Capital Inflow and Direct Foreign Investment in Ireland 1952 to 1970

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INTRODUCTION[1]

The role of foreign capital in activating and sustaining Ireland's post-War economic growth is a subject of compelling interest. The capital inflow has taken many forms: Marshall Aid, foreign subscriptions to Irish bonds, loan flotations by state-sponsored enterprises, takeovers of Irish companies or direct investment in new enterprises etc. As in most capital-receiving countries, popular attention in this country has focussed mainly on direct investment inflows, since these, by definition, involve a degree of control by non-nationals over part of the nation's resources. Despite their manifest relevance to our economic well-being, the implications of Ireland's capital inflow are only now beginning to receive systematic attention.

The aims of this paper are twofold: first to examine the constituents of the capital inflow, paying particular regard to the experience of the last decade and, secondly, to analyse the composition, origin and principal features of direct investment in manufacturing enterprises. It must be admitted from the start that our analysis has no pretensions to be definitive. Many issues are merely touched upon in the course of the paper which deserve much more detailed treatment. Our intention is to record what work has been done already in this field and what still needs to be done.

The paper is divided into four sections. We begin with a discussion of the magnitude of the capital inflow during the last two decades in absolute terms and also in relation to gross fixed investment and merchandise imports. An effort is made to compare Ireland's experience with that of other countries at a broadly similar stage of economic development. In the second section, the composition of the capital inflow is described, in as much detail as data limitations allow, with the breakdown consisting of five elements: government borrowing, state-sponsored company borrowing, direct investment, portfolio investment and a residual "other" item. The third section is devoted to an analysis of direct manufacturing investment.

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The salient features of this inflow are outlined, the "cost" of financial incentives to new foreign manufacturing enterprises is discussed and the determinants of the direct investment inflow are briefly analysed. The final section contains a summary of our main results and concluding remarks.

MAGNITUDE OF THE CAPITAL INFLOW 1947-70

Throughout this paper, the capital inflow is defined as the sum of changes in external reserves and the current balance of payments deficit. A capital inflow, in other words, can be used to finance a deficit or to add to external reserves or some combinations of both. The capital inflow so defined is a *net* concept i.e. gross inflow minus gross outflow and, in interpreting our results, it must be remembered that small proportionate changes in the gross magnitudes can sometimes exert a large proportionate effect on the net figure. Short-term capital inflows are also included in our definition, but their effect on the total capital inflow taken over a period of years is assumed to be slight.[2]

A striking feature of the Irish economy since the Second World War is the more or less persistent net inflow of capital from abroad. In only three of the twenty-four years since 1947 has there been a net capital outflow from this country and, as Table 1 shows, the amounts involved on these occasions were small. Cumulative net capital inflow amounted to £171 million during the years 1947-58 inclusive and reached the still higher figure of £357 m. between 1959 and 1970.[3]

Associated with the net capital inflow was an equally persistent balance of payments deficit on current account. Balance of payments surpluses are recorded in only three years of the total period—1957, 1961 and 1967. Nevertheless, as Table 1 indicates, the difference between the cumulative balance of payments deficit of £269m. in the period 1959-70 and that of £214m. in the period 1947-58 is considerably less pronounced than the difference between the cumulative capital inflows in the same periods. The explanation of this fact is easy to find. During the first period, the current account deficits were financed partly by the capital inflow and partly by a depletion in the external reserves of £43m. whereas in the second period external reserves increased by £88m., thus implying a capital inflow *greater* than the cumulative current account deficit.

[2] A capital movement is officially considered short-term if it is embodied in a credit instrument of less than a year's maturity. The transfer of funds may be undertaken for speculative reasons or may be a response to changes in international interest-rate differentials. However other motives are also possible and it must be admitted that classification according to instrument is an unsatisfactory way of determining whether a transaction is permanent or impermanent. On the definition of short-term capital see *Balance of Payments Manual*, International Monetary Fund (3rd ed.) 1961.

[3] At the time of writing, every indication points to an unprecedently high rate of capital inflow in 1971, perhaps as much as £160 m. External reserves are likely to increase by over £100m. In comparing the two periods 1947-58 and 1959-70, the disproportionately high capital inflows during the last two years of the latter period and maintained into 1971 must be borne in mind.

TABLE 1

CURRENT BALANCE OF PAYMENTS, CHANGES IN EXTERNAL RESERVES, AND NET CAPITAL INFLOW IN CURRENT AND CONSTANT PRICES, 1947-1970

£ million

	Current Balance of Payments Deficit (−) Surplus (+)	Changes in External Reserves	Net Capital Flow: Inflow (+) Outflow (−) (2)—(1)	Current Balance of Payments in constant 1953 prices	Net Capital Inflow in constant 1953 prices
	(1)	(2)	(3)	(4)	(5)
1947	−29·8	−16·2	+13·6	−36·5	+16·7
1948	−19·6	− 1·4	+18·2	−23·7	+22·0
1949	− 9·7	+25·2	+34·9	−12·3	+44·2
1950	−30·2	+ 4·2	+34·4	−35·0	+39·9
1951	−61·6	−39·0	+22·6	−58·4	+21·4
1952	− 8·9	+ 5·4	+14·3	− 8·4	+13·4
1953	− 7·0	+13·9	+20·9	− 7·0	+20·9
1954	− 5·5	+ 4·2	+ 9·7	− 5·5	+ 9·6
1955	−35·5	−47·3	−11·8	−34·1	−11·3
1956	−14·4	−14·7	− 0·3	−13·6	− 0·3
1957	+ 9·2	+ 6·9	− 2·3	+ 8·2	− 2·1
1958	− 1·0	+15·9	+16·9	− 0·9	+15·8
Total 1947-1958	−214·0	−42·9	+171·1	−227·2	+190·2
1959	− 8·7	+ 4·4	+13·1	− 8·3	+12·5
1960	− 0·8	− 0·3	+ 0·5	− 0·8	− 0·5
1961	+ 1·2	+14·6	+13·4	+ 1·1	+12·4
1962	−13·4	+ 9·5	+22·9	−12·5	+21·3
1963	−22·1	+ 2·9	+25·0	−20·2	+22·9
1964	−31·4	+ 5·2	+36·6	−28·4	+33·2
1965	−41·8	−17·2	+24·6	−37·0	+21·8
1966	−16·1	+22·4	+38·5	−14·3	+34·1
1967	+15·2	+46·3	+31·1	+13·5	+27·7
1968	−16·3	− 7·9	+ 8·4	−13·4	+ 6·9
1969	−69·1	+ 5·9	+75·0	−54·7	+59·3
1970	−65·3	+ 2·4	+67·7	−48·4	+50·1
Total 1959-1970	−268·6	+88·2	+356·8	−223·4	+302·7

NOTES: (1) Figures relate to year ended 31 December.

(2) Post-1965 figures for external reserves are not strictly comparable with previous year's figures, because of the exclusion of gold reserves and the super-gold tranche in the latter. However, the discrepancy between external reserves on the old and the new basis is small. It amounted to only £6·6m. in 1965.

(3) Changes in the IMF reserve position (i.e. Ireland's quota of £50·4m. minus IMF holdings of Irish currency) exercise only a marginal influence on our total reserve position since movements in our IMF reserves tend to be counterbalanced by offsetting changes in holdings of foreign currency. An exception is the increase of £5·6m. in 1970, representing Ireland's allocation of SDR's.

