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## CRISIS RECOVERY IN A COUNTRY WITH A HIGH PRESENCE OF FOREIGN OWNED COMPANIES – The case of Ireland<sup>1</sup>

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### ABSTRACT

Compared to other euro area countries, Ireland has been one of the countries most heavily hit by the worldwide financial crisis, yet, also one with the strongest and quickest recovery. Foreign controlled affiliates of multinational companies dominate economic activity, attracted by low corporate taxation rates. Low Irish tax rates contribute to downward competition of taxation in the EU and constitute a beggar-thy-neighbour-policy. Effects on Ireland are neither clearly positive: Profits of foreign affiliates do not necessarily stay in the country. A consequence is the huge difference between GNI and GDP: GNI per capita is by about 15 percentage points lower than GDP per capita. Hence, GDP can be misleading, when judging the recovery since the financial crisis. The paper instead concentrates on the development of national income, employment, and wages. Judged by these indicators, the Irish recovery ceases to be successful compared to other crisis countries. The benefits to Irish citizens are nevertheless questionable: GNI decreased stronger than GDP. Even worse are labour market developments since the recent crisis: employment and wages are still to recover, and the wage share decreased by more than 10 %-points.

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I am grateful for the financial support.

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# **Crisis recovery in a country with a high presence of foreign owned companies - The case of Ireland<sup>1</sup>**

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## Abstract

Compared to other euro area countries, Ireland has been one of the countries most heavily hit by the worldwide financial crisis, yet, also one with the strongest and quickest recovery. Foreign controlled affiliates of multinational companies dominate economic activity, attracted by low corporate taxation rates. Low Irish tax rates contribute to downward competition of taxation in the EU and constitute a beggar-thy-neighbour-policy. Effects on Ireland are neither clearly positive: Profits of foreign affiliates do not necessarily stay in the country. A consequence is the huge difference between GNI and GDP: GNI per capita is by about 15 percentage points lower than GDP per capita. Hence, GDP can be misleading, when judging the recovery since the financial crisis. The paper instead concentrates on the development of national income, employment, and wages. Judged by these indicators, the Irish recovery ceases to be successful compared to other crisis countries. The benefits to Irish citizens are nevertheless questionable: GNI decreased stronger than GDP. Even worse are labour market developments since the recent crisis: employment and wages are still to recover, and the wage share decreased by more than 10 %-points.

## Zusammenfassung

Irland hat im Zuge der weltweiten Finanzkrise einen der stärksten Wachstumseinbrüche verzeichnet, sich aber auch schneller als andere Krisenländer davon erholt, wenn man die Wirtschaftsentwicklung mit dem Bruttoinlandsprodukt (BIP) misst. Die Konzentration auf die BIP-Entwicklung ist aber problematisch in einem Land mit hohem Anteil von Unternehmen in ausländischem Besitz, da die Gewinne dieser Unternehmen größtenteils repatriiert werden. Folglich sind die Einkommen der Inländer deutlich geringer als es das BIP suggeriert: Das Bruttonationaleinkommen (BNE) liegt ca. 15 Prozentpunkte unter dem BIP. Um die Krisenfolgen für die Inländer besser zu erfassen, konzentriert sich die Studie auf die Entwicklung von nationalen Einkommen, Löhnen und der Lohnquote. Nach diesen Indikatoren hat sich Irland nicht besser als andere Krisenländer im Euroraum von den Krisenfolgen erholt. Einkommen und Löhne haben die Vorkrisenniveaus noch nicht erreicht, während die Lohnquote um mehr als 10 Prozentpunkte gefallen ist. Dass nicht einmal die Inländer eindeutig von der hohen Präsenz ausländischer Unternehmen profitieren, ist problematisch, weil Irland diese gezielt mit einer niedrigen effektiven Unternehmensbesteuerung anlockt, die negative Auswirkungen auf andere Euroraumländer hat.

JEL: E01, F23, H26, F62

Key words: Ireland, effective corporate taxation, ESA 2010, wage share, GDP, GNI, global value chains, multinational companies, tax evasion

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## 1. Introduction

Since 2014, Ireland has experienced a remarkable real GDP growth of 8.5% in 2014 and 26.3% in 2015 (Eurostat, Oct. 2016). The extraordinary high figures mainly result from the new EU accounting framework (see Eurostat 2016 and below). Yet, Ireland would have shown rates above 5% in real terms even under the old accounting framework. The European Commission (EC) praises this development as a “remarkable economic rebound” (EC 2016: 1): Ireland was among the heaviest hit European countries during the financial crisis, but also one with the strongest recovery.

The European Commission attributes this success to reforms that have started at the end of 2010 and focused (next to financial sector and structural reforms) on increasing competitiveness (EC 2016: 1). Labour productivity has increased by about 34 % since 2010 and nominal unit labour costs have decreased by about 17 % since 2010 (Eurostat, Sep. 2016). These factors may have contributed to remarkable export growth rates since 2014, besides accounting rules (see below).

Yet, part of the impressive developments stem from the difference between reported and real economic activity. Differences between reported activity in official GDP as well as trade figures and real economic activity are a problem of many countries in a globalized world, but especially relevant for countries with a high share of foreign owned affiliates like Ireland (FitzGerald 2015). As GDP developments overstate economic activity (see below), they do not answer the question, if Irish domestic citizens have benefitted from economic developments since the global financial crisis. The aim of this paper is to answer this question by concentrating on national income and labour market developments in Ireland.

Why is this question relevant? An often-voiced critic on the Irish model of economic development is the use of low effective corporate taxation rates in order to attract foreign affiliates, thereby contributing to downward competition of corporate taxation in the European Union. According to a survey by Devereux and Loretz, downward competition of corporate taxation is “strongest in the European Union” (Devereux/Loretz 2012). Downward competition of corporate taxation negatively affects public investment (Gomes/Pouges 2008), and changes the tax structure to a less progressive one, thereby furthering income inequality (Tanzi 1996).

Besides negatively affecting other EU countries, it is not even clear in how far such a strategy is beneficial for Ireland. Empirical studies for the effect of net FDI inflows on growth find a positive correlation for countries with a certain level of development, but causality is unclear. Employment and welfare effects are more critical (see the overview on those studies in Contessi/Weinberger 2009). Yet, for small countries, the positive effect of increasing employment by foreign owned companies and increasing the amount of taxable companies may outweigh potential losses due to the lower tax rates.

