

FORFÁS

Statement on Outward Direct Investment

October 2001

FUNCTIONS OF FORFÁS

Is é Forfás an bord náisiúnta um polasaí agus comhairle le haghaidh fiontraíochta, trádála, eolaíochta, teicneolaíochta agus nuála. Is é an comhlacht é a bhfuil comhactaí dlíthiúla an stáit maidir le cur-chun-cinn tionscail agus forbairt teicneolaíochta dílsithe ann. Is é an comhlacht é freisin trína dciomnaítear cumhachtaí ar Fhiontraíocht Éireann le tionscail dúchais a chur chus cinn agus ar ghníomhaireacht Forbartha Tionscail na hÉireann (GFT Éireann) le hinfheistíocht isteach sa tír a chur chun tosaigh. Is iad feighmeanna Fhorfáis:

- ▶ *comhairle a chur ar an Aire ó thaobh cúrsaí a bhaineann le forbairt tionscail sa Stát*
- ▶ *comhairle maidir le forbairt agus comhordú polasaithe a chur ar fáil d'Fhiontraíocht Éireann, d'GFT Éireann agus d'aon fhoras eile dá leithéid (a bunaíodh go reachtúil) a d'fhéadfadh an tAire a ainmniú trí ordú*
- ▶ *forbairt na tionsclaíochta, na teicneolaíochta, na margaíochta agus acmhainní daonna a spreagadh sa Stát*
- ▶ *bunú agus forbairt gnóthas tionsclaíoch ón iasacht a spreagadh sa Stát, agus*
- ▶ *Fiontraíocht Éireann agus GFT Éireann a chomhairliú agus a chomhordú ó thaobh a gcuid feidhmeanna.*

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 technology 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. The broad functions of Forfás are to:

- ▶ *advise the Minister on matters relating to the development of industry in the State*
- ▶ *to advise on the development and co-ordination of policy for Enterprise Ireland, IDA Ireland and such other bodies (established by or under statute) as the Minister may by order designate*
- ▶ *encourage the development of industry, technology, 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 and IDA Ireland in relation to their functions.*

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Foreword

Ireland's success in attracting high levels of inward direct investment over the last decade has been well documented. The flow of direct investment has not, however, been all in one direction. Although still well below inward flows, outward direct investment from Ireland also rose significantly during the 1990s, reflecting the emergence of a growing cohort of Irish multinational enterprises. Ireland is not unique in this regard. The role of outward and inward foreign direct investment in the global economy has increased significantly in recent years. International production – production by the foreign affiliates of multinational companies - grew exponentially during the 1990s, and is now a more important means of selling into foreign markets than “traditional” exporting from a home base.

Reflecting Ireland's heretofore limited role as a source of direct investment flows, there has been relatively little analysis of, or interest in, the role of Irish multinationals in national economic development. Indeed, the lack of detailed statistical data on the nature and scope of overseas investments by Irish companies has inhibited investigation. Yet, over the coming years growth in outward direct investment flows will most likely accelerate further, as barriers to overseas investment fall and Irish firms become more sophisticated. Over time, Ireland may become less important for many fast-growing Irish-owned and managed companies, both as a market and as a location for primary production. Concerns among policy makers and the public at a possible “hollowing out” of Irish industry and employment may push outward direct investment to the forefront of Irish enterprise policy.

This “Statement on Outward Direct Investment” by Forfás aims to promote a better understanding of the scale and character of Irish outward direct investment flows, to explore the implications of these flows for the Irish economy, and to outline existing government policy with regard to outward direct investment. It is hoped that this statement may stimulate greater research into the role of Irish multinationals in national economic development by the Irish academic and policy community.

Pending this, the report relies heavily on research in other advanced economies with longer experience of high levels of outward direct investment. While by no means conclusive, overseas studies suggests that outward direct investment has been broadly beneficial for the “home” economies concerned, boosting domestic exports, employment and wages, and providing a catalyst for restructuring of the domestic economy into higher value-added activities. They also indicate that countries with high levels of outward direct investment spend more on research and development, and have highly skilled workers. Where key drivers in the business environment, such as taxation, infrastructure and the availability of skilled workers, are supportive of high value-added activities being located in the domestic economy, then outward direct investment acts as a positive force in economic development, leading to the creation of high-skilled, highly paid employment.

In this context, it is widely recognised that far from being symptomatic of economic decline, growing levels of outward direct investment by Irish companies reflect a restructuring of Irish-owned industry into higher value-added activities that will form the basis of long-term growth in competitiveness, exports and employment. In this sense, outward direct investment is a crucial element in furthering the aims of Irish enterprise policy with regard to raising the average skills content and value-added of Irish-based enterprise activities. As long as the Irish business environment remains supportive of high value-added activities, then outward direct investment by Irish companies should be consistent with rising average wages and living standards in this country.

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Glossary of Terms

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

Investment flows between Ireland and the rest of the world are heavily influenced by the International Financial Services Centre in Dublin (see IFSC below). A significant proportion of inward direct investment into Ireland entails movement of capital by foreign-owned companies to their treasury, fund management and other financial subsidiaries at the IFSC. In contrast, overseas investment by IFSC-related enterprises covers mostly the acquisition of foreign equities, bonds and other money market instruments in the form of portfolio investment (see below), and is not considered outward direct investment from Ireland.

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

Outward Direct Investment – refers to direct investment by Irish investors in foreign companies.

Inward Direct Investment – refers to direct investment by foreign investors in Irish companies.

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

Multinational Companies (MNCs) – are incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates.

Foreign Direct Investor – A foreign direct investor is an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises which have a direct investment enterprise that is a subsidiary, associate or branch – operating in a country other than the country or countries of residence of the direct investor or investors.

Direct Investment Enterprise – is an enterprise that controls assets of other entities in countries other than its home country, usually by owning a certain stake. An equity stake of 10 per cent or more of the ordinary shares or voting power for an incorporated enterprise (subsidiary/associate/affiliate), or its equivalent for an unincorporated enterprise (branch), is normally considered as a threshold for the control of assets.

Host Economy – is the country that receives FDI from the foreign investor(s).

Home Economy – is the country of origin/residence of the company that invests in the foreign economy/host economy.

Subsidiary – is an incorporated enterprise in the host country in which the foreign investor owns more than 50 per cent of the shareholder's voting power or has the right to appoint or remove a majority of the members of this enterprise's administrative, management or supervisory body.

Associate – is an incorporated enterprise where the direct investor owns a total of at least 10 per cent, but not more than a half, of the shareholders' voting power.

Branch – is a wholly or jointly owned unincorporated enterprise in the host country which is one of the following: (i) a permanent establishment or office of the foreign investor; (ii) an unincorporated partnership or joint venture between the foreign direct investor and one or more third parties; (iii) land structures (except structures owned by government entities), and /or immovable equipment and objects directly owned by a foreign resident (e.g. holiday and second homes); (iv) mobile equipment (such as ships, aircraft, gas-or oil-drilling rigs) operating within a country other than that of the foreign investor for at least one year.

Equity capital – comprises of equity in branches and ordinary shares in subsidiaries and associates.

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

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

CSO – Central Statistics Office. This Irish government body collects, compiles, analyses and disseminates statistical information relating to the economic and social life of Ireland. It is also responsible for co-ordinating official statistics of other public authorities and for developing the statistical potential of administrative records.

Eurostat – Statistical Office of the European Communities.

Euro-zone – Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

IFSC – International Financial Services Centre. The IFSC was founded in 1987 and is one of Europe's largest off-shore financial centres. It now ranks as one of the leading locations world-wide for international banking, investment funds, corporate treasury and insurance activities. It is host to more than half the world's top 20 insurance companies and to more than half the world's largest banks.

WTO – World Trade Organisation.

Multilateral Agreement on Investment (MAI) – The MAI was an attempt by OECD countries to agree binding rules on cross-border direct investment flows in order to provide multinational investors with long-term stability of rules and procedures. The negotiations came to an end in 1998 without concluding the agreement.

1

Introduction and Overview

1.1

Introduction

- ▶ *The fast growth in FDI flows into Ireland during the 1990s has been well documented. The flow of direct investment has not, however, been all in one direction. In recent years, flows of outward direct investment (ODI) from Ireland have increased significantly reflecting the emergence of a growing cohort of Irish multinational companies.*
- ▶ *This “Statement on Outward Direct Investment” by Forfás aims to promote a better public understanding of the scale and character of outward direct investment flows from Ireland, to explore implications of these flows for the Irish economy, to outline existing government policy with regard to outward direct investment and to identify policy issues that may require further analysis and consideration over the coming years.*

1.2

Overview

ODI - Recent International and Irish Trends

- ▶ *Driven by technological change, the deregulation of industries and liberalisation of trade and investment rules, global foreign direct investment (FDI) flows have grown exponentially over the last decade, reaching \$800 billion in 1999.*
- ▶ *International production - the sales of foreign affiliates of multinational companies - increased world-wide from \$3 trillion in 1990 to \$14 trillion in 1999 and is now nearly twice as high as global exports. Thus, outward direct investment and international production are now more important than exporting, in terms of the delivery of goods and services to foreign markets.*
- ▶ *Ireland has an unusual direct investment relationship with the rest of the world compared with other advanced economies; in 1998, Irish outward FDI as a proportion of inward FDI measured just 27 per cent, compared with an OECD average of 130 per cent.*
- ▶ *This stems from both high levels of inward direct investment into Ireland, and also small levels of outward direct investment compared with other advanced countries. This reflects the fact that Ireland has few large indigenous corporations in those industries responsible for the bulk of direct investment flows, Ireland’s relatively recent industrialisation, the historically heavy focus of development policy on inward investment, and the more active promotion and facilitation of outward investment by other EU governments.*
- ▶ *While Ireland’s outward FDI stock remains small by the standards of most other EU countries, it has been rising quickly in recent years. In nominal terms, the stock of Irish outward direct investment rose from \$202 million in 1985 to \$15,096m in 1999, representing an increase of 2,086 per cent over the fifteen-year period. The higher levels of outward direct investment in the 1990s are likely the result of the fast pace of Irish economic development over this period.*
- ▶ *To date, Irish ODI flows have been mainly concentrated in the UK and the United States. Data from the U.S. Department of Commerce estimate that Irish companies in the United States employed almost 65,000 people in 1999, compared with just over 100,000 workers employed by U.S. companies in Ireland. The importance of the UK and the United States as destinations for Irish investment outflows may reflect a common language, cultural affinity, lower tax rates and familiar legal systems in these countries.*

Profile and Strategies of Companies Investing Abroad

- ▶ *The largest and most successful companies in the world are also the companies that dominate cross-border direct investment flows and international production. It is clear that multi-country presence is international best practice for fast growing companies.*
- ▶ *There are two distinct reasons why companies may invest overseas: (1) to better serve a local market ("horizontal" FDI); or (2) to access lower-cost inputs ("vertical" FDI). Horizontal FDI typically involves duplication in foreign locations of the activities of the firm in the home market in order to better supply foreign customers. The main motive is to reduce the costs involved in supplying the foreign market and to improve the firm's competitive position there. Vertical FDI involves breaking up the vertical chain of production and relocating part of the firms' activities in a lower cost location.*
- ▶ *Barriers to trade, high transport costs, the non-tradability of some goods and services and the desire for rapid expansion into new markets are some of the reasons why firms may prefer to access foreign markets through outward direct investment and overseas production rather than traditional export channels.*
- ▶ *There are two modes of outward direct investment: mergers and acquisitions (M&As) and "greenfield" investment. The value of cross-border M&As reached \$720 billion in 1999, compared with \$145 billion in greenfield investment.*
- ▶ *Speed and access to proprietary assets are usually deemed as being the two most important factors in explaining why firms may prefer to grow via M&As rather than through the establishment of new operations. Greenfield investment is usually the optimal choice for foreign market entry if there are no adequate take-over targets in the host country.*
- ▶ *Survey evidence suggests that the main motives for Irish companies investing abroad are to enter new foreign markets and acquire new technologies rather than to lower the cost base. Most Irish companies invest in advanced economies, mainly the UK and the United States, via mergers and acquisitions. As the Irish labour market tightens, however, capacity constraints may encourage more Irish companies to consider vertical direct investments in lower-cost locations.*
- ▶ *The bulk of Irish FDI outflows come from around 10-15 long-established Irish companies in services and traditional industrial sectors. While these "old economy" firms still dominate the stock of Irish-owned direct investment assets overseas, a small number of "new economy" high-technology firms have recently started to make significant overseas investments.*
- ▶ *An analysis of the Forfás/Enterprise Ireland "Annual Business Survey of Economic Impact (ABSEI) 2000" shows that companies supported by Enterprise Ireland employed 23,259 workers in overseas operations in 2000, equal to 17.5 per cent of total employment in these companies. Supported companies involved in the telecommunications, software and other international services employed more people in overseas operations than in Ireland.*
- ▶ *Sales by foreign affiliates of twelve publicly quoted Irish multinationals came to IR£17.1 billion in 1999. By comparison, exports by Irish-owned firms in the same year amounted to an estimated IR£15.0 billion. These figures clearly illustrate the importance of outward direct investment and overseas production to the ability of Irish companies to access foreign markets.*

Implications of ODI for the Irish Economy

- ▶ *Despite fears that outward direct investment by Irish companies may lead to a "hollowing out" of industry and loss of exports, studies of countries with long experiences of high levels of outward direct investment all indicate that outward direct investment and exports are broadly complementary. According to one OECD study of member countries, each \$1.00 of outward direct*

investment was associated with \$2.00 of additional exports and a trade surplus of \$1.70. This reflects the importance of outward FDI as a mechanism for gaining access to foreign markets. Through outward direct investment, a country's exports of finished goods are, over time, replaced and overtaken by exports of high value-added intermediate goods and "headquarter" services to foreign affiliates.