Continued overleaf

The distinction between early and late post-war experience can be more accurately drawn by making allowance for the change in purchasing power of the capital inflow and current deficit which took place since 1947. If both series are deflated by the import price (unit value) index,[4] we find, first, that the cumulative current balance of payments deficit in the 1959-70 period turns out to be less than the corresponding figure for 1947-58 and, secondly, that net capital inflow in real terms during the later period exceeds that of the early period by only 58 per cent compared with an excess of more than 100 per cent in current value terms. It would be unwise, therefore, to consider the experience of the last decade as wholly unprecedented.

Absolute capital inflow figures, whether in real or current value terms, are not a sufficient basis on which to judge the economic significance of capital movements. A common procedure is to relate the net capital inflow to gross domestic fixed capital formation, since the inflow could in theory be utilised solely for investment purposes without either reducing domestic consumption, or running into balance of payments problems. Chenery, for example, uses this measure to divide countries into "high capital inflow" and "moderate capital inflow" categories, the former having more than 30 per cent and the latter 15-30 per cent of their investment capable of being financed externally.[5] In a study of post-War economic development, he shows that many small countries began the period with high capital inflows, usually financed from public rather than private sources, but those with high growth rates managed to graduate quite rapidly to a "moderate" capital inflow status with a much heavier preponderance of private external finance in the total. The pattern evidenced by Ireland since 1947 conforms in general outline to the Chenery development pattern. In Table 2, the ratio of net capital inflow is seen to fall from the high level of 42 per cent during the years 1947-52 to a level of 15 per cent or less for each succeeding six-year period. At the same time, it must be admitted that the period of post-War recovery was obviously exceptional in many respects. If instead the years 1953-58 are taken as a starting point, the capital inflow/investment ratio would emerge as having

[4] Other price indices could be used—for example the imported producers' capital goods index—but none possesses any evident superiority over the import price index used here.

[5] Hollis B. Chenery "Growth and Structural Change", *Finance and Development*, No. 3, 1971. Chenery's concern, however, is confined to countries with per capita incomes in the $50-$300 range in the 'fifties which attained income levels of $300-$1,000 per capita at a later stage of development. His study thus includes many underdeveloped countries in the Third World which are not comparable with Ireland.

(4) The deflator used in cols. (4) and (5) is the import price (unit value) index for "All Items" to base 1953 = 100.

(5) Current account figures in col. (1) are adjusted for Balance of Payments purposes and include the balance of trade for Shannon.

SOURCES: *Annual Report of the Central Bank 1970-71*
K. A. Kennedy and B. R. Dowling, *Domestic Demand, Exports and Economic Growth in Ireland* (forthcoming).

increased from 10 per cent to 15 per cent. Furthermore there is no evidence of any decline in this ratio during the last decade and, as we show in the next section, the share of the public sector in the total inflow has increased rather than decreased in recent years. This underlines the difficulty in fitting the Irish experience into any preconceived growth pattern.

TABLE 2
NET CAPITAL INFLOW, CURRENT ACCOUNT DEFICIT AND EXTERNAL RESERVES RATIOS IN IRELAND 1947-70

Period	(1) Net Capital Inflow as % of Gross Domestic Fixed Capital Formation	(2) Net Capital Inflow as % of Merchandise Imports	(3) Current Account Balance of Payments Deficit as % of Merchandise Imports	(4) External Reserves as % of Merchandise Imports
Average 1947-52	42·0	15·2	16·5	157·8
Average 1953-58	10·1	3·0	4·5	111·8
Average 1959-64	14·9	6·4	4·2	84·9
Average 1965-70	15·0	8·3	6·1	59·7

SOURCE: Cols (2)-(4) as in Table 1. Col. (4) Capital formation figures from *National Income and Expenditure* 1968 and 1969, with an estimate for 1970 taken from the Autumn 1971 issue of E.S.R.I.'s *Quarterly Economic Commentary*.

The diminished proportionate impact of the net capital inflow in the last decade as compared with the immediate post-War period also emerges if the inflow is expressed as a proportion of current merchandise imports. During the years 1947-52, the average net capital inflow/imports ratio was 15·2 per cent in contrast to an average of 8·4 per cent during the last six years. On the other hand, it is clear from Table 2 that the significance of the net capital inflow relative to current imports has increased substantially since the mid-fifties. Much the same pattern is observed if net foreign disinvestment (i.e. the current account deficit) is related to imports, although the change since the mid-fifties is less pronounced because of the additions made to reserves during the last decade. It is worth emphasizing, especially in view of Ireland's recent large balance of payments deficits, that the average deficit/imports ratio has risen by only 1·6 per cent since 1953-58 and still remains substantially *below* the 1947-52 average of 16 per cent.

Another aspect of our external accounts worth drawing attention to is the behaviour of external reserves. Despite the different trend in the absolute level of reserves between the first and second twelve-year period, the reserve ratio—external reserves as a proportion of merchandise imports—has nevertheless declined fairly steadily over the whole period. Ireland's reserves were obviously at an exceptionally high level in the years immed-

iately after the war, due to the more or less "forced" savings imposed on us by the difficulty of securing imports, and a subsequent fall in the reserve ratio was only to be expected.

In order to place the Irish experience in an international perspective, comparisons are made in Table 3 between Ireland's net capital inflow and external reserves ratios and those of twelve selected countries. In choosing these countries an effort has been made to ensure broad comparability as to size of population and level of economic development. This has proven difficult to achieve and we are left with a fairly heterogeneous

TABLE 3
NET CAPITAL INFLOW AND EXTERNAL ASSET RATIOS FOR IRELAND AND SELECTED COUNTRIES 1959-70

	(1)	(2)	(3)		(4)		(5)	
	Population (millions)	GNP per capita ($)	Net Capital Inflow as % of Gross Domestic Fixed Capital Formation		Net Capital Inflow as % of Merchandise Imports		External Reserves as of % Merchandise Imports	
Country	1969	1969	1959–64	1965–69	1959–64	1965–70	1959–64	1965–70
Cyprus	0·6	799	n.a.	17·5	n.a.	10·5	n.a.	81·2
Israel	2·8	1,663	22·7	24·2	26·6	25·4	54·2	54·8
New Zealand	2·8	1,918	2·2	0·4	2·2	1·1	25·9	8·7
IRELAND	2·9	1,169	14·7	14·8	6·7	8·4	88·6	62·1
Norway	3·9	2,528	9·8	4·0	9·1	4·1	16·9	23·7
Finland	4·7	1,944	4·6	3·6	5·4	5·4	25·4	10·2
Denmark	4·9	2,860	8·6	7·6	6·2	7·0	14·7	16·3
Austria	7·4	1,687	4·9	4·5	5·6	4·4	61·9	58·2
Greece	8·8	950	11·1	14·9	14·0	19·9	38·8	23·7
Portugal	9·6	600	20·1	9·1	15·8	5·4	141·0	125·0
China(Taiwan)	13·8	346	20·2	11·1	18·3	10·7	43·1	44·1
Spain	32·9	870	6·0	8·0	12·2	12·5	64·2	32·4
Mexico	48·9	566	14·0	9·6	24·7	27·0	42·8	36·8

NOTES: (1) External reserves are defined as official IMF reserves plus net external assets of deposit-taking banks and corresponds to net Foreign Assets (item 31) of the *International Financial Statistics*.