The attraction of foreign owned companies apparently supported the Irish catching-up process in the past (see below), but appears less beneficial for Irish citizens regarding developments of national income levels, employment, and wages since the financial crisis. Doubts do not only stem from the difference between GNI and GDP, but also from forecasts for employment (in persons, AMECO, Sep. 2016) according to which employment will not even reach the 2008 levels in 2016. Similarly, the (adjusted) wage share is expected to decrease to 40% in 2016, down from 53% in 2008, according to official European Commission forecasts.

The paper is organized as follows: The next section explains why income generated in the Irish borders (measured by GDP) differs from income received by Irish citizens (measured by GNI) and why GDP overstates economic activity. Section 3 concentrates on additional data distortions in GDP

measurement due to the new EU system of national accounting. Section 4 briefly portrays developments since the 1970s. Section 5 analyses GDP and GNI developments during and after the financial crisis. Section 6 evaluates labour market indicators, trying to analyse, if Irish citizens really benefitted. Section 7 concludes.

## 2. Economic activity in a country with a high presence of foreign owned companies

Ireland's economy is special in being heavily dependent on foreign controlled affiliates of multinational companies. According to the OECD, foreign controlled affiliates of multinational companies provide about 80% of domestic value added and turn-over in manufacturing, 47% of employment. Even in services, more than 40% of value added and turn-over stem from foreign controlled affiliates and are responsible for 28% of employment (OECD 2010: 156-7).<sup>3</sup> "A very high proportion of Irish trade (over 90 percent of manufacturing exports, and almost 80 percent of all exports) reflects the output of foreign-owned manufacturing enterprises." (Honohan/Walsh 2002: 38).

Elschner and Vanborren show for 2009 that Ireland is an EU-country with very low statutory corporate tax rates as well as low effective average tax rates of 14.4% (EATR), even taking into account that Ireland had to increase statutory corporate tax rates to 12.5%.<sup>4</sup> Only some of the New Member States like Bulgaria and Cyprus undercut the Irish levels. Latvia, Lithuania, and Romania show comparably low levels, while all other countries have higher corporate tax levels (Elschner and Vanborren 2009: 16).

Low (effective) corporate tax rates are an incentive to report profits in Ireland, even if economic activity takes place in other countries. Honohan and Walsh point to the problem that "... the huge profits recorded by the Irish affiliates have very little to do with the manufacturing activities being conducted in Ireland." (Honohan/Walsh 2002: 40). Companies are tempted to shift profits to Ireland by using high transfer prices for inputs and services from affiliates abroad, plus charging them for the use of intellectual property rights, including patents. These are relevant factors increasing Irish GDP (FitzGerald 2015). As profits (net of tax) of foreign affiliates do not necessarily stay in the country, there is a remarkable difference between GDP and GNP or GNI. In contrast to the income generated by domestic production, GNI (as GNP)<sup>5</sup> only measures the income of domestic citizens and only amounts to about 82% of GDP in 2016 (AMECO, Sep. 2016).

Employment creation by foreign affiliates in reaction to increased demand is lower than for domestic companies (Department of Finance 2014), and some foreign companies may not at all offer employment opportunities: Re-domiciled Public Limited Companies (PLCs) may be legal entities without any economic activity in Ireland. The term refers to companies that relocate their

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<sup>3</sup> Yet, OECD figures for employment creation by foreign owned companies are higher than the ones presented by the Department of Finance (2014).

<sup>4</sup> "The 10% effective tax rate then fell foul of EU rules in 1998 and, in turn, was replaced by a general 12.5% tax rate that applied to company trading profits (a 25% tax rate applied to non-trading profits, and the capital gains tax rate applied to corporate chargeable gains, currently 33% but then 20%). In 1999 imputation was removed and the Irish tax system became a classical system for the first time. The 12.5% general tax rate first applied on 1 January 2003" (Walsh/Sanger 2014: 5). The Department of Finance states that effective corporate tax rates are even below 11% (Department of Finance 2014).

<sup>5</sup> GNI is the sum of value added by all resident producers plus any product taxes (less subsidies) not included in the valuation of output plus net receipts of primary income (wage and capital income) from abroad. The paper concentrates on GNI, instead of GNP, as this is the more often used indicator. The difference to GNP are any product taxes (less subsidies) not included in the valuation of output.

headquarters back to Ireland, typically in order to avoid tax payments in other countries and benefit from low taxation in Ireland. Their only contribution to the Irish economy are tax payments.

Relocations of companies' headquarters to Ireland increase Irish current account surplus and Irish GNI as well as GDP. The reason is that headquarters tend to receive more profits than are paid to foreign shareholders (FitzGerald 2015: 10). Retained earnings of re-domiciled PLCs increase the value of the firm "... [but] are treated as an outflow in the current account of the balance of payments (as reinvested earnings)" (FitzGerald 2015: 10). According to the author, undistributed profits have grown in relevance since 2009 and account for almost 4% of GDP in 2014 and more than 4% for GNI. The accounting rule also drives up the current account surplus, which is higher by almost 4 %-points in the year 2014 (FitzGerald 2015: 11-12), even though retained earnings are subtracted.

Yet, many foreign owned affiliates contribute to domestic income not only by paying corporate taxes, but also by paying wages. Nevertheless, employment creation differs between sectors. In manufacturing, foreign owned affiliates dominate the sector of chemical and pharmaceutical products, as well as software and communication (Department of Finance 2014: 7). Wages make up for only 5% of gross value added in the high tech manufacturing sector since the 2000s, including pharmaceutical and engineering (FitzGerald 2015: 6). In the IT sector, the share is higher: Wages account for about 40% in gross value added (FitzGerald 2015: 8).

### 3. Recent distortions of national accounts data due to ESA 2010

Ireland surprised with real GDP growth of 8.5% in 2014 and 26.3% in 2015. Yet, these recent figures overstate economic activity in Ireland. The new EU national accounting framework ESA 2010 is bloating GDP, GNI, net exports, and the current account. Hence, all GDP-related indicators are bloated.