Similarly, international evidence suggests that outward FDI has broadly positive effects on employment and wage levels in the domestic economy. According to recent research commissioned by Forfás, overseas investment by Irish companies has created demand for high-skilled employment at their respective head offices in Ireland, e.g. for accountants, managers and marketing specialists.

Outward direct investment by Irish companies has also proved a useful mechanism for Irish industry to address capacity constraints in the context of Ireland's tightening labour market. In this sense, outward FDI levels are correlated to macro conditions for the supply of, and demand for, key factors of production for industry in the home economy. While lower overseas labour costs are obviously a factor in some overseas investment decisions by Irish companies, it seems that accessing skills that have become scarce in Ireland appears to be an equally important driver.

Outward FDI represents one important mechanism of gaining access to foreign technologies. Countries with high levels of outward FDI also tend to have high levels of spending on R&D. Multinational companies tend to be more R&D intensive than "national exporting firms" and tend to have more highly skilled workers.

International research links outward FDI with economic restructuring of home countries into higher value-added activities, through the movement of scarce capital and labour resources into new, higher-tech, industries. Outward FDI may also have a positive impact on the balance of payments and the degree to which countries are protected from regional economic downturns.

The most crucial issue in assessing the impact of outward FDI on the home economy is whether high or low value-added activities and jobs are being located, or relocated, overseas. If key factors in the wider business environment, such as infrastructure, taxation and skills availability, are supportive of high value-added activities in this country, then the impact of outward FDI flows will be to relocate lower value-added and labour intensive activities to more cost competitive locations. This should in turn lead to a restructuring of industry in the home economy favouring higher value-added activities that pay higher wages.

Public Policy towards ODI

It is widely recognised that growing levels of investment abroad by Irish companies reflect a restructuring of Irish-owned industry into higher value-added activities that will form the foundation of long-term growth in competitiveness, exports and employment. At the same time, there is little evidence of market failures or institutional barriers to outward FDI by Irish companies that require a strong state intervention at firm level.

Growth in cross-border FDI flows between Ireland and the rest of the world is best supported at the macro level, by removing tax and regulatory barriers to investment flows between countries through international agreements. This will be done by expanding Ireland's network of Double Taxation Agreements, and through Irish support for the negotiation of a multilateral agreement on investment rules under the auspices of the World Trade Organisation. The Department of Enterprise, Trade and Employment has asked Forfás to undertake an industry consultation process, in conjunction with the industrial development agencies, on overseas trade and investment barriers to take into account the views of Irish companies on these issues in the next round of negotiations at the WTO.

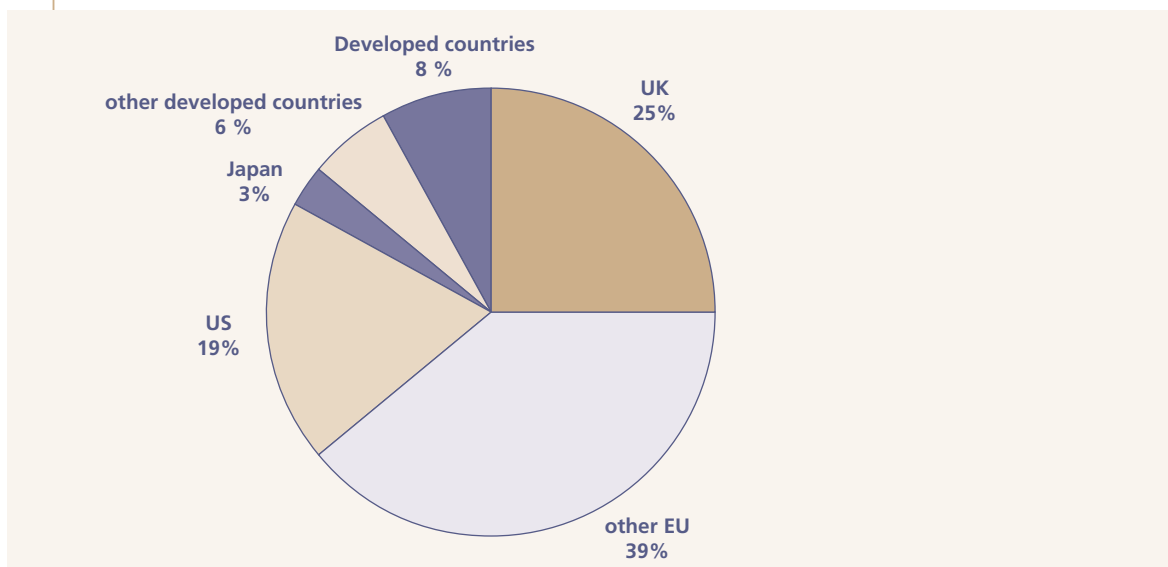
- ▶ *Enterprise Ireland may also offer “soft” supports to companies wishing to expand through overseas investment. These include Enterprise Ireland’s:*
 - *Overseas Network;*
 - *Overseas Incubator Facilities;*
 - *Acquisition Service;*
 - *Outsourcing Missions; and*
 - *Foreign Trade and Investment Missions.*
- ▶ *The likely growth of outward direct investment in years to come and the fears that outward FDI may lead to a “hollowing out” of industry and employment in Ireland, may serve to increase the focus of enterprise policy on the role of Irish multinationals in national economic development.*
- ▶ *As with all channels of economic restructuring, the “winners” and “losers” from growing outward FDI may not be the same, as managerial, professional and technical skills replace labour as the key inputs into enterprise activities in Ireland. Where outward direct investment by Irish companies is associated with economic dislocation, there may be calls for measures to discourage Irish companies from making overseas investments. Such measures should be avoided. Instead, public intervention should focus on providing those dislocated by outward direct investment with new skills and training.*
- ▶ *The impact of growing levels of outward direct investment on economic development in Ireland may depend not on our policies towards outward FDI in themselves, but instead on the wider environment for business in Ireland. As long as the Irish business environment is supportive of high value-added activities locating in this country, then outward direct investment by Irish companies should be consistent with rising average wages and living standards. This will require a renewed commitment to improving the competitiveness of Ireland’s industrial policy framework across a range of indicators including the macroeconomic climate, infrastructure, the taxation system and the availability of skilled labour.*

2 Outward Direct Investment – Recent International and Irish Trends

2.1 Global Developments in ODI Flows and Stocks

The role of multinational companies in the world economy has expanded rapidly over the last decade. International flows of foreign direct investment (FDI)¹ rose to around \$800 billion in 1999, representing an increase of around 25 per cent over 1998 levels. Over the period 1990 to 1999, global FDI flows more than trebled, while global FDI stocks increased almost three-fold. At the end of 1999, the global stock of FDI stood at \$5 trillion. According to the World Investment Report 2000 by the UN Conference on Trade and Development, the sum of world FDI stocks, calculated as a percentage of world GDP, rose from 10 per cent in 1980 to 31 per cent in 1999.

Figure 2.1 Sources of Outward FDI Flows by Geographic Region, 1999



Source: UCTAD, World Investment Report, 2000.

Together with increased cross-border trade, this rapid expansion of international production has been the main driver of globalisation of the world economy. Indeed, it is noteworthy that "international production" - overseas production by the foreign affiliates of multinational companies - has grown faster than global trade over the last decade. Sales of foreign affiliates world-wide increased from \$3 trillion in 1990 to \$14 trillion in 1999 and are now nearly twice as high as global exports. Thus, outward direct investment and production by foreign affiliates has become considerably more important than exporting in terms of delivering goods and services to foreign markets.

¹ The Central Statistics Office defines FDI as the value of financial flows (including the value of in-kind assets) from "home" countries to foreign affiliates in "host" countries. A direct investment enterprise is an unincorporated or incorporated enterprise in which a direct investor owns ten per cent or more of the ordinary shares of the company or voting power (for an incorporated enterprise) or the equivalent for an unincorporated enterprise. Most data on FDI flows take into account only the acquisition or establishment of foreign affiliates involving the use of so-called foreign direct investment funds, consisting of equity, intra-company loans and re-invested earnings. FDI financed through equity or debt issues in the domestic capital market of the host country or in international capital markets or through equity contributed by local partners in non-wholly owned foreign affiliates, is not included.

The main driving force behind the large increase in global FDI flows in recent years has been the exceptional wave of cross-border mergers and acquisitions (M&As). These were driven by a number of factors: the liberalisation of trade, investment and capital markets (including the relaxing of controls on M&As across the world); the deregulation and privatisation of service industries; and increased competitive pressures stemming from globalisation and technological change, thereby increasing the need to achieve economies of scale through overseas expansion. In addition, favourable economic conditions in the United States, Europe and Canada, and improved economic conditions in the Asia-Pacific region, enhanced the profit potential of foreign direct investments and boosted the earnings of existing affiliates and their parent companies, which in turn provided a ready source of financing for further FDI flows.

2.2 Outward Direct Investment from Ireland

Published data on direct investment flows between Ireland and the rest of the world is available from three main sources, the UN Conference on Trade and Development (UNCTAD), the Irish Central Statistics Office (CSO) and Eurostat (the statistical office for the European Union). As the UNCTAD and Eurostat data are sourced originally from the CSO, all three sets of published data are produced using similar methodologies and definitions (see Glossary of Terms for detailed definition of Foreign Direct Investment). All three are, however, limited, and do not provide a comprehensive breakdown on Irish outward direct investment flows and stocks by sector of origin or country of destination. The published UNCTAD data dates from 1985, but is provided in aggregate form only. Eurostat data provide a useful comparison with other EU countries, but again are provided only in aggregate form. The CSO data offers greater detail in terms of the geographic breakdown and form of outward investment flows, but date only from 1998. Data on Irish overseas investment is also sometimes available from counter-party sources (the statistical agencies of other countries), such as the U.S. Department of Commerce. However, these often differ to Irish-sourced statistics due to different survey populations and collection techniques.

Historically, Irish outward FDI has been small compared with other EU countries

According to the UNCTAD data, Ireland's direct investment relationship with the rest of the world is unusual by the standards of most other advanced economies (Table 2.1). As of 1998, the ratio of the stock of outward FDI to the stock of inward FDI was lower in Ireland than in any other advanced economy, and was significantly lower than most other small EU countries (27 percent against an OECD average of 130 per cent). Ireland's rather unique direct investment relationship with the rest of world reflects not only the high levels of inward investment into Ireland compared with other advanced countries, but also very low levels of outward investment flows from Ireland over the period 1985-1998.