(2) There are small discrepancies between the IMF and the Central Bank's valuation of external reserves (attributable mainly to divergent treatment and valuation of our gold holdings). Consequently the ratios for Ireland recorded in this Table are not exactly equivalent to those calculated on the basis of Tables 1 and 2 data. The 1970 figure for Ireland's external assets (IMF definition) is author's own estimate.

(3) Later period figures in col. (3) for Spain, Greece and Mexico are based on 1965-68 data; in the absence of 1970 data for Spain, the ratios in cols. (4) and (5) for that country are based on 1965-69 data; and per capita GNP for Mexico refers to the year 1968.

SOURCES: Computed from *International Financial Statistics*, International Monetary Fund; *U.N. Statistical Yearbook 1970*, United Nations; *OECD Observer*, February 1971; *U.N. Yearbook of International Accounts Statistics 1969*, United Nations.

sample, with Taiwan at one end of the scale with per capita GNP of $346 and Denmark at the other end with a per capita GNP of over $2,860 in 1969. Nevertheless, virtually all the countries included in the Table are presently undergoing a process of industrialisation, are dependent to some degree on foreign capital and to a considerable degree on foreign trade and, with the exception of Spain and Mexico, have a population of less than 15 million. All the countries listed in Table 3 have experienced satisfactory growth during the sixties; in no case has the average annual real GDP growth rate fallen below 4 per cent.[6]

Comparing ratios of net capital inflow to gross investment, the figures in Table 3 indicate an above-average level of capital inflow into Ireland during the last decade. Of the six countries with higher per capita GNP than Ireland's,[7] only Israel has experienced higher proportionate levels of capital inflow from abroad. On the other hand, the Irish figures are on average roughly in line with those of Cyprus, Greece, Portugal, Taiwan, Spain and Mexico.

In interpreting these results, it must be remembered that the proportion of GNP invested differs between countries, a factor which will tend to decrease the relative importance of a given absolute capital inflow in countries such as Norway, Finland, Austria and Israel with a high propensity to invest. These countries, for example, invested 21 to 30 per cent of their GNP on average during the years 1959-67 compared with Ireland's 17 per cent. Fortunately, the relative position of Ireland is not greatly affected by the measure used. Relating capital inflow to merchandise imports rather than to investment leaves this country in roughly the same relative position as before although naturally, in view of our high import propensity, the contrast between the Irish figures and those of the higher income countries is considerably less marked. Denmark, for instance, a country which shares many common characteristics with this country, has relied to only a marginally smaller extent on external financing measured relative to imports during the last decade than Ireland has.

A final feature of Table 3 is the high level of reserves in Ireland relative to imports. Despite the reduction in the reserve ratio noted earlier it is clear that, by the standards of the countries considered here, Ireland can still be considered quite comfortably supplied with international reserves.

Viewed in a historical and international perspective, therefore, four conclusions about Ireland's capital inflow can be drawn. *First*, net capital inflow during the period 1959-70 was only 58 per cent higher than during the period 1947-58, if the inflow is measured in constant import prices. Measured in relation to either gross fixed investment or merchandise imports the capital inflow during the sixties was less than that of the 1947-52 period but noticeably above the level of capital inflow during the years 1953-57. The present level of capital inflow therefore is not unprecedentedly high. *Secondly*, allowing for changes in reserves as well as changes

[6] *Yearbook of National Accounts Statistics*, 1969, Vol. II, Table 4A.

[7] Viz. Denmark, New Zealand, Norway, Finland, Israel and Austria, on the basis of 1969 figures.

in the import-purchasing power of external funds, the level of net foreign disinvestment (defined as the cumulative current account deficit) during the first period 1947-58 turns out to be greater than the level of the period 1959-70. *Thirdly*, relative to other countries undergoing rapid structural change, Ireland can be described as a "moderate" capital inflow country with the level of net capital inflow now amounting to roughly 15 per cent of gross fixed investment and 8 per cent of merchandise imports. Relative to other small European countries and countries at roughly similar stages of development, however, the Irish figures appear slightly higher than average. Owing to the impossibility of constructing a completely satisfactory basis of comparison,[8] this conclusion must necessarily remain imprecise. However, it is clear that Ireland is by no means the only country to have relied for long periods on a capital inflow. *Fourthly*, despite the increase in the absolute level of reserves during the years 1959-70, the external reserve ratio, i.e. reserves as a percentage of merchandise imports, fell substantially, but the ratio still remains high by international standards.

COMPOSITION OF THE CAPITAL INFLOW

Five Components of the Capital Inflow

Having discussed the net capital inflow in relation to macro-economic aggregates, the next logical step is to examine the composition of these funds and their allocation as between different sectors of the economy. Data limitations unfortunately place a severe check on any analysis along these lines. In the first place, the figures for direct and portfolio investment are expressed in *net* terms, thus preventing a separate assessment of the magnitude and stability of gross inflows and outflows. Secondly, no breakdown of the sectoral distribution of the net inflow of direct investment is yet available in published form.[9] In other words, there are no official figures on the proportion of the net capital inflow being invested in property, manufacturing, services, etc. The third limitation of capital inflow data relates to the definition of the current account deficit, a key statistic in deriving the figure for capital inflow. In Ireland, the practice is

[8] This issue has arisen with particular acutences in a recent controversy over the "usefulness' of foreign aid to developing countries. If the amount of aid a country receives is related to gross investment, countries which have squandered foreign aid will emerge with high aid/investment ratios, whereas those countries which have used aid constructively to generate growth and further investment will end up with low aid/investment ratios. The importance and significance of aid will thus vary inversely with the aid/investment ratio in this instance. Exactly the same difficulty arises when it comes to evaluating the comparative significance of capital inflows. See K. Griffin, "Foreign Capital, Domestic Savings and Economic Development", *Bulletin of the Oxford University Institute of Economics and Statistics*, May 1970 and subsequent comments in the May 1971 issue of the *Bulletin*.

[9] The C.S.O. is at present investigating the possibility of obtaining such information from subsidiaries and branches of foreign firms by means of a capital survey. Professor Fogarty's forthcoming study of the ownership of Irish industry ought to be of interest in this connection also.

to include the "balance unaccounted for" as an item in the current account, rather than as a residual coming at the bottom of the balance of payments statement. The omission of unremitted profits of subsidiaries of foreign firms from the balance of payments also has the effect of reducing the official current account deficit and consequently the capital inflow below what they would otherwise be (i.e. if the IMF statistical convention rather than, as at present, the United Nations' convention were adopted in this regard).[10]

Despite these shortcomings, some useful disaggregation of the net capital inflow can still be achieved. It is possible, for example, to divide the capital inflow into government and semi-state bodies' funds and non-government funds. This is done in Table 4 for the period 1961-70. The emergence of the government and the state-sponsored companies as borrowers in the international capital market in recent years is clearly illustrated. Over the whole period, net public sector borrowing accounted for 37 per cent of the total capital inflow. The only previous occasion since the war in which the government sought external financial assistance on a large scale was at the time of the Marshall Plan in the early fifties. Between 1949 and 1952, the government received under the Marshall Aid Programme a loan of £40·8m. together with a grant of £6·5m. Even during these years, however, it is curious to note that the total net capital inflow of £106m. was more than twice the total amount of our receipts of Marshall Aid.[11]

Next in importance to public sector borrowing is direct investment, with a cumulative net inflow of £113m. recorded under this heading since 1961. As already pointed out, however, the omission of unremitted profits of foreign subsidiaries lends a downward bias to the direct investment estimate. The direct investment content of part of the inflow through the non-associated banks should also be noted. This could take the form of a permanent commitment of funds by the parent bank to its subsidiary in Ireland the funds being then lent to Irish residents. Inflows of this type are unlikely to be large, however. On the other hand, there is close link between inflows through the non-associated banks and direct investment activity in so far as loans to subsidiaries are guaranteed by the foreign parent and financed directly by bank drawings on external sources.