ESA 2010 was supposed to improve national accounting in a globalized world characterized by worldwide production chains. Instead of basing trade accounting to physical movements of exports and imports, ESA 2010 relies on a change in ownership approach, thereby avoiding that goods sent abroad for processing would count as exports.<sup>6</sup> Yet, the changed accounting rules have severely affected Irish GDP, GNI, and current account calculations, leading to an upward revision of 2015 GDP growth that enforced a press release by Eurostat, a Directorate-General of the European Commission, acknowledging the correctness of GDP figures in September (Eurostat 2016).<sup>7</sup>

Bloated GDP and current account data are a consequence of the new EU accounting rules in countries with a high presence of foreign owned multinational companies (MNCs) that use contract manufacturing in worldwide production chains (FitzGerald 2015). According to the change in ownership approach in ESA 2010, goods manufactured offshore in country A for an MNC based in Ireland, and directly sold to another country B, are counted as Irish trade activities, even without any production in or physical contact with Ireland, as long as the Ireland-based MNC is the owner (figure 1). Once the goods produced in country A leave the country's borders, the goods are counted as Irish imports. Even if the goods are directly sold to customers in country B, without crossing Ireland, they constitute Irish exports. As export prices values tend to be higher than the production (or "import")

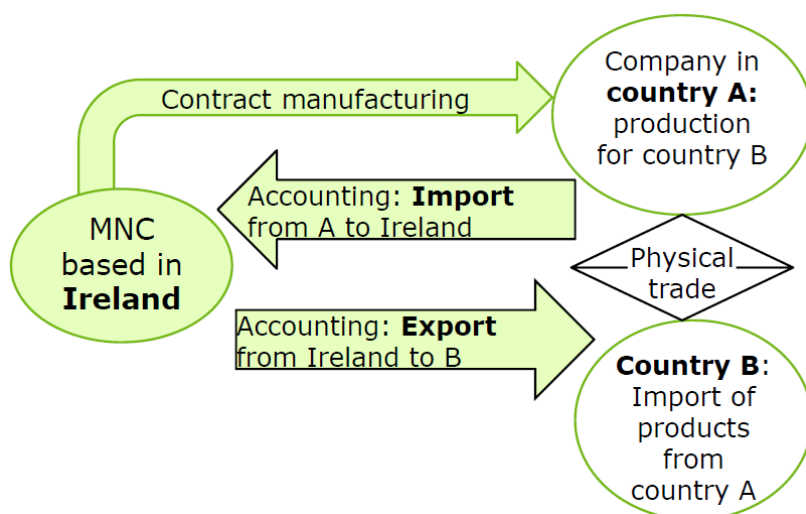
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<sup>6</sup> See the information provided by Eurostat, [http://ec.europa.eu/eurostat/statistics-explained/index.php/European\\_system\\_of\\_national\\_and\\_regional\\_accounts\\_-\\_ESA\\_2010](http://ec.europa.eu/eurostat/statistics-explained/index.php/European_system_of_national_and_regional_accounts_-_ESA_2010)

<sup>7</sup> The effect on Irish GDP seems to have come as a surprise, as the EU website for statistical changes due to ESA 2010 in GDP aggregates (set-up in March 2016) does not name Ireland as an especially affected country, see: [c.europa.eu/eurostat/statistics-explained/index.php/Annual\\_national\\_accounts\\_-\\_how\\_ESA\\_2010\\_has\\_changed\\_the\\_main\\_GDP\\_aggregates](http://ec.europa.eu/eurostat/statistics-explained/index.php/Annual_national_accounts_-_how_ESA_2010_has_changed_the_main_GDP_aggregates)

value, this new accounting rule leads to an increase in net exports values and thereby overstates the current account surplus as well as GDP and GNI (FitzGerald 2015: 12ff).

**Figure 1: Effects of contract manufacturing on trade accounting following the ownership approach**



An indicator for the too high trade statistics according to national accounting is the difference between export values according to national accounting in contrast to the value of physical exports, visible in trade statistics. This difference has increased (see FitzGerald 2015: 15). Table 1 shows the relationship for goods trade data (goods exports, goods imports, and net goods exports) according to “artificial” national accounting in relation to “physical” trade in trade statistics. As can be seen, national accounting figures have already been higher since 2007 and lead to bloated trade figures. In 2015, goods exports in national accounting are higher by 19 percentage points, goods imports by 30 percentage points, net goods exports by 47 percentage points. The calculation follows Fitzgerald (2015: 15), where he presents merchandise exports in national accounting in relation to trade statistics in figure 6. In contrast to his figures, the differences in table 1 are higher and start earlier. This is probably due to the here used more recently published data that already incorporates backward revisions according to ESA 2010.

**Table 1: National accounts data relative to trade statistics (goods exports, imports, net exports in %)**

	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>Goods exports</b>	116.2	111.3	130.2	136.3	116.6	123.3	117.2	116.8	118.6
<b>Goods imports</b>	112.5	112.5	117.0	117.5	111.1	111.6	112.4	123.3	129.9
<b>Net goods exports</b>	104.3	114.9	101.5	97.4	104.0	96.1	104.6	136.1	147.0

Source: AMECO, own calculations, accessed in Oct. 2016.

Hence, the new national accounting framework artificially increases indicators for economic activity (GDP, trade data) in addition to existing effects due to tax evasion mentioned in the previous section. Yet, FitzGerald argues that GNI should be less affected, as profits from the difference between export and import value mainly constitute factor income of foreign shareholders in the case of foreign owned multinational companies (FitzGerald 2015: 16).

Second, ESA 2010 leads to other distortions, as it also implies a different accounting for aircraft leasing. This seems to be a relevant factor for the Irish economy, as “...almost 20 per cent of the world’s civil aircraft fleet is owned by leasing companies in Ireland” (FitzGerald 2015: 23). According to FitzGerald, it does not affect GDP and GNI, but the Irish current account balance (FitzGerald 2015: 16ff). Yet, the Financial Times argues that it also contributes to the high growth rate in 2015 (FT 2016).

Fitzgerald also shows that offshore activities based on patents distort the measurement of GDP. These activities are accounted for in the country of the company owning the intellectual property. “On-shoring” these patents increases Irish GDP. Once patents of pharmaceutical companies are running out, they have the opposite effect (FitzGerald 2015).