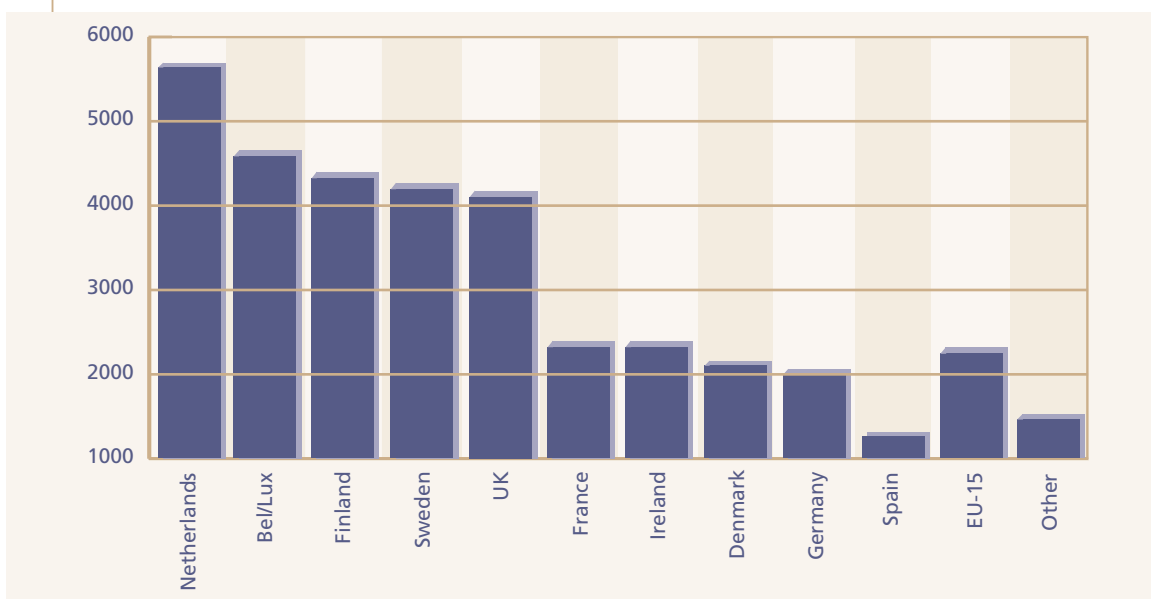
Table 2.1 *The Ratio of Outward FDI Stocks to Inward FDI Stocks for Selected Countries*

	1985	1990	1995	1998
Japan	9.28	20.5	7.11	9.78
Switzerland	2.12	1.95	2.51	2.94
Finland	1.37	2.19	1.77	2.11
Sweden	2.12	3.97	2.35	1.74
Germany	1.62	1.36	1.62	1.70
Italy	0.76	0.97	1.53	1.62
Netherlands	1.79	1.48	1.45	1.55
UK	1.57	1.06	1.46	1.53
Norway	0.15	0.88	1.15	1.36
United States	1.36	1.10	1.3	1.14
Denmark	0.50	0.80	1.03	1.13
Belgium/Lux.	0.52	0.70	0.76	0.78
Austria	0.51	0.43	0.67	0.66
Spain	0.23	0.24	0.33	0.58
Portugal	0.05	0.05	0.15	0.36
Ireland	0.04	0.39	0.34	0.27

Source: UNCTAD, *World Investment Report (1998)*

A comparison of Ireland with other EU countries shows that Ireland has lagged well behind in terms of its outward investment flows. On a per capita basis, outward FDI from Ireland measured at €2,296 in the two-year period 1998 to 1999, well behind EU leaders the Netherlands (€5,626), Belgium/Luxembourg (€4,587), Finland (€4,362) and Sweden (€4,193) (Figure 2.1).

Figure 2.2 *Per Capita Outward Direct Investment Flows by EU Member States, 1998-99 (Euros)*



Source: Eurostat, *EU Direct Investment Yearbook (2000)*.

The historically small flows of direct investment from Ireland are also apparent from the comparison of data on the stocks of inward and outward FDI as a percentage of GDP (Table 2.2). In 1998, the stock of Irish outward investment as a percentage of GDP was 12.4 per cent, just over half of the average EU level of 22.9 per cent. Ireland's outward FDI stock as a percentage of GDP was lower than every other EU country except Austria (8.2 per cent), Greece (0.7 per cent) and Portugal (8.6 per cent). By comparison, some other small, advanced, EU countries have much larger ODI stocks as a percentage of GDP, including Belgium/Luxembourg (50.2 per cent), the Netherlands (68.9 per cent), Sweden (41.3 per cent) and Finland (23.4 per cent).

Table 2.2 *Inward and Outward Investment Stock as a % of GDP, 1980-1998*

	Inward Investment (%)					Outward Investment (%)				
	1980	1985	1990	1995	1998	1980	1985	1990	1995	1998
EU	5.3	8.3	10.7	12.4	17.3	6.1	10.3	11.7	15.4	22.9
Austria	4.0	5.7	6.2	7.6	11.3	0.7	2.0	2.7	5.1	8.2
Belgium/Lux.	5.9	22.0	28.3	40.1	61.7	4.9	11.4	19.7	30.4	50.2
Denmark	6.3	6.2	6.9	13.2	17.4	3.1	3.1	5.5	13.7	19.4
Finland	1.1	2.5	3.8	6.7	13.1	1.4	3.4	8.3	11.9	23.4
France	3.4	6.4	7.2	9.4	11.7	3.6	7.1	9.2	12.0	15.9
Germany	4.0	5.3	6.8	6.9	9.3	4.7	8.6	9.2	11.1	17.3
Greece	11.3	24.9	16.9	16.6	18.3	2.1	2.6	1.0	0.7	0.7
Ireland	19.5	24.5	12.2	18.6	32.7	N/A	1.1	4.8	6.4	12.4
Italy	2.0	4.5	5.3	5.8	8.8	1.6	3.9	5.2	10.0	14.1
Netherlands	11.1	19.5	25.9	31.5	48.0	24.5	37.3	38.4	45.4	68.9
Portugal	10.0	16.0	14.1	16.8	20.8	0.4	0.8	0.7	3.5	8.6
Spain	2.4	5.4	13.4	19.1	21.5	0.9	2.7	3.2	6.3	12.5
Sweden	2.9	5.0	5.4	13.4	22.5	3.0	10.7	21.5	31.6	41.3
UK	11.7	14.0	20.8	18.0	23.3	15.0	21.9	23.4	27.4	35.9
Switzerland	8.4	10.8	15.0	18.6	26.5	21.1	27.0	28.9	46.3	69.1
United States	3.1	4.6	7.1	7.6	9.5	8.1	6.2	7.8	9.9	11.5
Japan	0.3	0.4	0.3	0.7	0.7	1.9	3.3	6.8	4.6	7.1

Source: UNCTAD, World Investment Report, 2000.

The low levels of outward direct investment from Ireland in comparison with many other EU countries reflect a number of historical factors. With the exception of financial services, Ireland has few large indigenous corporations in the industries that generate the bulk of global FDI flows (such as oil, automobiles, telecommunications, electronics and pharmaceuticals). Other factors may have included Ireland's relatively recent industrialisation, the historically heavy focus of development policy on inward investment, and the more active promotion and facilitation of outward investment by other EU governments.

It is also the case that many foreign acquisitions and investments by Irish companies are financed by non-FDI funds not recorded in the balance of payments, i.e. through finance raised not in Ireland, but rather in international capital markets or in the capital markets of the country of the acquired asset. This may reflect limited development in Ireland's capital markets, as well as a desire by Irish outward investors to match foreign currency assets and liabilities. If so, the arrival of the euro may spur an increase in Irish-financed outward direct investments in continental Europe.

Table 2.3 *Ireland's Outward FDI Stock 1980 – 1999*

(US\$ Millions)

Year	1985	1990	1995	1998	1999
Outward FDI Stock	202	2,150	4,037	9,678	15,096

Source: UNCTAD, *World Investment Report, 2000*.

But outward FDI by Irish companies has grown quickly in recent years

While Ireland's outward FDI stock remains small by the standards of most other EU countries, it has been rising quickly in recent years (Table 2.3). In nominal terms, the stock of Irish outward direct investment rose from \$202 million in 1985 to \$15,096m in 1999, representing an increase of 2,086 per cent over the fifteen-year period.

Table 2.4 *Ireland's Outward and Inward FDI Flows 1988 – 1999*

(US \$ Millions)

Year	1988-1993	1994	1995	1996	1997	1998	1999	1994-1999
	(annual average)						(annual average)	
Outward FDI Flows	400	438	820	727	1,008	3,906	5,418	2,053
Inward FDI Flows	787	838	1,447	2,618	2,743	8,579	18,322	5,758
Net Balance	387	400	627	1,891	1,735	4,673	12,904	3,705

Source: UNCTAD, *World Investment Report, 2000*.

In line with the growth in outward investment stocks, a sharp upward trend is also evident in Ireland's outward FDI flows during the 1990s (Table 2.4). Irish outward FDI flows grew from an average of just \$400 million in the period 1988-93 to \$5.4 billion in 1999. While this was still well below total inward FDI of \$18.3 billion, it was not far below non-IFSC related "industrial" inward investment of \$6.5 billion.²

Table 2.5 *FDI Outflows from Ireland, 1998-2000*

(IR£ Millions)

	1998	1999	2000
Total	2,743	4,005	2,269
Equity	717	1,735	1,748
Reinvested Earnings	1,202	1,465	1,304
Other Capital	824	806	-783

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

2. The remaining \$11.8 billion of inward FDI in that year went into companies associated with the International Financial Services Centre (IFSC) in Dublin. This mostly entails large movements of capital by foreign-owned companies to their treasury, fund management and other financial subsidiaries at the IFSC, mostly to be reinvested in overseas assets. In this sense, inward flows of direct investment into the IFSC are roughly matched by outward flows of portfolio investment, and have little impact on the productive potential of the domestic economy.

The most recent data on Irish outward direct investment flows comes from the Irish Central Statistics Office (CSO), which has published data dating from 1998 to 2000 on direct investment flows between Ireland and the rest of the world (Table 2.5). According to the CSO data, outward investment flows grew from IR£2.7 billion in 1998 to IR£4.0 billion in 1999, before dropping again to IR£2.3 billion in 2000. Given the clear direction of the trend since 1985 as indicated by the UNCTAD data (Tables 2.3 and 2.4), however, it would be a safe to assume that the drop in 2000 is a temporary aberration in a long-term growth trend. Outward direct investment flows in 2000 in the form of equity capital and earnings reinvested in overseas operations were only marginally down on 1999 levels, while the drop in overall direct investment outflows is almost entirely the result of repayment of debt capital to Irish companies from their overseas subsidiaries (this may even be the result of a single transaction).