Another important item in Ireland's capital account is portfolio transactions.[12] Gross inflows and outflows of funds under this heading have

[10] Working against these factors however, is the "strong suspicion" referred to by Dr. Kennedy, that the balance of payments figures understate total exports, especially invisible exports. See K. A. Kennedy "The Irish Economy in 1972" paper read to C.I.I. Conference, January 1972, p. 4.

[11] Figures for E.C.A. funds are taken from K. Kennedy and B. Dowling, *Domestic Demand, Exports and Economic Growth in Ireland* (forthcoming).

[12] The distinctive feature of direct investment is its association with a degree of control of the enterprise being invested in. A portfolio investor by contrast has no specific desire to secure control. Borderline cases exist but in most instances direct and portfolio investment flows can be distinguished from each other. Portfolio investment includes investment by an Irish citizen in foreign government securities, but a foreigner's investment in Irish government securities is counted as government borrowing.

TABLE 4
DISTRIBUTION OF NET CAPITAL INFLOW, 1961-70

	Net Government Borrowing	Net Borrowing by State-sponsored Companies	Net Direct Investment	Net Portfolio Investment	Other Items	£ million Total
	(1)	(2)	(3)	(4)	(5)	(6)
1961	4·0	−2·3	11·0	0·6	0·1	13·4
1962	2·0	0·6	15·7	0·6	4·0	22·9
1963	4·7	—	14·6	1·7	4·0	25·0
1964	−1·1	9·5	21·4	3·4	3·4	36·6
1965	0·8	2·2	15·3	2·6	3·7	24·6
1966	16·2	0·5	4·1	3·4	14·3	38·5
1967	2·4	2·7	13·0	2·6	10·4	31·1
1968	0·3	0·7	15·9	−2·4	−6·1	8·4
1969	10·6	31·3	−11·9	−2·7	47·7	75·0
1970	11·4	30·9	14·1	−2·1	13·4	67·7
Total	51·3	76·1	113·2	7·7	94·9	343·2
%	14·9	22·2	33·0	2·2	27·7	100·0

NOTES: (1) Net Government borrowing col. (1) equals new borrowing each year *less* amortization payments on all past borrowings. Changes in private foreign holdings of Irish government securities are also included. The figures correspond to the sum of items 10·1 and 10·2 of the balance of payments statement.

(2) Borrowing by State-sponsored companies from branches of foreign banks is not treated as foreign borrowing after 1967. Capital inflows through foreign bank branches are included under "other" items col. (5).

(3) Direct investment col. (3) refers to subscriptions by non-residents to shares in private companies and all other direct investment in Ireland by non-residents.

(4) Portfolio investment col. (4) consists of foreign subscriptions to public share issues and transactions through Irish stockbrokers in securities other than Irish government securities. The annual value of these transactions (inflow plus outflow) equalled roughly £60m. in 1968. Transactions through foreign stockbrokers by insurance companies etc. may may be covered by direct enquiries conducted by the CSO but the sums involved will appear in col. (5).

(5). "Other items" is a residual, calculated as col. (6) minus cols. (1) ot (4), containing a large number of miscellaneous items, the most important of which are: changes in the net external position of the non-associated banks and hire purchase finance eompanies, changes in value of acceptances discounted by Irish banks in London and payment of premiums to foreign life assurance companies.

(6) The negative entry for direct investment in 1969 must be considered in relation to the large inflow of capital into non-associated banks, "much of which is thought to be for direct investment purposes". (*Irish Statistical Bulletin*, June 1970, p. 88).

Finance for expansion of foreign enterprises may, in other words, have been obtained by borrowing from the non-associated banks, with the

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reached as high as £30m. each way. Data on net movements in portfolio capital are recorded in Table 4. The most surprising feature of these figures must undoubtedly be their small size—the cumulative net inflow between 1961 and 1970 amounted to only £7·7m. or 2 per cent of the total net capital inflow, and the highest figure for net transactions in any one year is £3·4m.

The remaining components of the net capital inflow, amounting to £95m. or 28 per cent of the total, are gathered together under the title of "Other" transactions. The most important net transactions included in this category are changes in the net external position of the non-associated banks, premiums to foreign life assurance companies and acceptances discounted in London by Irish banks. It is significant that over half the cumulative net inflow under "Other Items" can be traced to a single year, namely the inflow of £47·7m. in 1969, which in turn coincided with an exceptionally large capital inflow through the non-associated banks. The same year also witnessed an apparent net outflow of direct investment. These anomalies, as the *Irish Statistical Bulletin* noted, are likely to be interrelated,[13] but exactly how is still a matter for speculation.

Summarising our results, it is clear that the net capital inflow during the sixties can be attributed to three major factors. The first is foreign borrowing by state-sponsored companies and the government. Their combined net borrowing accounted for 37 per cent of the total net capital inflow. No less than two-thirds of this borrowing occurred in the years 1969 and 1970. If a shorter period, 1961-68, is considered, the share of government and state-sponsored companies' borrowing in the total net capital inflow falls to 22 per cent. The second factor is direct investment by non-residents in this country, which as officially computed accounted for a further 33 per cent of the net inflow. It was suggested, however, that the official figures are likely to underestimate the true magnitude of this flow. Again, the choice of a shorter period, 1961-68, has the effect of raising the direct investment share to 55 per cent. The third factor is a miscellany of items, the most important of which is perhaps the inflow of capital through the non-associated banks. The case was made that from a functional point of view, part of this inflow could be classified as direct investment. A final point of interest was the negligible influence of net movements in portfolio investment on the total net capital inflow.

Further research on published balance of payments data could be undertaken but, given present data limitations our efforts would quickly encounter diminishing returns. Henceforward attention is directed to direct foreign investment flows and an attempt is made to determine their major components from independent sources.

[13] I.S.B. June 1970, p. 88.

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parent company perhaps providing the security for the loan. The non-associated banks could then have acquired their funds by drawing on foreign sources.

SOURCES: Successive issues of the *Irish Statistical Bulletin*. Col. (4) and part of col. (1) figures kindly supplied by the Central Statistics Office.

Direct Foreign Investment

The part of capital inflow with the most direct bearing on Ireland's economic development during the last decade has been the inflow of direct investment. It is also the most controversial part, since direct investment necessarily implies a degree of foreign control over the resources of the host country. Although no official figures on the composition of these funds are available, it is possible to piece together a rough estimate of the magnitude of cumulative gross inflows during the last decade or so.[14] The results indicate that substantial direct investment funds are coming from abroad into at least three sectors of the economy: (1) mining; (2) manufacturing; (3) land, property and services.