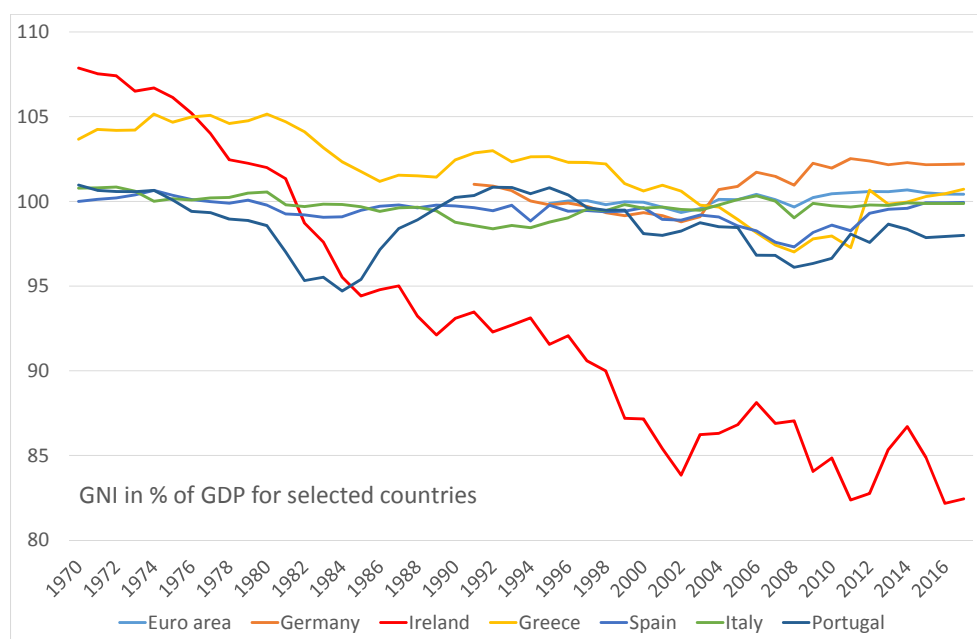
Most of these factors imply that GDP, GNI, as well as the current account and net exports from national accounting are overstating Irish economic activity. While this is true for all countries following the new accounting framework, the effect is more relevant in a country like Ireland, where foreign owned affiliates have a high relevance for economic activity (FitzGerald 2015). The new accounting framework distorts all GDP-based figures even further, in addition to the general problem of overstated profits of MNCs for reasons of tax evasion: accounting rules lead to overstated labour productivity, but understated unit labour costs, fiscal deficits and fiscal debt levels. This is not new: Honohan and Walsh stress that productivity figures for Ireland should be treated with care (Honohan Walsh 2002: 22). Yet, ESA 2010 increases the problem.

Nevertheless, besides problems in interpreting Irish data, Ireland’s recovery seems to be more successful than the one of other crisis countries, even ignoring the latest effects of the new national accounting framework, and even using GNI instead of GDP. The question is if Irish citizens benefit from a growth strategy that mainly relies on the presence of foreign companies. The following section will briefly discuss this for the past, before section 5 and 6 analyse the developments since the financial crisis.

#### 4. GDP and GNI developments since the 1970s

The discrepancy between Irish GDP and Irish GNI due to profit repatriation is not something new, but has already started in the 1970s. Ireland’s growth strategy has focused on attracting foreign direct investment (FDI) and foreign affiliates since then (Honohan/Walsh 2002; Department of Finance 2014). Figure 2 indicates that GNI as a share of GDP has gone down from levels above 100% in the 1970s to 82% in 2016.

**Figure 2: GNI in percent of GDP for selected peripheral EMU countries**

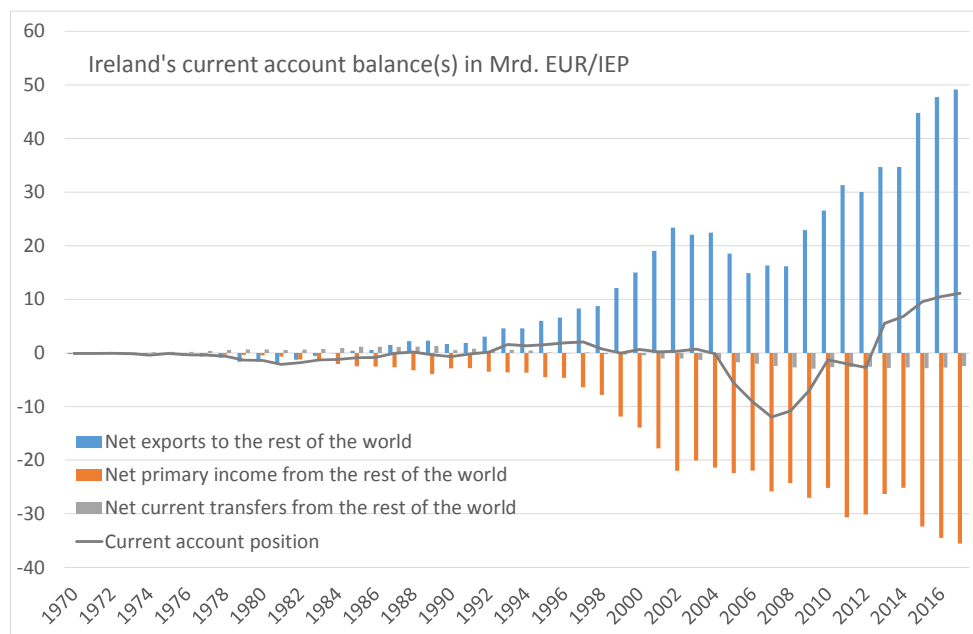


Source: AMECO, GNI and GDP at current prices (UVGD), own calculations, data download Sep. 2016



Figure 3 shows that the increasing difference between GDP and GNI is a consequence of net primary income increasingly leaving the country, in this case capital income (yields, dividends, and profits). While this is nowadays mainly driven by foreign shareholders repatriating profits and dividends, net capital outflows used to be driven in the past by interest payments of the once highly indebted Irish government (Honohan and Walsh 2002: 44).

**Figure 3: The Irish current account balance and its sub-balances**



Source: AMECO, data download Sep. 2016.

Even if not all the income generated in Irish borders ends up in the hands of Irish citizens, past growth developments have been beneficial for Irish citizens. After the mid-1980s, GDP per head of population increased remarkably, allowing Ireland to catch-up to EU-15 levels of GDP per head of population at the end of the 1990s and even to surpass these levels in the 2000s (see table 2). As GNI per head of population is a better indicator for the average standard of living, table 2 portrays both indicators. According to GNI per head of population, Ireland's standard of living is above EU-15 levels, yet, not to the extent reflected in GDP. Figure 4 shows that economic growth in Ireland (measured by GNI) clearly exceeded the one in other peripheral EMU countries during the 1990s and 2000s, albeit starting from very low levels.