Recent growth in ODI from Ireland is the result of economic development

The strong growth in Irish outward direct investment flows in the last decade (notwithstanding the drop in 2000) is consistent with the concept of the "Investment Development Path" (IDP) developed by John Dunning in the early 1980s.³ According to the IDP concept, a country's net outward direct investment position (outward less inward direct investment) is influenced by its level of economic development. With increasing economic development, a country evolves from being a net recipient of investment to being a net outward investor. As the domestic economy becomes more advanced, indigenous firms develop "firm-specific" assets, allowing them to become more internationally competitive and to exploit their competitive advantages by investing overseas (see Section 3). Also, economic development results in rising labour costs in the home economy, leading to a reduction in inward investment flows. According to recent analysis, Ireland progressed steadily along the "Investment Development Path" during the 1990s.⁴

Most ODI from Ireland goes to the UK and the USA

Table 2.6 *FDI Outflows from Ireland by Geographic Region, 1998-2000*

(IR£ Millions)

	1998	1999	2000
Total	2,743	4,005	2,269
EU	885	1,189	-634
Non-EU	1,858	2,817	2,905
EMU	367	478	-480
Non-EMU	2,376	3,527	2,749

Source: Central Statistics Office, Balance of International Payments

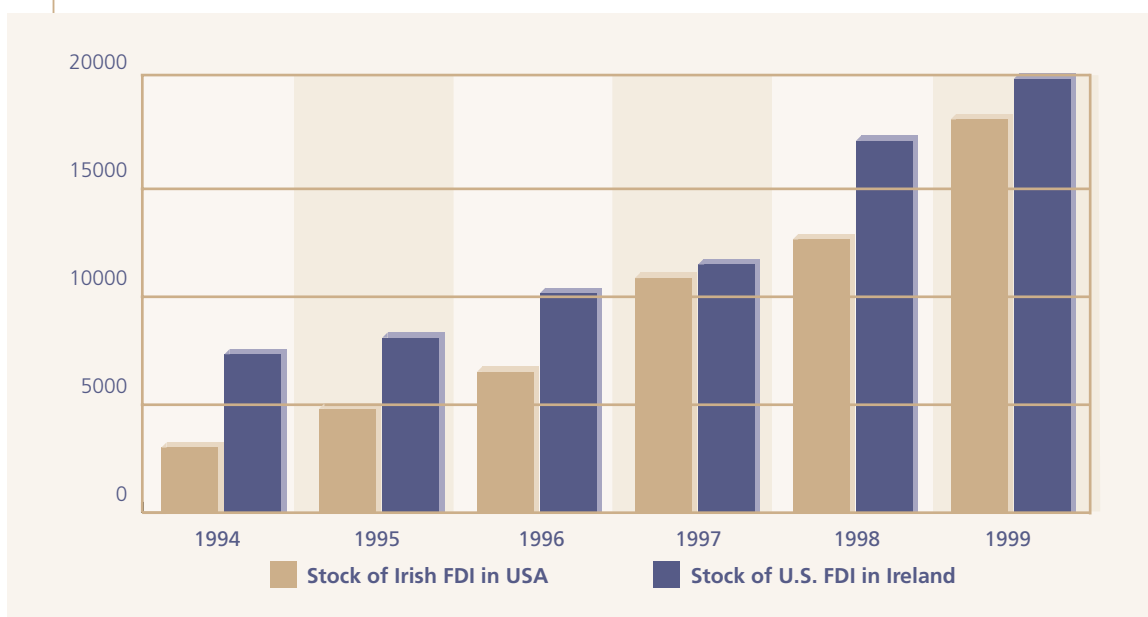
The UK and the United States are the two largest individual destinations for Irish outward direct investment flows. While not broken down by individual countries, CSO data show that 84 per cent of Irish outward FDI in the 1998-2000 period went to non-EU countries (Table 2.6). Anecdotal evidence and data from U.S. sources suggests that most of this goes to the United States. Other, less significant, non-EU destinations for Irish outward direct investment include Canada, Latin America, Central and Eastern Europe and the Far East. Only four per cent of Irish ODI flows in the 1998-2000 period went to other euro-zone countries. Indeed, in 2000 Irish companies withdrew IR£480 million in direct investment from other euro-zone countries, mainly by running down loans to euro-zone subsidiaries. The remaining 12 per cent of Irish ODI flows over this period went to non-euro EU countries, presumably mostly to the UK. According to UK statistics, employment by Irish-owned firms in the UK grew from 8,900 in 1981 to over 23,000 by 1996.

3. John Dunning, "Explaining the International Direct Investment Position of Countries: Towards a Dynamic or Developmental Approach" (1981).

4. Holger Görg, "Irish Direct Investment in the US: Evidence and Further Issues", Leverhulme Centre for Research on Globalisation and Economic Policy, University of Nottingham (2000).

The importance of the United States as a destination for Irish FDI flows is confirmed by data from the U.S. Department of Commerce. These show that Irish FDI flows to the United States in 1999 measured \$2.5 billion. Figure 2.3 charts the development of Irish outward FDI stocks in the United States and U.S. FDI stocks in Ireland during the 1990s. The figure shows that Irish FDI stocks in the United States almost caught up with U.S. FDI stocks in Ireland during the late 1990s. By 1999, Irish-owned FDI stocks in the United States measured \$18.0 billion, only \$1.8 billion less than U.S. direct investment stocks in Ireland.⁵ According to the U.S. data, of all EU countries, only France, Germany, Luxembourg, the Netherlands and the UK have higher FDI stocks in the United States than Ireland. The U.S. data also show that by the end of 1999, Irish-owned companies in the United States employed almost 65,000 people, compared with just over 100,000 workers employed by U.S. companies in Ireland.

Figure 2.3 *U.S.-Irish Direct Investment Relations, 1994-99 (\$millions)*



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

The dominance of the United States and the UK as locations for Irish direct investment overseas reflects the obvious factors: these are geographically proximate locations with large markets, strong, politically stable economies and a common language. It is also possible that similar legal systems, lower corporate tax rates and business-friendly governments in the UK and the United States have attracted Irish ODI flows to these countries. By contrast, unfamiliar legal systems, higher tax rates and language barriers may have hindered Irish direct investment in other euro-zone countries.

5. It should be noted that this figure is greater than CSO estimates of total Irish outward FDI stocks in the same year. The difference is due to different survey populations and collection techniques and it is not possible to say which is closest to the "true" figure.

2.3

Summary

- ▶ *Driven by technological change, the deregulation of industries and the liberalisation of trade and investment rules, global foreign direct investment (FDI) flows have grown exponentially over the last decade, reaching \$800 billion in 1999.*
- ▶ *International production - the sales of foreign affiliates of multinational companies - increased world-wide from \$3 trillion in 1990 to \$14 trillion in 1999 and is now nearly twice as high as global exports. Thus, outward direct investment and international production are now more important than exporting, in terms of the delivery of goods and services to foreign markets.*
- ▶ *Ireland has an unusual direct investment relationship with the rest of the world compared with other advanced economies; in 1998, Irish outward FDI as a proportion of inward FDI measured just 27 per cent, compared with an OECD average of 130 per cent. This stems from both high levels of inward direct investment into Ireland, and also small levels of outward direct investment compared with other advanced countries. This reflects the fact that Ireland has few large indigenous corporations in those industries responsible for the bulk of direct investment flows, Ireland's relatively recent industrialisation, the historically heavy focus of development policy on inward investment, and the more active promotion and facilitation of outward investment by other EU governments.*
- ▶ *While Ireland's outward FDI stock remains small by the standards of most other EU countries, it has been rising quickly in recent years. In nominal terms, the stock of Irish outward direct investment rose from \$202 million in 1985 to \$15,096m in 1999, representing an increase of 2,086 per cent over the fifteen-year period. The higher levels of outward direct investment in the 1990s are likely the result of the fast pace of Irish economic development over this period.*
- ▶ *To date, Irish ODI flows have been mainly concentrated in the UK and the United States. Data from the U.S. Department of Commerce estimate that Irish companies in the United States employed almost 65,000 people in 1999, compared with just over 100,000 workers employed by U.S. companies in Ireland. The importance of the UK and the United States as destinations for Irish investment outflows may reflect a common language, cultural affinity, lower tax rates and familiar legal systems in these countries.*

3 Strategies and Profile of Companies Investing Abroad

3.1 Introduction

Outward direct investment, international production and corporate size are closely related. The largest and most successful companies in the world are also the companies that dominate cross-border direct investment flows and international production. It is clear that multi-country presence, whether aimed at optimising market access or exploiting the cost advantages of different countries in various aspects of the production process, is international best practice for fast growing companies. The rapid expansion in FDI flows during the 1990s has revived considerable interest among academics and policy makers globally in the reasons why companies make overseas investments, the advantages of establishing an overseas presence compared with exporting finished goods from the home country, and the preferred form of foreign direct investment for companies in new markets.

3.2 Why Companies Invest Overseas

There are two main, distinct, reasons why companies invest in foreign countries:

- ▶ *To better serve a local market. This form of foreign investment is often characterised as “horizontal FDI”. It typically involves the duplication in foreign locations of the activities of the firm in the home market in order to better supply foreign customers. The main motive is to reduce the costs involved in supplying the foreign market and to improve the firm’s competitive position there. This may be particularly appealing to a company when its home market is small and saturated and there are barriers to exporting.*
- ▶ *To access lower-cost inputs. This form of foreign investment is often characterised as “vertical FDI”, since it involves breaking up the vertical chain of production and relocating part of the firms’ activities in a lower cost location. Firms with labour intensive operations, but based in advanced high cost countries, may establish operations in lower-wage countries to cut costs. Companies may also invest overseas to acquire new technologies perceived as being important for future competitive success.*

Of course, the distinctions between “horizontal” and “vertical” FDI can become blurred, as overseas investments may serve both purposes, i.e. to lower costs and improve sales in a foreign market. Other related reasons for companies to invest overseas may include the following:
- ▶ *Some intangible assets require global exploitation. Many companies that invest overseas often have some type of intangible assets that they want to keep within the firm rather than exploit through licensing. Under these circumstances, the value of the firm’s intangible assets can only be fully realised through a global presence and FDI. Intangible assets include, for example, brands/ reputations, management, technical skills and know-how, access to finance and R&D.*
- ▶ *Risk-spreading. Firms may wish to reduce their exposure to regional or national economic downturns by expanding into new geographic regions through buying or establishing overseas subsidiaries.*

3.3 Outward Direct Investment vs. Exporting

Overseas expansion via ODI rather than exporting is often optimal

A firm can supply a foreign market either by exporting from home or by producing in the foreign market – by going “multinational”. Although establishing foreign operations may involve significant costs, and require the economies of scale of a single production location to be sacrificed, recent research has identified a number of reasons why companies may prefer to access foreign markets through outward direct investment rather than through exporting. These include:

- ▶ *Barriers to Trade: Often, exporting to foreign markets is not feasible because of high tariff or non-tariff barriers to imports in the foreign market. Under these circumstances, it may be necessary to supply the foreign market through local production. This is known as “tariff-jumping” foreign direct investment.*
- ▶ *High Transport Costs: Similarly, traditional exporting may not be feasible because of the costs of transporting goods to foreign markets. This is particularly true for many industrial and perishable consumer goods industries. In such cases, it is often advantageous for companies to establish a new operation or to buy an existing producer in the foreign market in order to be close to the final customer.*
- ▶ *Non-tradability of Services: Many services are not internationally tradable; the purchase of services requires close physical contact between the buyer and the service supplier. Accordingly, the internationalisation strategies of service firms will rely heavily on foreign direct investment rather than exporting.*
- ▶ *Speed: Establishing or buying a presence in a foreign market is often a quicker route to market entry than traditional exporting. This is particularly true of mergers and acquisitions, through which firms can quickly access new market opportunities and develop critical mass without adding additional capacity to an industry. Also, taking over an existing foreign company often provides immediate access to an existing network of suppliers, clients and distribution channels.*
- ▶ *Ownership Advantages: Firms investing overseas rather than exporting often possess “firm-specific” assets that more than compensate for the extra costs of operating in a different, less familiar environment. These advantages are often costly to create, but can generally be easily transferred to new locations. They may include firm-specific technologies, brand names, privileged access to certain factor or product markets or superior technological or management skills. Most firms prefer to keep these key intangible advantages within the firm, due to the difficulty of pricing and contracting the sale of these assets to third parties, as required by exporting.*

While exports and outward direct investment may on occasion be alternative strategies at the firm level, most research shows that, at the macro level, outward direct investment and exports tend to be complementary (see Section 4).

3.4 Greenfield Investment vs. Mergers and Acquisitions

M&As have surpassed “greenfield” investment as the most popular form of ODI

There are two forms or modes of foreign direct investment: Mergers and Acquisitions (M&As) and “Greenfield” Investment. M&As involve the purchase of, or merger with, an existing company in a foreign country. In contrast, greenfield investment involves the establishment of a new factory or operation. In recent years, M&As have made up the vast bulk of global FDI flows. According to UNCTAD data, the value of cross-border M&As reached \$720 billion in 1999, compared with \$145 billion in greenfield investment.

Speed and access to proprietary assets are the two most important factors in explaining why firms increasingly prefer to invest overseas via M&As rather than through the establishment of new operations. When time-to-market is vital, the take-over of an existing firm in a new market with an established distribution system may be far more preferable to developing a new local production, distribution and marketing organisation. Also, shorter product life cycles make it necessary for firms to respond quickly to opportunities in their competitive environment. The second factor – the quest for strategic assets - refers to the need for companies to acquire proprietary R&D or technical know-how, patents, brand names, local permits and licences, and supplier or distribution networks. Ready made access to proprietary assets through M&As can be important because, by definition, they are not available elsewhere in the market and they take time to develop.