(1) *Mining*

The conventional view of Ireland as a country possessing negligible mineral resources has had to be drastically revised in recent years. Discoveries of rich silver deposits, barytes and mercury in Co. Tipperary and lead/zinc deposits in Tynagh, Co. Galway and Navan, Co. Meath have attracted large inflows of foreign capital, most of it in dollars, to this country over the last decade. According to estimates provided by the Mining Companies,[15] £23m. had been invested in capital equipment and land and a further £8m. in exploration by 1970. The bulk of this capital expenditure dates from 1965 when the Tynagh mine was opened and virtually all capital outgoings were financed from abroad.

(2) *Industry*

This is one of the most important destinations of capital inflow and much of the foreign investment in land, tourism, etc. can be said to have followed or been induced by the growth of direct investment in industrial enterprises. Thus, one of the motivating forces bringing the North American banks into Ireland[16] was the need to provide financial services for their large U.S. customers setting up new establishments in this country.

Four forms of direct investment in industry may be distinguished: (a) the takeover of existing Irish firms by foreign enterprises, (b) the expansion of already established foreign enterprises, (c) the establishment of new enterprises and (d) joint ventures with Irish firms. While estimates of the gross inflow under the last three headings can be attempted with the aid of the annual reports of the Industrial Development Authority (IDA), the task of collecting the requisite information on take-overs would prove exceedingly onerous and has not been undertaken here. Non IDA-sponsored foreign enterprises are also excluded from our calculations

[14] Although these figures on their own tell us nothing about the *stock* of foreign ownership in the economy, they would indicate the sectors which foreign investors have found most attractive in recent years.

[15] *Tynagh, A Case History*, published by Irish Base Metals Co. Ltd. 1971. The capital expenditure figure does not cover the dolmite-processing plant in Dungarvan as this is included among the IDA-sponsored industries below.

[16] Cf. J. Koszul "American Banks in Europe" in *The International Corporation: A Symposium*, C. P. Kindleberger (ed.), M.I.T. Press, 1970.

but such enterprises are unlikely to account for more than 10 per cent of the gross inflow.[17]

According to the figures supplied by the IDA, total investment in fixed assets and working capital by firms with foreign participation (excluding joint ventures of £5m.) amounted to £122m. between 1960 and 1970. Obviously not all the capital expenditure was financed from abroad. It is customary, for instance, to borrow much of the working capital requirements from Irish banks. Hence in our calculation, two-thirds of the working capital of roughly £30m. is assumed to be provided from domestic sources, and only one-third from abroad.[18] A further deduction must be made for IDA grants given to foreign firms in respect of their expenditure on fixed assets. Assuming that the ratio of grants paid to fixed assets is the same for foreign firms as for all enterprises taken collectively, an estimate of £29m. for grants received by non-Irish enterprises is obtained.[19] This leaves a balance of £73m. which then constitutes an estimate of foreign direct investment inflow during the period 1960-70 by IDA-sponsored enterprises. To this must be added a figure of £11m. for foreign direct investment in Shannon.[20] We conclude, therefore, that up to £84m. could have been brought into this country over the last decade to finance direct foreign investment in the industrial sector. Our estimate is based on a number of special assumptions, of course. By changing these within reasonable bounds, different estimates may be obtained but the £84m.

[17] They are to be found usually in import-substitution activities e.g. cosmetics, oil refining and textiles. According to the *Survey of Grant Aided Industry*, about ten per cent of new manufacturing projects were established by foreigners without grant assistance. The projects tended to be well-below average in size and were designed primarily to serve the Irish domestic market. Other foreign firms may have gone ahead without even applying to the IDA for assistance and hence fail to appear in the IDA's statistics, but we may assume that their number is extremely small.

[18] Figures for working capital back to 1965 were supplied by the IDA, We took the average ratio of working capital to total capital investment for these years (25 per cent) as applicable to the whole period. Working capital is defined by the IDA as finance which must be obtained from the firm's own resources or through bank borrowing to cover disbursements other than the acquisition of fixed assets when setting up the investment project.

[19] This figure is calculated from Table 7 below. Figures in this table refer to year ended March. Hence three-quarters of the 1970-71 grant figure of £11·7m. is assumed to relate to the calendar year 1970. A similar adjustment is made when excluding grants paid during the years 1952-59. The grant/fixed assets ratio, implied by these calculations, of 32 per cent (£29m.) divided by £92m is implausibly low. The discrepancy may be due to delays in the receipt of grant payments. Alternatively, it is possible that the fixed assets expenditure reported in Table 5 exaggerates the amount actually spent at the time the figures were collected. Absolute precision in these matters is almost impossible to achieve, however, and one must have regard to the order of magnitude rather than to the absolute value of any particular figure. The conclusions of this section are not affected by these inevitable minor inaccuracies in the data.

[20] A figure of £14.1m. was provided by SFADCO as an estimate of private investment in the Shannon Estate up to March 1971 (*excluding* grants received). Since most of the buildings are provided by the Government, we assumed a working capital investment ratio slightly higher than 25 per cent i.e. £4.7m. of which £3.1m. is assumed to be supplied by resident banks. Total capital inflow, therefore, emerges as the sum of £9·4m. and £1·6m. i.e. £11m.

figure should remain a reliable indicator of the order of magnitude of the inflow.

(3) *Land*

Direct investment under this heading may be of two kinds: (a) investment in farms or studs, (b) investment in urban property for speculative or development purposes.[21] Considerable quantities of agricultural land were acquired by non-nationals in the early sixties. According to official records, 46,000 acres were sold during the period 1961-65.[22] If, in the absence of any scientifically based figure, we assume an average value of £150 per acre, the value of the investment amounts to £6·9m. This figure undoubtedly under-estimates the true amount since payment of the discriminatory stamp duty on sales to non-nationals could be and was extensively evaded by forming an Irish company for the specific purpose of making the purchase. This and other loopholes were closed by the Land Act of 1965 which was designed to curtail the amount of foreign purchases. The effectiveness of the Act may be judged by the fall in recorded sales to non-nationals from 46,000 in 1961-65 to 21,000 acres in the succeeding five years, 1965-70,[23] which on the basis of an assumed average price per acre of £250, would involve inflows of capital of up to £5·2m. during the latter period. Land required as sites for industrial undertakings does not, of course, come under the jurisdiction of the Land Commission and is reasily available for foreign acquisition subject only to permission of the Minister for Industry and Commerce.

It must be remembered, however, that the necessary qualifications for Irish citizenship are exceptionally liberal, which means that funds well in excess of those implied by the Land Commission's acreage figures could be brought in for the purpose of buying land.

Investment in urban property offers attractive prospects for the foreign investor, especially in view of the rapid inflation in property values during the last decade. Unfortunately, no quantitative estimates of the amount of capital inflow devoted to this purpose are available. Much of the activity appears to be financed by U.K. life assurance companies with net premiums collected in their Irish branches and by holders of pension funds, with non-institutional investors playing a secondary role. Perhaps only a small proportion of property transactions by foreign interests are financed from abroad; it is likely that foreign investors would prefer if possible to match their assets with liabilities in the same currency by borrowing on the Irish market.

[21] Land acquired for industrial purposes is included in the industrial investment figure above.

[22] Figures supplied by the Land Commission.