**Table 2: Ireland's GDP and GNI per head of population relative to EU-15 average (in %)**

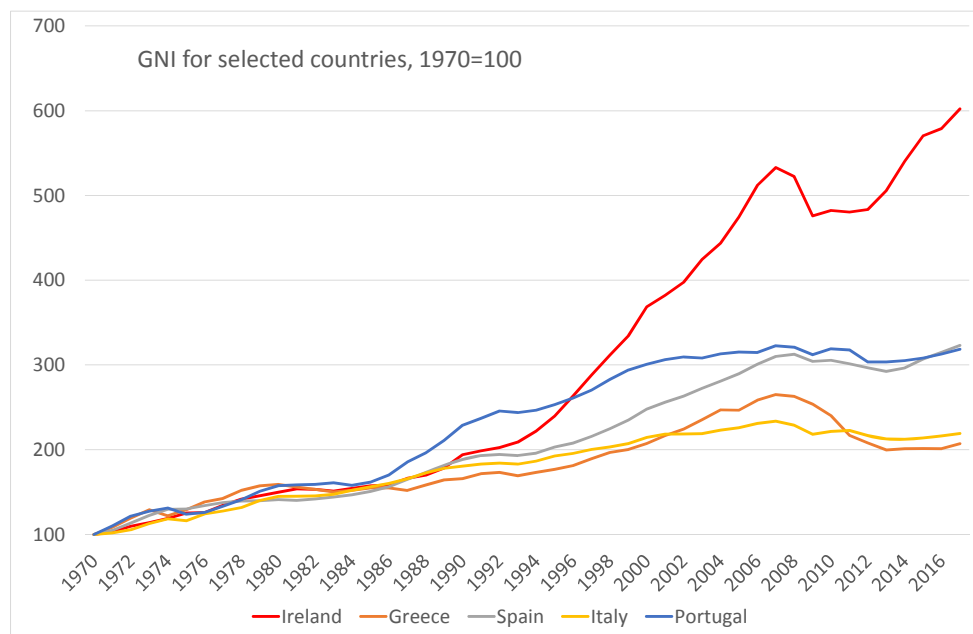
	1960s	1970s	1980s	1990s	2000s	2010s
<b>GDP p.c. (EUR)</b>	62.3	58.3	67.4	82.3	137.3	132.2
<b>GDP p.c. (PPS)</b>	65.6	65.4	68.9	88.2	122.4	125.0
<b>GNI p.c. (EUR)</b>	65.7	60.6	64.4	74.7	117.1	115.8
<b>GNI p.c. (PPS)</b>	68.5	67.5	66.0	80.1	104.4	110.8

Source: AMECO, GDP at current prices per head of population (HVGDP), own calculations.

Honohan and Walsh discuss as "catalytic effects" for the strong catch-up in growth from the mid-1980s onward the combination of "...the flow of EU structural funds, the devaluations of 1986 and 1993, and the revitalized promotion of tourism and inward FDI (including offshore financial services)" (Honohan/Walsh 2002: 50). The authors admit: "Each of these elements also could have a flavor of beggar-thy-neighbor about them..." (Honohan/Walsh 2002: 50). While they admit the contributing role of these elements, they stress... the more important role of labour market developments: From

the mid-1980s onwards, working population relative to total population increased enormously, driven by an increase in activity rate and demographic changes. In addition, the former emigration country experienced net immigration (Honohan/Walsh 2002: 25ff). At the same time, wage competitiveness increased from 1987 onwards, an important element for the catching-up (Honohan/Walsh 2002: 21f).

**Figure 4: GNI for selected peripheral EMU countries, 1970=100**



Source: AMECO, GNI at constant prices (OVGD), national currency, own calculations, data download Sep. 2016

The authors do not consider foreign owned companies as the main driver of the catch-up process after 1987, besides their supporting role for GDP and productivity gains. “But although productivity has been high and the role of foreign firms important, a simplistic reading of the numbers can greatly overstate their contribution to the Irish boom.” (Honohan/Walsh 2002: 38). They show that the observable increase in productivity during that period is bloated, due to the shift of economic activity to less labour intensive sectors plus tax incentives to over-report profits in Ireland. They also argue that tax incentives for foreign companies did not improve after 1987 (and even slightly worsened with the EEC accession (Honohan/Walsh 2002: p.40), with the exception of new incentives for offshore financial services.

Nevertheless, taxation played an important role for wage moderation, but rather changes in personal income tax instead of corporate taxation: The authors stress the importance of improving wage competitiveness of Irish companies during the catch-up process. They attribute this success to the introduction of a “corporatist social partnership” that managed to moderate wage developments in the face of decreasing income taxation. The new centralized wage agreement, installed in 1987, was able to dampen nominal wage increases, as the decreasing income taxation boosted net wage income (Honohan/Walsh 2002: 51ff).

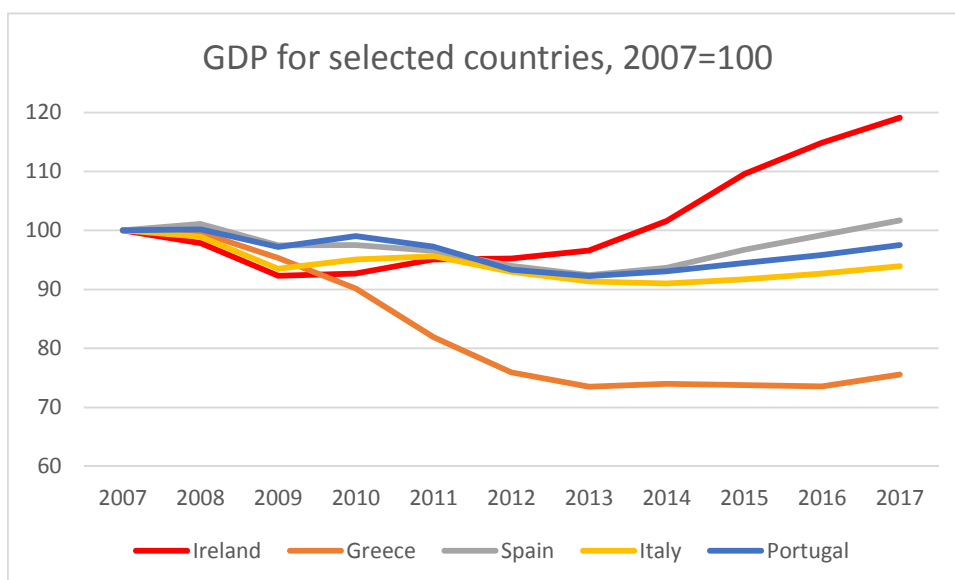
## 5. GDP and GNI developments since the financial crisis

Ireland was among the heaviest hit European countries during the financial crisis, yet, has shown a “remarkable economic rebound” according to the European Commission (EC 2016: 1). Figure 5 portrays GDP developments for Ireland since 2007, in comparison to other peripheral EMU countries.