Greenfield investment is usually the optimal choice for foreign market entry if there are no adequate take-over targets in the host country. Hence, greenfield investment has been the dominant form of market entry in countries with a less developed industrial structure, such as Ireland had in the past, or in Central and Eastern European countries more recently. Also, firms may prefer greenfield investment even when there are takeover targets if the cost of adapting the existing firm to the production, management and marketing techniques of the acquiring company are considered to be too high.

3.5 Profile of Irish Companies Investing Abroad

“Old Economy” firms dominate the stock of overseas Irish investment

While the CSO does not break down Irish outward direct investment flows by industrial sector, anecdotal evidence suggests that the bulk of Irish direct investment outflows come from around 10-15 long-established Irish companies in the services (e.g. banking, insurance and property development) and traditional industrial sectors, such as construction materials, agribusiness and paper and packaging. These “old economy” firms tend to be dominant home players in non-traded sectors that use their existing strong positions in terms of expertise and finance in the domestic market in order to develop overseas. They include Allied Irish Banks (AIB), Bank of Ireland, Cement Roadstone Holdings (CRH), Greencore, Glanbia, Waterford Wedgewood and Smurfit.

Table 3.1 Top 10 Foreign Acquisitions by Irish Companies in 2000

Buyer	Target	Sector	Value (IR£m)
Elan	Dura	Medical	1,655
Baltimore	Content Technologies	IT and Telecommunications	980
Green Property	P&O (property portfolio)	Construction and Property	647
Elan	Liposome	Medical	470
Ind. News and Media	Belfast Telegraph	Print, Paper and Packaging	384
Greencore	Hazelwood Foods	Food, Drink and Agribusiness	337
CRH	Jura Group	Construction and Property	335
CRH	The Shelly Company	Construction and Property	283
Tullow Oil	North Sea Gas Assets from BP	Natural Resources	255
Lionbridge	INT'L.com	IT & Telecommunications	164
Kingspan	Tate Global Corporation	Construction and Property	157

Source: *cfm Capital, 2000 Acquisition Survey*

Note: These figures may not be consistent with outward FDI data as reported by the CSO in Section 2, since these acquisitions may in part have been funded by finance raised by Irish companies outside of Ireland.

But “new economy” firms are catching up quickly

While “old economy” firms still dominate the stock of Irish direct investment assets overseas, a small number of Irish “new economy” high-technology firms have recently started to set up significant operations and acquire new businesses overseas, predominantly in the United States. It is noteworthy that four of the largest ten foreign acquisitions (including the two largest) by Irish companies in 2000 were in high-technology sectors (Table 3.1). The most important “new economy” Irish companies making investments overseas include Elan, Iona Technologies, Baltimore Technologies, Trinity Biotech, Lionbridge and CBT Systems. While the stock of direct investments overseas owned by “new economy” Irish firms remains small compared with “old economy” firms, it seems likely that they will increase in importance in the future.⁶

An analysis of the Forfás/Enterprise Ireland “Annual Business Survey of Economic Impact (ABSEI) 2000” shows that companies supported by Enterprise Ireland employed 23,259 workers in overseas operations in 2000, equal to 17.5 per cent of total employment in these companies (Table 3.2). Of total overseas employment, 10,076 are employed in the overseas operations of client companies in the healthcare, pharmaceuticals, paper, print and packaging and construction industries. The vast majority of these work for foreign subsidiaries of Irish multinationals such as CRH, Jefferson Smurfit and Elan. The growing overseas presence of “new economy” Irish companies is also clear from the data. Supported companies involved in the financial, healthcare, training, software and services sectors employed 3,268 people overseas, more than the number of people employed by these companies in Ireland.

Table 3.2 *Number of Persons Employed in Overseas Operations of Client Companies of Enterprise Ireland, 2000*

Division	Number of Employees	% of Total
Healthcare/Pharmaceuticals/Paper/Print & Packaging/ Construction	10,076	36.8
Engineering	679	6.0
Electronics & Precision Components	990	7.7
Consumer Foods/Fish/High Potential Start-ups	1,109	9.1
Dairy/Drinks	480	1.9
Beef/Lamb/Pigmeat	2,723	27.0
Timber & Furniture	450	6.5
Consumer Products	478	3.8
Information/Telecommunications Services	2,016	90.6
Financial/Healthcare/Training/Software & Services	3,268	52.6
Design/Entertainment & Other Services	991	17.2
Total	23,259	17.5

Source: Forfás/Enterprise Ireland, Annual Business Survey of Economic Impact 2000.

Similarly, the 2016 people employed by Enterprise Ireland supported companies in the information and telecommunications sectors accounted for 91 per cent of total employment in these operations. Other industrial sectors with a large overseas presence include the drinks and dairy sectors (e.g. the Kerry Group), consumer foods and the fish, poultry and horticulture sectors.

6. Frank Barry, Holger Görg, Andrew McDowell, "Outward FDI from Ireland: An Analysis of the Investment Development Path of a Late-Industrialising Economy", University College Dublin.

Table 3.3 *Turnover of Selected Irish Companies by Geographical Region, 1999*

(IR£m)

Company	Rep. of Ireland	USA	UK	Rest of World	Total Overseas Turnover	Overseas Turnover as a % of Total Turnover
CRH	493	2,919	664	1,242	4,825	91%
Jefferson Smurfit	20	1,071	N/A	2,481	3,552	99%
Bank of Ireland	1,614	N/A	1,402	116	1,518	48%
Kerry Group	483	484	N/A	967	1,451	75%
Allied Irish Banks	969	641	420	195	1,256	56%
Fyffes	247	N/A	495	743	1,238	83%
Glanbia	959	N/A	N/A	1,013	1,013	51%
Independent News	245	N/A	119	556	676	73%
Irish Life and Permanent	3,480	N/A	N/A	614	614	15%
Elan	303	405	N/A	38	443	59%
Greencore	377	N/A	N/A	302	302	44%
Ryanair	56	N/A	129	48	177	76%

Source: Annual Company Reports

The importance of foreign operations for many of Ireland's most successful companies is evident from data on sales by foreign affiliates of publicly quoted Irish multinationals. For the twelve large Irish-managed companies listed in Table 3.3, total overseas sales came to IR£17.1 billion in 1999. By comparison, total exports by Irish-owned firms in the same year came to an estimated £15.0 billion. Clearly, overseas sales by foreign affiliates do not yield the same value-added and employment to the domestic economy as exports. Nevertheless, the figures offer powerful evidence of the importance of outward direct investment and overseas production to the ability of Irish companies to succeed in foreign markets.

3.6 Strategies of Irish Companies Investing Abroad

As discussed in Section 3.1, there are two main, distinct, reasons why companies, including those from Ireland, may invest overseas: (1) to access new markets and expand sales; and (2) to cut costs and gain access to key inputs. Naturally, the strategies behind overseas investments by Irish companies vary sector by sector and from company to company. Statistical and survey data do, however, offer some clues as to the dominant reasons for outward direct investment flows from Ireland.

Case Study 1 Elan Corporation plc

Main Activities

First incorporated in 1969, Elan floated on the Irish Stock Exchange in 1984 and is now a leading world-wide speciality pharmaceutical company, headquartered in Dublin. Elan's principal research and development, manufacturing and marketing facilities are located in Ireland, the US and Israel. Traditionally, Elan has focused on the development and commercialisation of products for pharmaceutical industry clients utilising its proprietary drug delivery systems, but has recently expanded its therapeutic focus through the development and commercialisation of new pharmaceutical products for selected target markets.

Corporate Strategies

Elan's goal is to become a fully integrated, worldwide speciality pharmaceutical company with a significant commercial presence in selected world markets and therapeutic areas. It has grown through a combination of organic growth and acquisitions. Its first acquisition occurred in 1996 with the acquisition of Athena Neurosciences, a U.S. company specialising in the discovery and treatment of neurological conditions including Alzheimer's and Parkinson's disease. Since then, Elan has made further acquisitions in the UK, the United States, Switzerland, Israel and Italy among other countries. Foreign acquisitions have allowed the company to:

- ▶ *Develop into a global force in the pharmaceutical market:* In 2000, Elan acquired Dura, a speciality pharmaceutical company engaged in the marketing and sale of prescription products for the treatment of infectious diseases and respiratory conditions. The acquisition added over 500 hundred hospital and primary care sales representatives to Elan's U.S. sales force to approximately 1,000 representatives. The acquisition broadened Elan's portfolio of marketed products by adding drugs such as Maxipime, Azactam and Nasarel. Also in 2000, Elan extended its therapeutic reach through the acquisition of Liposome, a biotechnology company engaged in the development, manufacturing and marketing of therapeutic products to treat cancer and related diseases. Also in 2000, Elan completed the acquisition of Quadrant, a UK-based drug delivery company that will enable Elan to expand the range of services of its drug delivery division.
- ▶ *Develop strategic collaborations:* Elan's objective is to be the pharmaceutical industry partner of choice for the development of drug delivery products and technologies. As part of this strategy, Elan has entered into licence agreements with certain emerging pharmaceutical and biotechnology companies to enable it to maximise the utilisation of its technologies and product base. This activity has involved licensing technologies or products to these strategic licensees and simultaneously making an investment in these companies, usually in the form of equity and convertible debt. Under this model, Elan invested approximately \$378 million in emerging pharmaceutical and biotechnology companies in 2000.
- ▶ *Acquire complementary technologies:* In 1998 Elan completed the acquisition of NanoSystems, a U.S. company engaged in the formulation and manufacturing of enhanced delivery forms of poorly water-soluble drugs using its proprietary NanoCrystal technology. Through the acquisition of this company, both the technology and the lead scientists who developed this technology were integrated into Elan. NanoCrystal technology is being made broadly available to the pharmaceutical industry under licences from Elan.
- ▶ *Achieve geographical spread of its manufacturing facilities:* Elan has manufacturing facilities in the United States, Ireland, Switzerland and Italy.

Market access, rather than cost reduction, is the main driver of Irish ODI

The most recent analysis on the strategies of Irish overseas investors comes from a survey of Irish chief executives carried out by corporate finance advisers *cfm Capital* in 1999. The survey evidence suggests that most Irish outward direct investment flows are aimed at market expansion rather than cost reduction. When asked for the dominant reason why their company had made an overseas acquisition, only 15 per cent of the respondents cited the need to lower the cost base (Table 3.4). In contrast, the most important reason for making an overseas acquisition cited by Irish CEOs was to increase earnings, which 17 per cent of company CEOs chose as the dominant factor. In addition, increasing market share and entry to foreign markets were cited by 14 per cent and 13 per cent of

respondents respectively as the dominant factors. Altogether, increased earnings, increased market share and entry to foreign markets were considered significantly more important than lowering costs as drivers of foreign direct investments. The dominance of market access and revenue considerations behind overseas acquisitions by Irish companies may suggest that Irish outward FDI is mainly of the horizontal type, i.e. firms invest abroad in order to penetrate new markets and expand horizontally. Lowering the cost base by creating a cross-border, vertically integrated, production chain appears to be a secondary, although still significant, reason for Irish companies to invest abroad.

Table 3.4 Reasons for Foreign Acquisitions, 1998 and 1999

	1998	1999
Most Important Reason for Making an Acquisition	% of Companies	
Increased Earnings	17	17
Maintain or Increase Market Share	18	14
Enter New Markets	14	13
Increase Production Capacity	4	12
Extend Product/Service Range	14	11
Lower the Cost Base	12	15
Diversify into New Business	8	5
Utilise Management Capacity	4	5
Investors Expectations	9	8

Source: cfm Capital, Acquisition Survey 1999

As the Irish economy approaches full capacity, however, it seems clear that vertical FDI flows out of Ireland will grow in importance. Indeed, increasing production capacity was cited by 12 per cent of survey respondents as the dominant factor behind a foreign acquisition in 1999, up from just four per cent a year earlier. This suggests that the tightening labour market, rising labour costs and capacity constraints are making it attractive for more and more Irish companies to make overseas investments.

