireland's FDI outflows reached their highest ever level in 2004, at €12.7 billion, and for the first time Ireland was a net exporter of FDI. Given the volatility of FDI flows, it is too early to tell if this trend will continue, but it indicates that Ireland may be adopting the profile of a more typical developed economy, in that is becoming more important as a source rather than as a destination of FDI.

Functions of Forfás

Forfás is the national policy and advisory board for enterprise, trade, science, technology and innovation. It is the body in which the State's legal powers for industrial promotion and technological development have been vested. It is also the body through which powers are delegated to Enterprise Ireland for the promotion of indigenous industry and to IDA Ireland for the promotion of inward investment. Science Foundation Ireland was established as a third agency of Forfás in July 2003.

The broad functions of Forfás are to:

- advise the Minister on matters relating to the development of industry in the State,
- advise on the development and co-ordination of policy for Enterprise Ireland, IDA Ireland, Science Foundation Ireland and such other bodies (established or under statute) as the Minister may by order designate,
- encourage the development of industry, science and technology, innovation, marketing and human resources in the State,
- encourage the establishment and development in the State of industrial undertakings from outside the State, and
- advise and co-ordinate Enterprise Ireland, IDA Ireland and Science Foundation Ireland in relation to their functions.

Is é Forfás an bord comhairleach agus polasaí náisiúnta do fhiontar, thráchtáil, eolaíocht, theicneolaíocht agus nuálaíocht. Is é an comhlacht ina bhfuil cumhacht dlíthiúil an Stáit dílsithe i leith tionscail a chur chun cinn agus forbairt teicneolaíochta. Is é an comhlacht freisin trína thiomnaítear cumhachtaí go Enterprise Ireland chun tionscal dúchais a chur chun cinn agus do IDA Ireland chun infheistíocht isteach a chur chun cinn. Bunaíodh Science Foundation Ireland mar thrú gníomhaireacht de Forfás in Iúil 2003. Is iad na feidhmeanna leathana de Forfás ná chun:

- comhairle a thabhairt don Aire ó thaobh cúrsaí a bhaineann le forbairt tionscail sa Stát,
- comhairle a thabhairt maidir leis an bhforbairt agus an gcomhordú de pholasaí do Enterprise Ireland, IDA Ireland, Science Foundation Ireland agus d'aon chomhlacht eile dá leithéid (bunaithe nó faoi reacht) mar a d'fhéadfadh an tAire a thiomnú de réir ordaithe,
- an fhorbairt de thionscal, theicneolaíocht, mhargaíocht agus acmhainní daonna a spreagadh sa Stát,
- an bunú agus an fhorbairt sa Stát de ghnóthais tionsclaíochta a spreagadh ó áiteanna lasmuigh den Stát, agus
- Enterprise Ireland, IDA Ireland agus Science Foundation Ireland a chomhairliú agus a chomhordú maidir lena bhfeidhmeanna.

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