With the exception of Greece, Irish GDP and GNI decreased quicker and stronger than in Italy, Spain, and Portugal, but also recovered quicker and stronger.

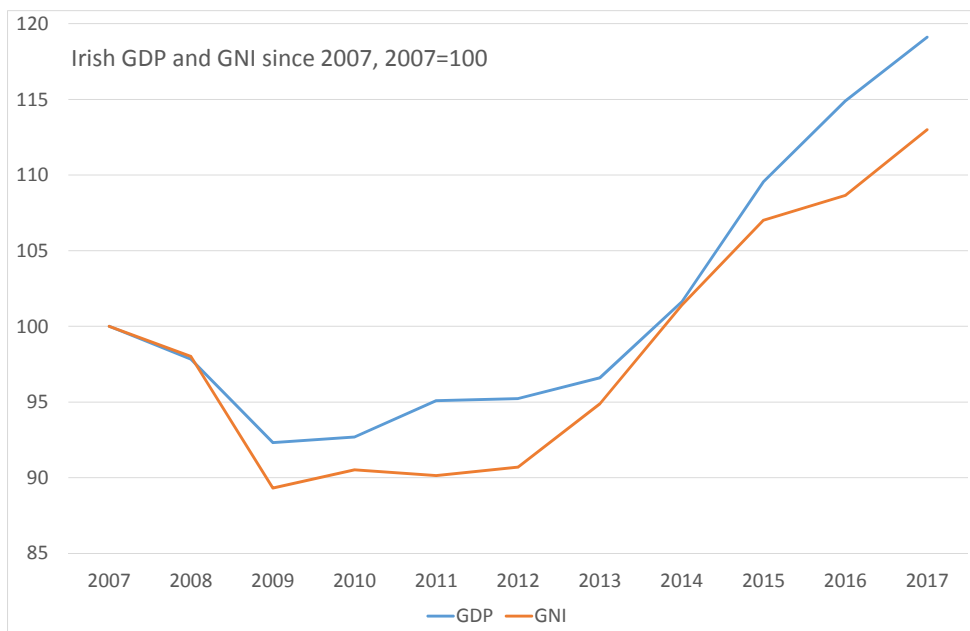
Figure 6 shows the different GDP and GNI developments since 2007 for Ireland: Interestingly, Irish GNI reacted stronger than Irish GDP, decreasing to 90% of the 2007 value, and has not yet recovered to the same extent as GDP. In other words, the income of Irish citizens was and is more affected than the value of (recorded) production in Ireland.

**Figure 5: GDP developments for selected peripheral EMU countries since 2007**



Source: AMECO, GDP at constant prices (OVGD) own calculations, data download Sep. 2016

**Figure 6: GNI and GDP developments for Ireland since 2007**



Source: AMECO, GNI at constant prices (OVGD), own calculations, data download Sep. 2016

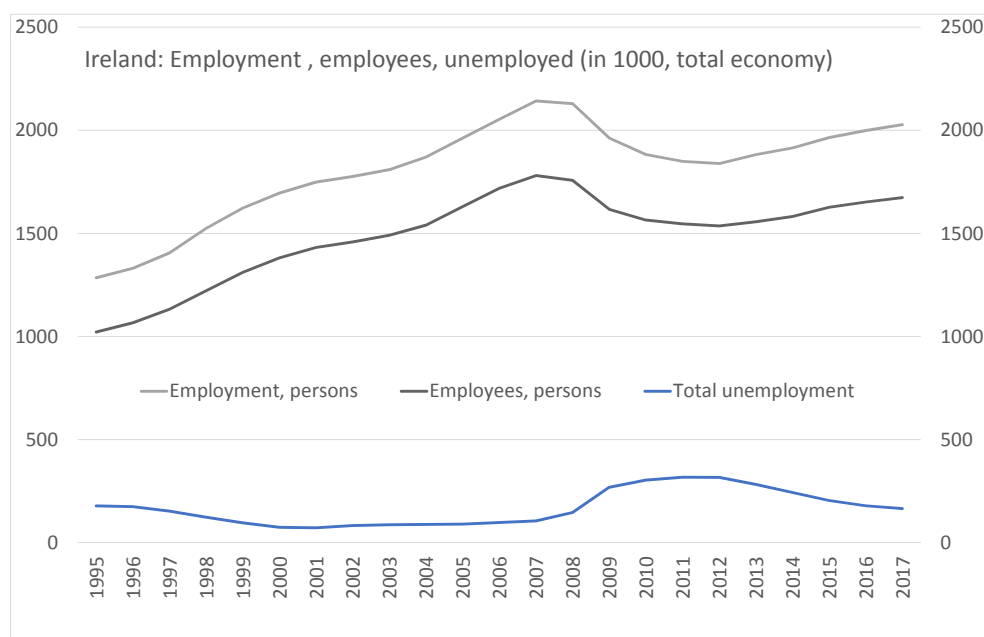
The increasing trade surplus in goods and services since the 1990s has been an important factor contributing to GDP and GNI growth. When net exports started to decrease from 2005 onwards, they decreased GDP and domestic income levels. Interestingly, net factor income continued to leave the

country at more or less similar growth rates like before (figure 3), leading to a stronger negative effect on domestic income (measured by GNI) than domestic production (GDP).

## 6. Effects on wages, employment, and the labour share

Irish citizens depending on wage income do not necessarily benefit from the FDI driven growth, at least not as much as GDP or GNI developments would indicate. This becomes obvious in employment and wage developments: European Commission forecasts for employment (in persons) do not even reach the pre-crisis levels in 2016 (figure 7). This is the more irritating, as Irish net immigration turned negative in 2010 and has remained negative until 2016 (CSO Ireland, August 2016),<sup>8</sup> a factor that should decrease labour supply.