The *cfm Capital* survey data is supported by the geographic distribution of Irish outward FDI flows, which mostly comprise acquisitions of companies in other advanced OECD economies. In 1999, only one per cent (by value) of cross-border M&As by Irish companies were outside Europe and the United States (Table 3.5).

Table 3.5 Foreign Acquisitions by Irish Companies by Location, 1995-1999

Economy/Region	1995		1996		1997		1998		1999	
	£000s	% of total	£000s	% of total	£000s	% of total	£000s	% of total	£000s	% of total
UK	453,349	67	979,137	42	484,186	24	1,026,500	39	1,277,874	44
Other European	118,600	18	172,750	7	156,507	8	585,100	22	1,007,231	34
US	64,550	9	999,301	43	1,300,056	66	892,000	34	638,441	21
Rest of the World	39,050	6	198,350	8	41,489	2	156,700	5	8,830	1
Total	675,549	100	2,349,538	100	1,982,238	100	2,660,300	100	2,932,376	100

Source: cfm Capital, Acquisition Survey 1996-99

With labour costs in other advanced OECD economies as high, if not higher, than in Ireland, this would support the survey evidence that the main purpose of Irish investments overseas is to access foreign markets, rather than to cut production costs.

Case Study 2 CRH

Main Activities

CRH's activities fall into two business segments: Building Materials and "Do-It-Yourself" (DIY). The Building Materials segment includes those Group companies engaged in the production of cement, readymixed concrete, aggregates, concrete products and a variety of construction related products and services. The DIY segment comprises those Group companies engaged in the marketing and sale of builders supplies to the construction industry and of materials for the DIY market. Since 1977, CRH has made over 200 acquisitions in 12 countries. The company and its subsidiaries operate all over Europe, including eastern and far northern countries, North America and Argentina.

Corporate Strategies

The overall strategy of the Group is to be an international leader in building materials, products and distribution, delivering sustained and superior shareholder returns. Foreign acquisitions assist this strategy through:

- ▶ *Facilitating Further Growth:* Growth via foreign acquisitions is driven partly by the nature of the business – the production and supply of heavy materials which are expensive to transport. Since transport costs for building materials are so high, the Group's presence in overseas markets is key to building up foreign market share and sales.
- ▶ *Adding Value to the Group's Businesses:* Many of the Group's acquisitions are mid-sized family companies, where owner-entrepreneurs continue to lead and grow their businesses within CRH. From time-to-time these mid-sized deals are augmented by larger acquisitions, which offer exceptional strategic fit, leadership positions or new platforms for growth. CRH's overseas presence is across the industry supply chains, from the manufacture of primary construction materials to building products and distribution.
- ▶ *Spreading Risks and Opportunities:* the group invests in many different foreign markets with a view to spreading risks and opportunities more broadly.
- ▶ *Offsetting the Cyclical Nature of the Industry in Any One Region:* Activity in the construction industry is characterised by cyclical nature and is dependent on the level of activity in the private housing and commercial construction markets and weather conditions. The company aims to achieve a unique balance across regions, products and all building and construction sectors to help smooth the effects of industry and economic cycles.
- ▶ *Achieving Economies of Scale through large scale production.*

The value of greenfield overseas investments by Irish companies is considerably smaller than that of overseas M&As. In contrast to M&As, anecdotal evidence suggests the direction of outward greenfield investment flows is more evenly spread between advanced and developing/transition economies. For example, many Irish companies have set up small new operations in Central and Eastern Europe, India, China and Latin America. Greenfield investment in developing/transition economies may involve some overseas redeployment out of Ireland of administrative and labour intensive operations for cost reasons. Even more importantly, relocation of production facilities to

transition/developing economies often provides companies with access to skills that have become scarce in Ireland. For example, Irish technology companies have made investments in Central and Eastern Europe and in India in order to gain access to a plentiful supply of highly trained software engineers and programmers in these locations.

3.7

Summary

- ▶ *The largest and most successful companies in the world are also the companies that dominate cross-border direct investment flows and international production. It is clear that multi-country presence is international best practice for fast growing companies.*
- ▶ *There are two distinct reasons why companies may invest overseas: (1) to better serve a local market ("horizontal" FDI); or (2) to access lower-cost inputs ("vertical" FDI). Horizontal FDI typically involves the duplication in foreign locations of the activities of the firm in the home market in order to better supply foreign customers. The main motive is to reduce the costs involved in supplying the foreign market and to improve the firm's competitive position there. Vertical FDI involves breaking up the vertical chain of production and relocating part of the firms' activities in a lower cost location.*
- ▶ *Barriers to trade, high transport costs, the non-tradability of some goods and services and the desire for rapid expansion into new markets are some of the reasons why firms may prefer to access foreign markets through outward direct investment and overseas production rather than exporting.*
- ▶ *There are two modes of outward direct investment: mergers and acquisitions (M&As) and "greenfield" investment. The value of cross-border M&As reached \$720 billion in 1999, compared with \$145 billion in greenfield investment.*
- ▶ *Speed and access to proprietary assets are usually deemed as being the two most important factors in explaining why firms may prefer to grow via M&As rather than through the establishment of new operations. Greenfield investment is usually the optimal choice for foreign market entry if there are no adequate take-over targets in the host country.*
- ▶ *Survey evidence suggests that the main motives for Irish companies investing abroad are to enter new foreign markets and acquire new technologies rather than to lower the cost base. Most Irish companies invest in advanced economies, mainly the UK and the United States, via mergers and acquisitions. As the Irish labour market tightens, however, capacity constraints may encourage more Irish companies to consider vertical direct investments in lower-cost locations.*
- ▶ *The bulk of Irish FDI outflows come from around 10-15 long-established Irish companies in services and traditional industrial sectors. While these "old economy" firms still dominate the stock of Irish-owned direct investment assets overseas, a small number of "new economy" high-technology firms have recently started to make significant overseas investments.*
- ▶ *An analysis of the Forfás/Enterprise Ireland "Annual Business Survey of Economic Impact (ABSEI) 2000" shows that companies supported by Enterprise Ireland employed 23,259 workers in overseas operations in 2000, equal to 17.5 per cent of total employment in these companies. Supported companies involved in the telecommunications, software and other international services employed more people in overseas operations than in Ireland.*
- ▶ *Sales by foreign affiliates of twelve publicly quoted Irish multinationals came to IR£17.1 billion in 1999. By comparison, exports by Irish-owned firms in the same year amounted to an estimated IR£15.0 billion. These figures clearly illustrate the importance of outward direct investment and overseas production to the ability of Irish companies to access foreign markets.*

4 Implications of Outward FDI for the Irish Economy

4.1 Introduction

Exports and outward direct investment have often been characterised as alternative strategies. Firms can either produce at home and export, or produce abroad and substitute local sales of foreign affiliates for exports. It is not surprising, therefore, that there are concerns that outward direct investment may lead to loss of investment, exports and employment from the home economy, leading to a “hollowing out” of domestic industry. Recent economic research, however, casts doubt on these assumptions and suggests that outward direct investment is beneficial to the home economy under certain conditions. For example, by enabling multinationals and their domestic suppliers to expand into new markets and to gain access to new technologies, “horizontal” outward direct investment can secure well-paid jobs in the home economy. “Vertical” outward direct investment can facilitate a restructuring of industry in the home economy up the value-added chain by moving some labour intensive production processes overseas to more cost competitive locations, allowing the domestic operations to concentrate on “strategic” high value-added activities that pay higher wages. Drawing on the experience of other countries, below we assess the likely effects on the Irish economy, across a range of key areas, of the increasing levels of outward direct investment.

4.2 The Impact of Outward Direct Investment on Exports

The relationship between outward direct investment and economic development of the home economy is not a constant. Outward FDI and exports can be substitutes when a company produces goods in the host country that had previously been exported from the domestic economy. In contrast, a complementary relationship between outward FDI and exports exists when expanding production and sales in the foreign market by the foreign affiliate increases demand for intermediate goods and services from the parent company in the home economy. Many small Irish software companies establish greenfield sites abroad for customisation and local sales of goods produced in Ireland. Foreign market penetration is also often achieved through the use of distribution channels of a foreign acquisition. In this sense, the relationship between outward direct investment and exports cannot be captured by a single holistic economic theory, but must also rely on empirical evidence.

Overseas evidence points to a complementary relationship between ODI and exports

Detailed studies of countries with long experiences of high levels of outward direct investment, notably the United States, Canada, Japan, Germany and Sweden all indicate that outward FDI and exports are broadly complementary. This is particularly true where the purpose of the overseas investment is horizontal in nature, i.e. where companies invest overseas in order to access new markets rather than to reduce costs through vertical production links. According to an OECD study of member countries (1998), each \$1.00 of outward direct investment was associated with \$2.00 of additional exports and a trade surplus of \$1.70.⁷ This reflects the high level of intra-company trade between parent companies and their foreign affiliates, particularly the export from the home country of royalties and licences, consultancy and other “headquarter” services. A significant proportion of world trade is now carried out between related affiliates of multinational companies,

7. OECD, “Open Markets Matter: The Benefits of Trade and Investment Liberalisation”, 1998, Paris: OECD.

which have become the principal agents in international transactions. Through outward direct investment, a country's exports of finished goods are, over time, replaced and overtaken by exports of intermediate goods and services. In other words, the evidence suggests that overseas investment by advanced economies leads to increased production in, and exports from, the home country.

Furthermore, in some cases of outward direct investment, particularly for non-traded goods and services industries, there are no exports to substitute. Output in the banking industry, for example, is largely non-tradable and cannot be easily exported. The only way to serve a foreign market is through direct investment, as the service provider needs to have a physical presence in the market to sell its product.

Rising Irish ODI levels have coincided with fast growth in exports

The effects of Irish outward direct investment flows on Irish exports have not been as extensively studied as in the United States, Sweden and other countries, due to limitations on statistical data for Irish direct investment flows and the associated exports and employment in the parent company. Nonetheless, there is no evidence that overseas direct investments by Irish companies has led to a reduction in Irish exports. Indeed, the fast rise in Ireland's total outward FDI stock during the 1990s coincided with an increase in Irish exports, both from foreign and indigenous companies, and a significant jump in Ireland's trade surplus with the rest of the world.

4.3 The Impact of Outward Direct Investment on Employment

As with exports, economic theory cannot provide an unambiguous answer regarding the effect of outward direct investment on employment in the home country. There are understandable fears that outward FDI hollows out the domestic economy by shifting jobs abroad. On the other hand, outward FDI can be an important vehicle for keeping domestic companies competitive through exploiting cost advantages in other countries and expanding the operations of domestically owned companies in foreign markets.

ODI is associated with higher employment and wages in the home economy

The most comprehensive empirical studies of employment effects of outward FDI have been carried out in the United States. Their conclusions are that outward FDI flows have had a marginally positive to neutral effect on employment levels in the U.S. economy. Similar studies in several European countries, including the UK, Belgium, France, Sweden, Germany and Austria, have found positive effects of outward direct investment on home country employment levels.

Much recent international research has focused on the relationship between outward direct investment and industrial restructuring in the home economy. Studies of the Swedish, U.S. and Canadian economies confirm that high levels of outward direct investment may be linked to the demise of traditional labour intensive manufacturing industries, with a consequent loss of employment in these sectors. They also suggest, however, that this process may have accelerated a restructuring of these economies into higher value-added activities, through the movement of scarce capital and labour resources into new, high-tech, industries.

Irish evidence links outward FDI with demand for high-skilled workers at home

Detailed research on the impact of outward FDI on Irish employment and wages has not been conducted due to unavailability of appropriate firm-level data. Nonetheless, a survey of 16 Irish companies with significant overseas operations commissioned by Forfás in 2000 found that outward

direct investment by Irish companies also had broadly positive impact on employment levels and wages in the companies' Irish operations. The study found that overseas investment by Irish companies has created demand for high-skilled employment at the head office in Ireland, e.g. for accountants, managers and marketing specialists. In line with the evidence from overseas research, this tentative positive correlation between Irish outward FDI and employment may reflect the largely horizontal nature of Irish direct investment flows, i.e. the fact that Irish companies invest overseas mostly to open new markets rather than to create vertically linked production chains and to cut costs.