[23] As an indication of Government policy, one might refer to a memorandum recently published by the Dept. of Lands giving details of control over purshase of land in Ireland which begins on the following starkly inhospitable note: "An idea circulating abroad that there is land to spare in Ireland and that people from outside the country are welcome to acquire it should be effectively discouraged". *Purchase of Land in Ireland by Non-Citizens*, issued by the Department of Lands, May 1969.

Summarising this section, our results show that the cumulative *identifiable* gross direct investment inflow since 1960 could be as high as £127m. (£31m. in mining, £84m. in manufacturing and £12m. in land). To the extent that foreigners investing in this country have financed their activity from loans raised in Ireland and/or undistributed profits, the capital inflow under the heading of direct investment will be less than the total amount invested.[24] On the other hand, a large number of items—takeovers in manufacturing and distribution, investment in property and hotels, for example—are excluded from the figure of £127m. It is thus quite within the bounds of possibility that the "true" capital inflow in direct investment activities could have summed to £160m. or more. In that case, the figure derived from Table 4 of a net inflow of direct investment of £116m. for the period 1960-70[25] suggests either a larger direct investment outflow than one would have expected, a tendency of the official direct investment figure to underestimate the true level of inflow under this heading, or substantial financing through Irish banks or through unremitted profits. In the absence of a capital survey of foreign firms here and of Irish firms with business interests abroad, it is impossible to decide which of these alternatives is the most plausible. An aspect of our results which deserves attention, however, is the addition to Ireland's supply of foreign exchange on capital account attributable to new foreign manufacturing enterprises. According to our calculations, the total inflow attributable to these enterprises during the sixties does not exceed £84m., compared with a total net capital inflow of £344m. over the same period, i.e. the *gross* inflow for which they are directly responsible amounts to less than one-quarter of the total *net* inflow.

FOREIGN DIRECT INVESTMENT IN NEW MANUFACTURING ENTERPRISES

Characteristics of New Industry

The primary source of statistical information on new manufacturing enterprises is the annual report of the IDA and, for years prior to 1959, the annual report of An Foras Tionscal. Unfortunately, IDA publications usually make no distinction between new enterprises which are foreign-owned and those which are owned locally or operated as a joint venture. As a result we are unable to identify the special characteristics (if any) of

[24] The proclivity to finance foreign investment by borrowing in the host country has prompted Kindleberger to remark that "direct investment represents not so much an international capital movement, as capital formation undertaken abroad". *International Economics* (fourth edition) p. 390. In this connection, Dunning estimates that "only about a quarter of the increase since 1950 in the capital stake of American-based companies has been financed by capital exports from the U.S.; the balance has been made up of reinvested profits and local capital" (John M. Dunning, "The Multinational Enterprise" *Lloyds Bank Review*, July 1970, p. 34).

[25] An estimate for 1960 of £2·8m. is derived by adding items 5(b) and 9 of the old Balance of Payments format.

each country's new enterprises in Ireland.[26] Financial data relating to profitability, source of funds, capital gearing etc. of foreign firms are almost totally lacking.[27] A certain amount of information on the national origin of new projects and their total investment is available, however, and is presented in Table 5.

According to the data of Table 5, 401 out of 570 new industrial projects initiated since 1960 have foreign equity participation.[28] As joint ventures account for no more than 50 of these projects, foreign participation can

TABLE 5
NEW INDUSTRIAL ENTERPRISES BY COUNTRY OF ORIGIN 1960-1970

Country	No. of Projects	% of Total	Total Investment (including working capital) £m.	% of Total	Average Investment per Project (£000)
United Kingdom	178	44	35	29	197
United States	98	25	42	34	428
Germany	72	18	12	10	167
Other	53	13	33	27	623
Total Foreign	401	100	122	100	305
Irish	169	—	42	—	249
Total, Domestic and Foreign	570	—	164	—	288

NOTES: (1) Total foreign investment is underestimated by £5m. due to the exclusion of joint ventures 1960-70 for which no country breakdown was available at the time of writing.
(2) Total investment refers to expenditure actually incurred up to December 1970. Estimated capital expenditure at full employment for IDA projects (including those which have not yet commenced production) was estimated as £301m. in March 1971.
(3) The figure for number of projects indicates the number of new projects and major expansions which commenced before December 1970.

SOURCE: Computed from data provided by the Industrial Development Authority.

[26] Mr. John Teeling is preparing a doctoral thesis for Harvard Business School on this subject and has already undertaken some preliminary research.

[27] Cf. the *Survey of Grant-Aided Industries* 1967 (prl. 117), where the absence of comprehensive data on the finances of grant-aided industries was noted with regret. On the basis of the limited information available, the survey concludes tentatively that American firms were highly geared (i.e. rely heavily on loan capital rather than equity) whereas German firms tend to have a low gearing—an interesting result especially in the light of our discussion of export tax reliefs later in this paper.

[28] According to the IDA's list of *Principal New Industries with Foreign Participation*, only 24 foreign firms (representing perhaps a slightly large number of projects) were established with the aid of grants between 1952 and 1960. Hence we may assume that the exclusion of the 1952-60 period leads to no significant distortion in Table 5.

be equated with foreign ownership without doing too much violence to reality. Foreign firms thus account for 70 per cent of total new projects, but 74 per cent of total investment by new enterprises, reflecting a slightly larger scale of operations than their Irish-owned counterparts. Table 5 shows the geographical composition of foreign projects to be as follows: 178 (or 44 per cent) are British, 98 (or 25 per cent) are American, 72 (or 18 per cent) are German and the remaining 53 projects (or 18 per cent) are owned by nationals of a medley of countries, chiefly European. The predominance of the United States, Britain and Germany emerges quite clearly: over 51 per cent of all new projects, Irish and foreign, accounting for 54 per cent of total investment in IDA new industries, have been sponsored by nationals of these countries alone.

Average investment per project varies considerably with owner-nationality. Investment per project in U.S. and "Other" ownership, for example, is more than twice that in German and British ownership. It would be interesting to explore the causes of this divergence in greater detail and examine the effect of excluding the larger projects (i.e. those with grant approvals exceeding £0·5m.) on the behaviour of the average. Inspection of the list of grant-aided firms in the IDA's 1969/70 Annual Report indicates a heavy preponderance of U.S. investors in the larger project class,[29] but since most of these projects have only recently been approved, they are unlikely to have substantially influenced the figures up to 1970. Finally we note that average investment per Irish project (£0·25m.) emerges as somewhat smaller than the average per foreign project (£0·3m.).

There are a number of characteristics of grant-aided industry in general which, on the (reasonable) assumption that they pertain also to new foreign enterprises, may be mentioned at this stage.

First, these firms are heavily export-orientated. It has been shown that grant-aided establishments on average export 75 per cent of their gross output as compared with an export/gross output ratio of 25 per cent for all other establishments.[30] Although the figures cover only the period up to 1966, the inclusion of observations from later years would be unlikely to affect the conclusion. The distinctive feature of Irish industry is not, however, the high export ratios of new firms but the low export ratios of the longer established firms. The former is the logical result of a small domestic market and, to a much lesser extent, the IDA's policy of discouraging new firms from competing on the domestic market with already established domestic suppliers. A key factor in explaining the low export propensity of the traditional firms is the exceptionally high level of effective protection afforded to Irish industry.[31]

[29] Nine of the seventeen firms listed in the 1969/70 *Annual Report* with approved grants exceeding one-half million pounds were U.S. owned.