**Figure 7: Employment, employees, and unemployed in Ireland**



Source: AMECO, data download July 2016

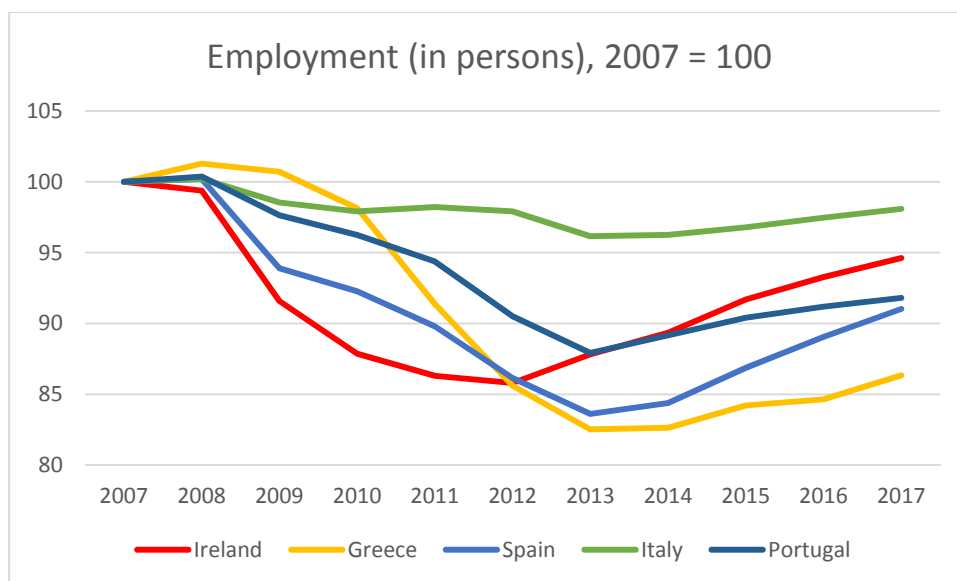
As figure 8 shows, employment did not develop worse than in other crisis countries, at least measured in persons: Employment fell quicker compared to the other crisis countries, but also recovered quicker, yet without having recovered to pre-crisis levels. In line with employment developments, nominal compensation per employee fell quicker than in the other crisis countries. Recovery is very slow, and wages still have to reach the 2008 levels (figure 9).<sup>9</sup> This is surprising, given the recent records in GDP growth rates. Only Greece shows a worse development of wage levels.

<sup>8</sup> Central Statistics Office Ireland,

<http://www.cso.ie/en/releasesandpublications/er/pme/populationandmigrationestimatesapril2016/>

<sup>9</sup> The development is slightly better for real wages, at least based on the GDP deflator.

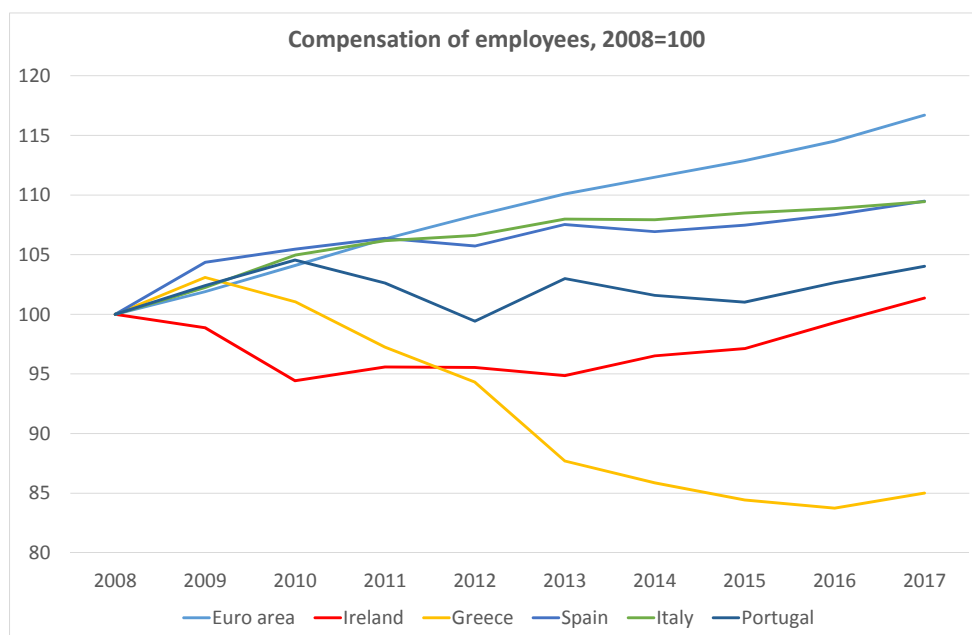
**Figure 8: Employment in selected peripheral EMU countries, 2007=100**



Source: AMECO, own calculations.

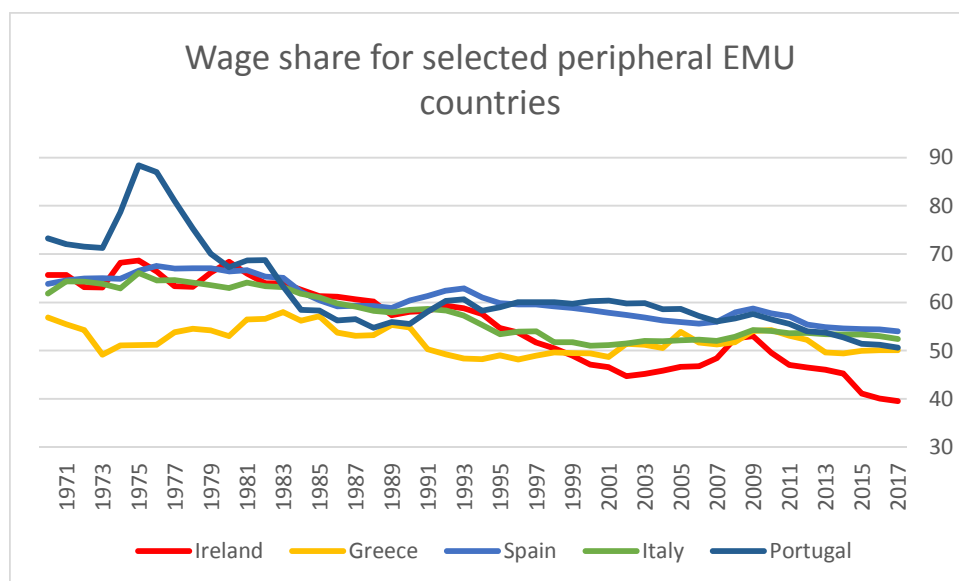
Both findings together explain the strong decrease in the wage share (figure 10). According to official EC forecasts, the (adjusted) wage share will decrease to 40% in 2016, down from 53% in 2008. This indicates that domestic workers may suffer more from adjustment costs than (domestic and foreign) capital owners do. As the bloated figures for GDP may artificially decrease the wage share, one can alternatively calculate the adjusted wage share based on GNI. The decrease is slightly smaller, going down to 49% in 2016, but effect and trend are the same (see appendix). Even if the decrease may be overstated, because reported profits of foreign owned companies bloat GNI and GNP, the extent nevertheless points to the problem that the presence of foreign owned companies may not be as beneficial as economic growth data suggests.