Outward direct investment by Irish companies has also proved a useful mechanism for Irish industry to address capacity constraints in the context of Ireland's tightening labour market, thereby helping to ensure the long-term survival of "head office" jobs in the Irish economy. While lower overseas labour costs are obviously a factor in some overseas investment decisions by Irish companies, it seems that accessing skills that have become scarce in Ireland appears to be an equally important driver. For example, some Irish companies have set up operations and made acquisitions in Central and Eastern Europe and in India in order to avail of these regions' plentiful supply of software engineers and programmers. In this sense, outward direct investment levels may be correlated with macro conditions for the supply of, and demand for key factors of production for industry in the home economy. As the home economy moves towards full employment, outward direct investment may offer companies in the home economy a channel for sourcing key inputs, including skilled labour, at a competitive price.

4.4 The Impact of Outward Direct Investment on Technology Development

The positive impact of inward direct investment into Ireland on technological development in this country is well documented. Less intuitive is the proposition that outward direct investment may also have a positive impact on technological development in Ireland. By leading to the acquisition of overseas R&D capabilities and technologies, outward FDI may facilitate Irish companies moving into high-tech activities. There is considerable evidence that Irish food companies, for example, have transferred technologies from the United States and other overseas production facilities back to Ireland, leading to new products and higher productivity levels at their Irish operations. Indeed, most cross-border mergers and acquisitions essentially involve the acquisition of foreign technologies and know-how. Even greenfield investments overseas can yield technological benefits to the parent companies and home economy in terms of "learning-by-doing" and foreign management practices.

Such positive technology spillovers from outward direct investment may not be limited to the parent company, but also to the parent company's customers and suppliers in the home country. For example, lessons learnt from overseas investments may lead to a parent company instructing suppliers as to how to meet higher quality standards. It is also possible that home country firms that do not have direct linkages to the multinational can benefit from spillovers if the newly acquired know-how disperses into the domestic economy. Such technological spillovers in the home country are more likely in cases where the parent and affiliate in the multinational company are involved in vertically integrated operations that require exports of intermediate goods and services from the home economy to the foreign affiliate.

Multinational companies tend to do more R&D than "national exporting firms"

Studies from the United States and Sweden have concluded that outward direct investment also has positive effects on the R&D capabilities of the parent companies in the home economy. According to these studies, multinational companies tend to be larger and more R&D intensive than "national exporting firms" – firms that produce and export from the home economy – and tend to have highly skilled workers. At the macro level, countries with high levels of outward FDI also tend to have high

levels of spending on R&D. Some studies have even concluded that outward direct investment is a greater source of technology diffusion, and rising productivity, in the home economy than inward FDI.

In this context, it is worth noting that increasing the levels of R&D undertaken by Irish companies is a central element of current Irish enterprise policy. Forfás' *Enterprise 2010* report, which outlines a new strategy for the development of enterprise in Ireland in the 21st century, calls for a doubling of the number of Irish-owned companies spending at least IRE100,000 per annum on R&D (in 1997 prices) from 350 in 1997 to 700 by 2010. It also calls for a rise in productivity per head in Irish-owned companies through improved efficiencies, new product development and the outsourcing of non-core activities.

Outward direct investment can, of course, also present dangers to the R&D capabilities of the home economy. Outward direct investment in the shape of overseas "technology sourcing" can lower the demand for high-skilled researchers in the home country. This may occur if R&D facilities are shifted abroad to benefit from advanced technologies available in the foreign country. A Swedish study found that outward direct investment flows from Sweden in the early 1990s led to a shift of high-skilled R&D activities away from Sweden to the affiliates abroad. This largely reflected the declining attractiveness of Sweden at that time for R&D functions because of high tax rates and the high cost of researchers. Accordingly, whether outward FDI yields positive or negative benefits to technology development and R&D capabilities in the home economy may largely depend on other competitiveness and infrastructural factors. In this context, it might be reasonably hoped that the improved environment for R&D in Ireland as a result of the government's Science Foundation Ireland initiative have a positive bearing on Irish companies when choosing locations for R&D.

4.5 Other Potential Implications of Outward Direct Investment for the Irish Economy

Outward direct investment may have other implications on the home economy as follows:

- ▶ **Impact of outward direct investment on the balance of payments:** *Outward FDI by definition involves capital outflows from the home economy to finance the purchase or establishment of an overseas operation. Over the longer-term, however, profits repatriated from foreign affiliates to the parent as a result of outward FDI can bring improvements to the home country's balance of payments position. Indeed, many countries with historically large outward FDI stocks finance deficits in goods and services trade through repatriated profits from overseas investments.*
- ▶ **Foreign profits can finance higher investment in Ireland:** *Many Irish companies have strong balance sheets and trading results as a result of overseas investments enabling them to remain under local control and to be able to acquire rather than be acquired. Strong foreign earnings also allow companies to increase their investment in their Irish operations.*
- ▶ **Reduction in exposure to regional economic downturns:** *Outward investment can reduce the exposure of parent companies, and their home economies, to regional economic downturns. Some Irish companies operate similar enterprises in several world market regions and this offsets the cyclical nature of the industry in any one region.*

4.6 Summary

- ▶ *Despite fears that outward direct investment by Irish companies may lead to a "hollowing out" of industry and a loss of exports, studies of countries with long experiences of high levels of outward direct investment all indicate that outward direct investment and exports are broadly complementary. According to one OECD study of member countries, each \$1.00 of outward direct investment was associated with \$2.00 of additional exports and a trade surplus of \$1.70. This reflects the importance of outward FDI as a mechanism for gaining access to foreign markets.*

Through outward direct investment, a country's exports of finished goods are, over time, replaced and overtaken by exports of high value-added intermediate goods and "headquarter" services to foreign affiliates overseas.

▶ *Similarly, international evidence suggests that outward FDI has broadly positive effects on employment and wage levels in the domestic economy. According to recent research commissioned by Forfás, overseas investment by Irish companies has created demand for high-skilled employment at the respective head offices in Ireland, e.g. for accountants, managers and marketing specialists.*

▶ *Outward direct investment by Irish companies has also proved a useful mechanism for Irish industry to address capacity constraints in the context of Ireland's tightening labour market. In this sense, outward FDI levels are correlated to macro conditions for the supply of, and demand for key factors of production for industry in the home economy. While lower overseas labour costs are obviously a factor in some overseas investment decisions by Irish companies, it seems that accessing skills that have become scarce in Ireland appears to be an equally important driver.*

▶ *Outward FDI represents one important mechanism of gaining access to foreign technologies. Countries with high levels of outward FDI also tend to have high levels of spending on R&D. Multinational companies tend to be more R&D intensive than "national exporting firms" and tend to have higher skilled workers.*

▶ *International research links outward FDI with economic restructuring of home countries into higher value-added activities, through the movement of scarce capital and labour resources into new, high-tech, industries. Outward FDI may also have a positive impact on the balance of payments and the degree to which countries are protected from regional economic downturns.*

▶ *The most crucial issue in assessing the impact of outward FDI on the home economy is whether high or low value-added activities and jobs are being located, or relocated, overseas. If key factors in the wider business environment, such as infrastructure, taxation and the skills availability, are supportive of high value-added activities in this country, then the impact of outward FDI flows will be to relocate lower value-added and labour intensive activities to more cost competitive locations. This should in turn lead to a restructuring of industry in the home economy favouring higher value-added activities that pay higher wages.*

5 Public Policy towards Outward Direct Investment

5.1 Introduction

A central goal of Irish enterprise policy over the next decade, as articulated in Forfás' *Enterprise 2010* report, will be the further development of Irish-owned and managed industry, including a significant number of firms of international scale operating successfully in high-growth sectors. As labour force growth slows, further fast growth in Irish living standards will require an acceleration of the shift towards high-growth, high-tech, high-productivity activities and a shift from production-type activities to service-type activities.

In this context, it is widely recognised that far from being symptomatic of economic decline, growing levels of outward direct investment by Irish companies reflect a restructuring of Irish-owned industry into higher value-added activities that will form the basis of long-term growth in competitiveness, exports and employment. In this sense, outward direct investment is consistent with the aims of Irish enterprise policy with regard to boosting exports and raising the average skills content and value-added of Irish-based enterprise activities. Clearly, the microeconomic interests of individual Irish multinationals and the broader goals of national economic development are not always aligned. But as long as the Irish business environment remains broadly supportive of high value-added activities, then outward FDI by Irish companies will, on aggregate, have a positive impact on employment, wages and living standards in this country.

While the development agencies see outward direct investment as broadly positive for the economy, there is little evidence of market failures or institutional barriers to outward FDI by Irish companies that require a strong state intervention at firm level (the fast growth in outward FDI during the 1990s is testament to this). Growth in cross-border FDI flows between Ireland and the rest of the world is best supported at the macro level, by removing tax and regulatory barriers to investment flows between countries through international agreements (see Section 5.2). That said, the development agencies recognise that for many individual Irish firms, overseas investment is crucial to long-term sales, competitiveness and export growth. Accordingly, Enterprise Ireland and other development agencies may offer "soft" supports to companies wishing to expand by investing overseas in the form networking, information and advice (see Section 5.3).

5.2 International Tax and Investment Agreements

Ireland has negotiated Double Taxation Agreements (DTAs) with 39 countries, of which 37 are in force.⁸ DTAs are entered into between two countries for the purpose of avoiding the possibility that the same income or gains might be fully taxed in both countries. They serve to promote trade and investment between two countries that might otherwise be discouraged by the possibility of double taxation. As can be seen from the appendix, Ireland's network of bilateral taxation treaties was expanded significantly during the 1990s, particularly in central and eastern Europe and the Asia Pacific region. There are a number of further DTAs under negotiation.

Aside from double taxation, Irish companies potentially face numerous other regulatory barriers to direct investment in other countries. While Ireland does not discriminate between indigenous and

8. A DTA seeks to allocate the taxing right over items of income and gains to one or other of the two countries. Where however, certain items remain taxable in both, the DTA will generally provide that the country of residence of the taxpayer will either exempt the income or gains from further taxation or alternatively give a credit against its tax for the tax paid in the other country. The move to a low 12.5 per cent standard rate of corporate taxation in Ireland will mean that dividends and profit repatriations from Irish-owned companies in many overseas countries will no longer be taxed in Ireland. For a full list of Ireland's DTAs, see Appendix.

foreign-owned companies, many other countries impose a wide range of barriers to the operations of foreign-owned companies in their markets. These take a number of forms, such as:

- ▶ *restrictions on the right to private ownership and establishment;*
- ▶ *restrictions on the legal form foreign investment must take e.g. compulsory partnerships with local enterprises;*
- ▶ *laws or constitutional provisions specifying sectors from which foreign investors are excluded;*
- ▶ *restrictions on the numbers of foreign firms that can operate in particular sectors;*
- ▶ *a lack of certainty over property rights, including the risk of expropriation of private property by public authorities;*
- ▶ *high tax rates;*
- ▶ *compulsory technology-sharing with indigenous companies;*
- ▶ *restrictions on repatriated profits and on other capital movements;*
- ▶ *a lack of effective dispute settlement mechanisms; and*
- ▶ *performance requirements e.g. where investment approval is tied to export or employment targets.*

Some countries address overseas investment barriers through Bilateral Investment Treaties (BITs). These are legal agreements between two countries aimed at providing legal protection for foreign investments from discriminatory treatment and/or expropriation as well as providing a mechanism for dispute resolution. To date, Ireland has signed only one BIT with the Czech Republic. It is the government's view that BITs are of limited use in facilitating flows of direct investment and trade between Ireland and other countries. Accordingly, it is government policy not to negotiate any further BITs at this time. This could, however, be reviewed where there are clear, identifiable benefits for Irish companies in specific cases.

Instead, Ireland, in association with our EU partners, is committed to securing agreements on direct investment rules at a multilateral level. This approach will require less resources on Ireland's part compared with the negotiation of multiple BITs, and should secure better results. Since the collapse of negotiations at the OECD on the "Multilateral Agreement on Investment" in 1999, efforts to create new international rules on cross-border flows of direct investment have been taking place under the auspices of the World Trade Organisation (WTO), which represents the interests of both developing and developed countries.