[30] Dermot McAleese, *Effective Tariffs and the Structure of Industrial Production in Ireland*, ESRI paper No. 62, 1971.

[31] An important factor explaining the low export propensity of traditional firms is the high level of effective protection to Irish industry. This matter is discussed at length in the study cited in the previous footnote.

Secondly, direct input-output linkages between new and already established industries tend to be extremely weak, with the single exception of the food-processing sector.[32] Most industrial raw materials are purchased from abroad. Again this situation reflects primarily the small size of the Irish economy which, incidentally, will continue to act as a constraint on IDA or government policy designed to increase inter-industry linkages.

Thirdly, failure rates appear to be quite low. While 11 per cent of all new enterprises (Irish and foreign) set up since 1952 failed, over half of these were taken over by new management, thus leaving a *net* failure rate of only 5 per cent.[33] Curiously, almost all the failures were foreign-owned and about 50 per cent were controlled by German nationals.[34]

Finally, grant-aided enterprises are widely dispersed being found in large numbers in the metals and engineering, food and milk products, textiles, clothing, pharmaceuticals and chemical industries. Another large group, producing a wide variety of products which often defines classification, are placed in the "miscellaneous" category. Regardless of the industry they belong to, grant-aided establishments tend to be small relative to the giant transatlantic enterprises which cause concern in Britain and the Common Market counties. Of the 195 enterprises receiving IDA new industry grants in 1970-71, only 21 had grant approvals greater than £0·5m.

Incentives to Foreign Industry

Ireland's present incentive scheme for new industrial ventures has two essential features. First, new industrial projects or major expansions of existing ones are encouraged by government grants in respect of fixed assets costs. Secondly, complete remission of income and corporation profits tax is granted on profits earned through the exporting of manufactures. Additional reliefs are also provided in the form of labour training grants, interest subsidies on loans, grants for research and development expenditure and marketing services to exporters of manufactured goods, but their importance in financial terms is relatively small. Rent subsidies on advanced factories and industrial estates amounted to no more than £100,000 in the year 1970-71.

In assessing the cost of fixed-asset grants, two points may be noted. First, the rate of grant paid rarely equals the maximum rate legally permitted. As Table 6 shows, grants amounting to 53 per cent of expenditure on fixed assets were paid to firms in Designated Areas in the period 1952-70 as compared with the current legal maximum of 60 per cent. The corresponding figures for non-Designated Areas are 40 per cent for percentage grant paid and 45 per cent legal maximum. The grant rate approved in 1970-71 has fallen even further, to 51 and 31 per cent for the Designated and non-Designated areas respectively, following the IDA's recent decision to set an administrative grant maximum of 50 and 35 per

[32] *Survey of Grant-Aided Industry*, p. 49.
[33] *I.D.A. Annual Report* 1970-71, p. 49.
[34] John Teeling, *loc. cit.*

cent. Secondly, although highly variable from year to year, it is evident from Table 6 that the grant per job created has risen very steeply especially since 1967. Average grant per job in the Designated Areas averaged £714 over the period 1952-67, compared with an average grant per job of £1,057 in the period 1952-70 and £1,373 in 1970-71. The experience of the non-Designated Areas follows a similar pattern. The rise in grant per job reflects in large measure the rapid price inflation experienced during the last four years.

TABLE 6
GRANTS TO NEW INDUSTRY AS A PERCENTAGE OF GRANT-ELIGIBLE COSTS (FIXED ASSETS)

Description of Grant		Designated Areas	Non-Designated Areas
		grant as a percentage of capital costs	
Legal maximum[1] (1969 Act)		60	45
Rate of Grant Approved[2] average	1952-70	53·5	40·2
	1969-70	53·3	41·1
	1970-71	50·8	30·6
		estimated grant (£) per job	
Administrative maximum		5,000	4,000
Projected grant payable[3] average	1952-70	1,057	1,119
	1969-70	2,286	1,944
	1970-71	1,373	2,646

NOTES: (1) The administrative maximum grant i.e. that determined by IDA itself, has fallen since 1969 and now stands at 50 per cent in Designated Areas, 35 per cent in non-Designated Areas and 25 per cent in the Dublin Region.
(2) Rate of grant approved is defined as grants approved expressed as a percentage of expected fixed assets cost at full production. Grants data for non-Designated areas refer to period after 1959. The figures for 1969-70 are by courtesy of the IDA.
(3) Estimated grant is calculated as the ratio of grants approved to employment at full production as estimated by the firms themselves. Grants paid per job actually created were estimated by the IDA in their 1970/71 Report as £1,260 per job for the period 1967-71. Projected grant per job varies greatly from year to year according to the particular projects which happen to be approved.
(4) The figures exclude Shannon and projects not proceeded with, but training grants are considered part of total new industry grants in compiling this Table.

SOURCES: Data are derived from IDA *Review 1952/70 and Annual Report 1969/70*, Table 10A, p. 50, and *Annual Report 1970/71*, p. 28. *Survey of Grant-aided Industries*, Table 2. 5, Government Stationery Office, 1967 (Prl. 117).

Grant payments on an annual basis are recorded in Table 7. Cumulative grants paid up to March 1970 amounted to £31m. The 1970-71 level of expenditure on fixed asset grants is £11·7m., thus leaving a total of £42·7m. paid in grants since the scheme began in 1952. Measured in 1970 prices, the total cost to the Exchequer since 1952 amounts to £48m.[35]

Export tax reliefs have been an integral part of Ireland's industrial promotion policy since 1956. The Finance Act of that year granted a 50 per cent tax remission on all profits earned on increases in export sales over the 1956 (or 1955) level.[36] Thus any firm established after 1956 would automatically obtain tax remission on all its export sales. In 1958 the proportion of tax remitted was raised from 50 to 100 per cent and the Finance Act of 1960 extended the period of full relief from ten to fifteen years. Concessions for a further five years were also granted, but at a diminishing rate so as to prepare firms in advance for their eventual liability to full tax rates.[37] The scheme was originally intended to terminate in 1979/80 but legislation was passed in 1969 providing for its continuance up to the tax year 1989/90.[38]

In Table 7, annual estimates of tax "lost" as a result of export tax remission are recorded beginning with the year 1960.[39] The importance of this concession can be appreciated by comparing the sum of grants paid during the three years 1968-70 (£16·5m.) with the corresponding amount of tax "lost" (£16·1m.). It must be stressed, however, that the proportion of the tax concessions received by new foreign manufacturing firms amounts to only a fraction—perhaps one-half—of the total, since all firms manufacturing and exporting from Ireland are eligible for relief,

[35] This figure was obtained by multiplying each year's grants by the rise in the capital goods price index between that year and 1970. A similar calculation was performed with the aid of the consumer price index, but with only marginal implications for the total grant payments figure—£51m. on the basis of the C.P.I. compared with £48m. on the basis of the capital goods index.

[36] A firm could also avail of an alternative scheme of tax relief, namely, they could request a 25 per cent tax rebate on all exports rather than the 50 per cent rebate on increases in exports. In practice, very few firms applied for tax relief under the former method of assessment and it has now effectively been abolished.