**Figure 9: Compensation per employee**



Source: AMECO, own calculations.

Figure 10: Wage share for selected peripheral EMU countries



Source: AMECO, data accessed in July 2016

The decrease in the wage share is in line with findings that part of the decrease in wage costs and unit labour costs were not fully translated to export prices. That unit labour costs decreases were not transmitted to export prices but instead used to increase profits has already been discussed by the European Commission and the IMF in 2013 (EC 2013, IMF 2013, see also Joebges 2014). Similarly, lower wage costs have not been transmitted to domestic price levels (see table 3 and Joebges/Logeay 2016): Even though the contribution of wage costs in Ireland decreased by almost 8%-points during 2008 and 2015, the GDP deflator hardly changed during that period, allowing for increasing contribution of profits by more than 8 %-points.<sup>10</sup>

Table 3: Contribution of wages, profits, and indirect taxes to changes of the GDP Deflator

	2000-2015	2000-2007	2008-2015
<b>GDP deflator, yoy, in %</b>	19.5	23.1	-0.2
	<b>Contribution of ... in %-points</b>		
<b>Wages</b>	4.7	10.6	-7.9
<b>Profits</b>	14.0	9.3	8.5
<b>Indirect Taxes</b>	0.8	3.2	-0.8

Source: Data based on Joebges/Logeay 2016: 325, calculation based on Feigl/Zuckerstätter (2013).

## 7. Conclusion

The recent astonishingly real GDP growth rates for Ireland are bloated by new EU accounting rules, and the general problem of an economy characterized by a high presence of foreign owned affiliates of multinational companies. In this case, GDP is not an adequate indicator for domestic citizens' income levels. GNI is more telling. Nevertheless, even this figure may portray a too optimistic picture of economic activity in Ireland.

Yet, even besides an over-recording of domestic activity, income levels, and trade activity, Ireland seems to have managed the crisis better than other peripheral EMU countries. Not only GDP, also GNI and employment (in persons), improved quicker than in other crisis countries. This improvement

<sup>10</sup> For the calculation of contributions to GDP inflation, please see and Feigl/Zuckerstätter (2013).

is not necessarily beneficial to Irish citizens: Employment is yet to reach pre-crisis levels. Recovery seems to have come at the cost of suppressed wage growth, leading to an impressive decrease in the wage share. This result holds when measuring the wage share based on GDP as well as GNI.

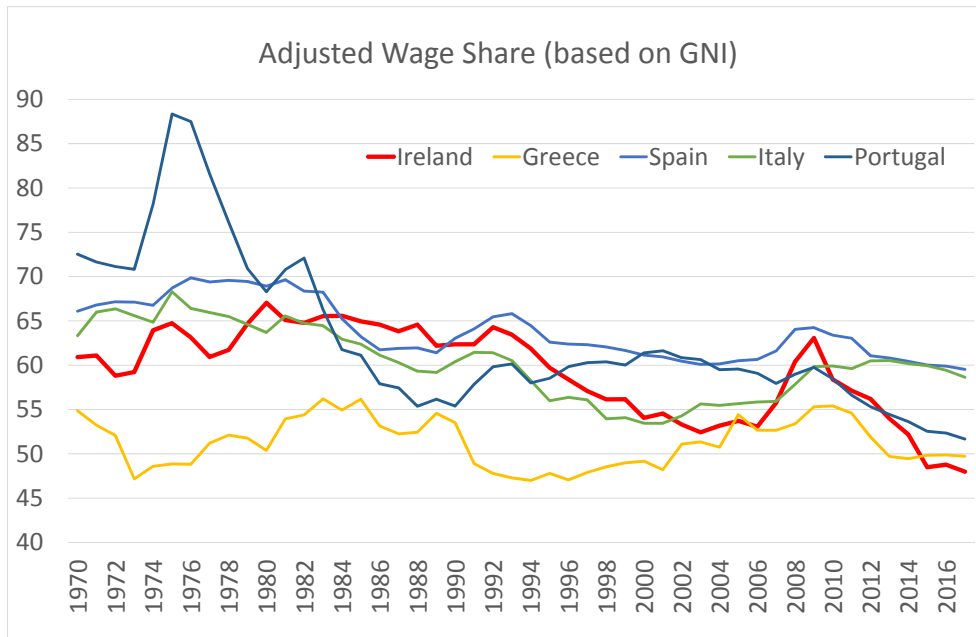
This result puts the Irish role as a blueprint for other countries into question. Ireland's strategy of attracting foreign owned companies by low corporate taxation rates can be seen as a beggar-they-neighbour strategy, increasing downward competition for taxation in the EU. The strategy is not even clearly positive for Irish citizens, at least not for those relying on wage income. Therefore, it is surprising that the government seems to be willing to continue to compete for foreign owned companies by low corporate taxation rates, as a series of publications of the Department of Finance (2014) seems to indicate as well as the discussion of having to accept tax payments of Apple (CNBC Sep. 7, 2016)<sup>11</sup>.

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<sup>11</sup> <http://www.cnbc.com/2016/09/07/ireland-will-have-to-accept-apple-tax-payment-leaders-admit.html>

## Appendix

Figure 10: Wage share for selected peripheral EMU countries, based on GNI



Source: AMECO, data accessed in Sep. 2016, own calculations



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