In order to be able to better represent the views of Irish companies at the WTO level, the Department of Enterprise, Trade and Employment has requested Forfás, in conjunction with Enterprise Ireland, IDA Ireland and the other enterprise development agencies, to undertake a consultation process with industry on investment barriers encountered by Irish companies in non-EU markets. This will be done as part of a more general industry consultation process on all WTO-related enterprise issues. This process is designed to learn from companies which barriers to investment they face in non-EU countries in order to address these in the forthcoming multilateral round on trade and investment negotiations at the WTO.

5.3 Support from Enterprise Ireland and Ireland's Overseas Diplomatic Network

Enterprise Ireland assists Irish companies to develop their internationalisation strategies in a number of ways, mostly through supports for exporting. Given the pace of globalisation and the small size of the domestic Irish market, however, Enterprise Ireland recognises that outward direct investment is becoming an increasingly essential stage in company development for many fast growing Irish

companies. This recognition is given substance through various forms of support now available to companies that wish to expand by establishing overseas operations, and through internal Enterprise Ireland targets for the number of client companies with an overseas marketing presence. Enterprise Ireland's assistance to outward investors comes mainly in the form of "soft" supports such as information and advisory services. These measures are primarily aimed at small- and medium-sized companies, as large Irish companies have largely been successful at overseas direct investment without direct state support. The main forms of support are as follows:

- ▶ *Enterprise Ireland's Overseas Network. Enterprise Ireland has 28 overseas offices, the primary function of which is to promote exports by indigenous Irish companies.⁹ These offices also provide informal advice and networking services for client companies interested in investing overseas. Indeed, support for outward direct investment and trade promotion are complementary activities. The knowledge of local market conditions, government regulations and overseas business practices built up by Enterprise Ireland overseas executives to assist Irish exporters are also valuable to companies interested in establishing overseas operations.*
- ▶ *Enterprise Ireland's Overseas Incubator Facilities. In addition to its overseas export promotion offices, Enterprise Ireland also currently operates three U.S.-based "Trade and Technology Centres" in New York, Boston and Silicon Valley. Otherwise known as "incubator facilities", these provide office space and support services to Enterprise Ireland clients for limited periods of time and have been highly successful in enabling indigenous companies to develop a market position in the United States, often leading to acquisitions and investment in the U.S. market. More than 220 Irish high technology companies are currently active in the United States and 130 have set up U.S. headquarters and local offices. Enterprise Ireland is currently in the process of extending its incubator network to other overseas regions, including the UK, continental Europe and the Pacific Rim.*
- ▶ *Enterprise Ireland's Acquisition Service. As part of its three-year European business development strategy, eur:opp 2003, Enterprise Ireland now offers a tailored service to support firms in implementing a European acquisition strategy. Working with a client company's acquisition team, Enterprise Ireland's staff provide practical assistance, advice and information on: drawing up a candidate list, market opportunities and level of competition, accessing professional legal and financial advice, local sources of information and key contacts.*
- ▶ *Enterprise Ireland's Outsourcing Missions. Enterprise Ireland also now offers support to Irish firms to outsource labour intensive operations to markets where costs are lower and labour supply is more plentiful. Eastern Europe is currently a major focus of attention in this regard.*
- ▶ *Enterprise Ireland's Technology Transfer/Business Partners Programme. This programme helps Irish and overseas technology companies to develop mutually profitable business alliances, often involving the purchase by Irish firms of equity stakes in foreign companies. Over 300 partnerships have been formed world-wide, using Enterprise Ireland's network of contacts in the five continents. Around 40 new partnership / joint venture agreements are signed each year.*
- ▶ *Foreign Trade and Investment Missions. In 2000, Enterprise Ireland organised 30 overseas trade and investment missions. Recent examples include a mission to India, led by the Tánaiste and a mission to Poland, led by the Taoiseach, both of which were accompanied by large delegations of indigenous Irish firms looking for overseas trade and investment opportunities.*

9. Amsterdam, Beijing, Berlin, Brussels, Budapest, California, Copenhagen, Düsseldorf, Glasgow, Hong Kong, Kuala Lumpur, London, Madrid, Manchester, Milan, Moscow, Munich, New York, Paris, Prague, Riyadh, Shanghai, Singapore, Stockholm, Tokyo, Vienna and Warsaw.

► *Foreign Embassies. Ireland has 43 overseas embassies and consulates, accredited to 107 foreign countries with which Ireland maintains diplomatic relations. Irish overseas embassies are committed to advancing Ireland's international economic and business interests. This entails for example, working with foreign governments to overcome barriers to Irish companies operating successfully in overseas markets.*

5.4 Future Public Policy towards Outward Direct Investment

The dismantling of overseas investment restrictions and growing outward FDI flows from Ireland should be seen as an opportunity for national economic development rather than a threat. As long as the Irish business environment is supportive of value-added activities locating in this country, this process is likely to catalyse a restructuring of the economy up the value chain, with labour intensive lower-tech operations relocating to more cost competitive locations. This process should result in higher average wages and living standards in Ireland.

Clearly, as with all channels of economic restructuring, the “winners” and “losers” from growing outward FDI may not be the same, as managerial, professional and technical skills replace labour as the key inputs into enterprise activities in Ireland. Where outward direct investment by Irish companies is associated with economic dislocation, there may be calls for measures to discourage Irish companies from making overseas investments. It is clear from existing overseas and Irish research, however, that outward direct investment is broadly beneficial to the Irish economy as a whole, and such measures should be avoided. Instead, public intervention should focus on providing those negatively affected by outward direct investment with the necessary skills and training to prosper in the new economy.

While the evidence suggests that outward direct investment is broadly positive for the Irish economy, there does not appear to be any pressing need for stronger public intervention to support outward direct investors at the firm level beyond the non-financial “soft” supports already offered by Enterprise Ireland. This view reflects the absence of any evidence of market failures or institutional barriers to outward direct investment requiring state intervention. Instead, government efforts should continue to be concentrated at the international level: expanding Ireland’s tax treaty network and supporting the negotiation of a multilateral agreement on investment rules under the auspices of the WTO that would provide a transparent, non-discriminatory environment for Irish companies investing overseas.

Economic theory and empirical evidence both suggest that the impact of growing levels of outward direct investment on economic development in Ireland will depend not on our policies towards ODI in themselves, but instead on the wider environment for business in Ireland. The dismantling of barriers to cross-border investment flows, and the general decline in the difficulties faced by Irish firms making investments abroad, will require a renewed commitment to improving the competitiveness of Ireland’s industrial policy framework across a range of indicators, including the macro economic climate, infrastructure, the taxation system and the availability of skilled labour.

5.5 Summary

► *It is widely recognised that growing levels of investment abroad by Irish companies reflect a restructuring of Irish-owned industry into higher value-added activities that will form the foundation of long-term growth in competitiveness, exports and employment. At the same time, there is little evidence of market failures or institutional barriers to outward FDI by Irish companies that require a strong state intervention at firm level.*

➤ *Growth in FDI flows between Ireland and the rest of the world is best supported at the macro level, by removing tax and regulatory barriers to investment flows between countries through international agreements. This will be done by expanding Ireland's network of Double Taxation Agreements, and through Irish support for negotiation of a multilateral agreement on investment rules under the auspices of the World Trade Organisation. The Department of Enterprise, Trade and Industrial Employment has asked Forfás to undertake an industry consultation process, in conjunction with the industrial development agencies, on overseas trade and investment barriers to take into account views of Irish companies on these issues in the next round of negotiations at the WTO.*

➤ *Enterprise Ireland may also offer "soft" supports to companies wishing to expand through overseas investment. These include Enterprise Ireland's:*

- *Overseas Network;*
- *Overseas Incubator Facilities;*
- *Acquisition Service;*
- *Outsourcing Missions; and*
- *Foreign Trade and Investment Missions.*

➤ *The likely acceleration of outward direct investment over the coming years, together with fears that outward FDI may lead to a "hollowing out" of industry and employment in Ireland, may push the role of Irish multinationals in national economic development towards the forefront of enterprise policy.*

➤ *As with all channels of economic restructuring, the "winners" and "losers" from growing outward FDI may not be the same, as managerial, professional and technical skills replace labour as the key inputs into enterprise activities in Ireland. Where outward direct investment by Irish companies is associated with economic dislocation, there may be calls for measures to discourage Irish companies from making overseas investments. Such measures should be avoided. Instead, public intervention should focus on providing those dislocated by outward direct investment with new skills and training.*

➤ *The impact of growing levels of outward direct investment on economic development in Ireland may depend not on our policies towards outward FDI in themselves, but instead on the wider environment for business in Ireland. As long as the Irish business environment is supportive of high value-added activities locating in this country, then outward direct investment by Irish companies should be consistent with rising average wages and living standards. This will require a renewed commitment to improving the competitiveness of Ireland's industrial policy framework across a range of indicators including the macro economic climate, infrastructure, the taxation system and the availability of skilled labour.*

Appendix

Irish Double Taxation Agreements

Ireland has comprehensive double taxation agreements in force with 39 countries. The agreements generally cover income tax, corporation tax and capital gains tax (direct taxes). The current (March 2001) list of agreements is as follows:

Ireland's Double Taxation Treaties

Country	Date of signature	Entry into Force
Australia	31 May, 1983	1984
Austria (Protocol 1988)	24 May, 1966	1964
Belgium	24 June, 1970	1973
Bulgaria**	5 October, 2000	-
Canada	23 November, 1966	1968
China	19 April, 2000	2001
Cyprus	24 September, 1968	1962
Czech Republic	14 November, 1995	1997
Denmark	26 March, 1993	1994
Estonia	16 December, 1997	1999
Finland	27 March, 1992	1990
France	21 March, 1968	1966
Germany	17 October, 1962	1958/1959*
Hungary	25 April, 1995	1997
India**	6 November, 2000	-
Israel	20 November, 1995	1996
Italy	11 June, 1971	1967
Japan	18 January, 1974	1974
Korea (Rep of)	18 July, 1990	1992
Latvia	13 November, 1997	1999
Lithuania	18 November, 1997	1999
Luxembourg	14 January, 1972	1968
Malaysia	28 November, 1998	2000
Mexico	22 October, 1998	1999
Netherlands	11 February, 1969	1965

New Zealand	19 September, 1986	1989
Norway	21 October, 1969	1967
Pakistan	13 April, 1973	1968
Poland	13 November, 1995	1996
Portugal	1 June, 1993	1995
Romania	21 October, 1999	2001
Russia	29 April, 1994	1996
Slovak Republic	8 June, 1999	2000
South Africa	7 October, 1997	1998
Spain	10 February, 1994	1995
Sweden (Protocol 1993)	8 October, 1986	1989
Switzerland (Protocol 1980)	8 November, 1966	1965
United Kingdom (Protocols 1976, 1994 and 1998)	2 June, 1976	1974/1976/1977*
United States	28 July, 1997	1998
Zambia	29 March, 1971	1967

* depending on tax head

** not in force yet

The treaty network continues to be expanded and updated. New double taxation agreements with China and Romania came into effect from January, 2001 and a treaty with Bulgaria will be effective from January, 2002. It is expected that new treaties which have been signed with India and Norway will also come into effect in 2002 (the Norwegian treaty replaces an existing agreement). A number of new treaties are in the course of being negotiated (including Croatia, Egypt, Iceland, Singapore, Slovenia, Turkey and Ukraine). Also, a number of existing treaties are being re-negotiated (including those with Canada and France).

Double taxation agreements with respect to direct taxes are aimed at avoiding the double taxation of income and gains where a resident of one country has taxable income arising in the other country. Generally, the agreement will provide that the income will either be taxed solely in one country or, if it remains taxable in both, that the taxpayer's country of residence will grant a credit for the tax paid in the other country. The agreements also usually provide for lower withholding taxes in both countries and for the exchange of relevant information. Non-discrimination provisions are also included.

Where a double taxation agreement does not exist with a particular country, there are provisions within the Irish Taxes Acts that allow unilateral credit relief against Irish tax for tax paid in the other country.

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