[37] The partial relief was given at the following rates: first year, 80 per cent of full rate; second year, 65 per cent, third year, 50 per cent; fourth year, 35 per cent; fifth year, 15 per cent.

[38] Details of the scheme are contained in *Principal Income Tax and Corporation Profits Tax Reliefs for Year* 1970-71, Leaflet No. 4, issued by the Revenue Commissioners, Dublin Castle. We may note, however, that the relief applies only to profits earned from the export of manufactured products. In 1958 the coverage was extended slightly to include the building and repairing of ships, certain manufacturing services carried on in Ireland and design and planning services rendered in connection with engineering works executed abroad; in 1969 similar concessions were also granted to the mining industry.

[39] Tax "lost" is the tax which export firms would have had to pay, after allowing for normal depreciation allowances, on their export profits.

TABLE 7
TOTAL TAX FOREGONE DUE TO EXPORT RELIEF SCHEME AND NEW INDUSTRY GRANT PAYMENTS UP TO YEAR ENDED MARCH 1970

	Grants (£m.)	Tax Relief (£m.)
1952-58	0·7	n.a.
1959	0·4	n.a.
1960	0·8	0·4
1961	0·6	0·6
1962	1·4	0·7
1963	1·6	1·2
1964	2·7	1·1
1965	1·7	1·1
1966	2·1	1·6
1967	2·5	2·0
1968	3·0	4·3
1969	4·6	5·1
1970	8·9	6·7
Total 1952-70	31·0	24·8
1971	11·7	15·1

NOTES: (1) Data exclude Shannon. According to information supplied by the Revenue Commissioners, relief on exports from Shannon is currently "costing" about £3.5m., per year. Grants to Shannon totalled £2.5m., by 1970.

(2) New Industry grants paid in the year 1970-71 amounted to £11·7m., to which a further £0·5m., must be added for Shannon. The figure for grants includes training grants totalling £2·1m. The small difference between the figures here and those in Section 4 of the 1970/71 IDA *Report* (Tables 1 and 2) is due to adjustments for grant repayments.

(3) Data refer to year ended 31 March, for grants, to 31 January in the case export tax relief.

SOURCES: The Industrial Development Authority and IDA *Annual Report 1970/71*. Figures on tax relief kindly supplied by the Revenue Commissioners.

including (since 1967) the mining companies.[40] The fact that the tax relief allowed in any one tax year relates to profits earned twelve to eighteen months previously must also be noted. The extraordinary increase to £15·1m. in tax-lost during the year 1970-71 may partly be explained

[40] The total increase in tax relief elibible exports since 1960 amounts to roughly £236m. This figure represents the sum of the increase in manufactured goods exports from £84m. in 1960 to £303m. in 1970 (as estimated in the *Review of 1971 and Outlook for 1972*, Table (i)) and the increase in metal ores exports since 1967 of about £17m. From the results of a study undertaken by Coras Trachtala, it can be deduced that 50 per cent of the increase in manufactured exports (less food and drink) originated in firms established since 1960. This result ties in well with the present author's calculation that 44 per cent of the increase in exports 1960-66 could be attributed to grant-aided firms. Hence we may assume that approximately one-half of the total manufactured exports increase of £219m. is attributable to grant-aided firms and, furthermore, that 74 per cent of these exports came from grant-aided foreign manufacturing enterprises. The latter are thus responsible for somewhat over £80m. (or one-third) of the total

by this lag as well as, in the case of some companies, by the inclusion of tax relief pertaining to more than a single year's trading profits. Finally, on the assumption that half the tax relief applies to new foreign manufacturing firms, we find that the cumulative amount of tax relief provided amounted to £20m. in historic prices, £23m. in 1970 consumer prices or £21m. in terms of 1970 capital goods prices.

The significance of Ireland's export tax relief scheme must, however, be considered in the light of the following two considerations.

First, in the past Irish tariff barriers indirectly raised the price on non-traded inputs used by export firms and in the early years of the scheme duty exemption on traded inputs was not always easy to obtain. These factors tended to discourage the development of an export trade. Furthermore, Ireland's high effective tariff rates (79 per cent average in 1966 compared with 28 and 19 per cent for the U.K. and the E.E.C. respectively) created an incentive to expand import substitution activities rather than export sales. Tax reliefs as a percentage of manufactured export sales amounted to no more than 5 per cent on average, a low figure compared with a nominal tariff on industrial imports of 25 per cent.[41]

Secondly, it cannot be automatically assumed that the foreign company will be able to repatriate the tax-free profits without losing the benefits of the scheme in the process. Under the U.K. and U.S. tax equalisation systems profits repatriated from a subsidiary to its parent firm are taxed at the same rate as domestic profits and deductions are allowed only in respect of taxes actually paid (as distinct from taxes payable) to the host country abroad. The aim of this legislation is partly to lessen the temptation for host countries to erode their tax base by offering increasingly large tax concessions[42] and partly to limit the outflow of direct investment from the donor countries themselves.

Continental European countries are in general less strict than the British and Americans. Double taxation agreements have been made with Germany, Canada and the Netherlands which effectively ensure that all the benefit of the tax relief accrues to the foreign investor. Tax-free dividends repatriated from Ireland to France or Switzerland are taxed at rates less than one-third of the standard domestic rate and, in the case of Switzerland, many cantons grant complete tax exemption. Similar arrangements have been made with Denmark, Sweden etc.[43] Nevertheless only one-third of direct foreign investment in Ireland comes from countries other than the United States and Britain.

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export increase of £236m. On the admittedly heroic assumption that the average profit/turnover ratio for foreign firms is twice that of all other enterprises, we conclude that only one-half of the tax concessions accrued to new foreign manufacturing enterprises (*See Annual Report of Coras Trachtala*, p. 11, and McAleese, *op. cit.*, Table 4, for basis of calculation of estimates cited above.)

[41] Data in this paragraph are taken from McAleese, *op. cit.* p. 45.

[42] See Kindleberger, *American Business Abroad*, Yale University Press, 1969, p. 177.

[43] In countries where company taxes are progressive, profits of foreign-based subsidiaries are added to domestic profits when assessing the total tax due. Exemption is then granted in proportion to the share of foreign-earned profits in total profits. An "exemption with progression" scheme of this kind is operated by Germany.

Obviously, to the extent that profits of American and British subsidiaries are repatriated and taxes duly paid, the only effects of the Irish export incentive scheme is to transfer taxable income from the Irish exchequer to that of the parent country. The issue is considered sufficiently important to justify the Irish Government's seeking, but so far without very notable success, "tax-sparing" agreements with these countries. Nevertheless, it would be wrong to give the impression that, in the absence of governmental initiatives, foreign subsidiaries are unable of their own accord to reduce their tax liability. Under the United States tax code, for example, an American firm which retains its earnings for a period of ten years after its establishment can repatriate the accumulated sum subject only to a capital gains tax.[44] Another perfectly legal way of reducing tax liability is to have the subsidiary's capital structure highly geared. The tax-free profits can then be used to pay off debt leaving the benefits to accrue in the form of capital gains to the parent company. This is, of course, analogous to reinvestment of profits. If the host country happens to be experiencing a shortage of foreign capital, the transaction becomes less attractive since part of the loan capital may well be raised in the host country itself.[45]

The export tax relief system has consequences over and above that of attracting new industry. The balance of payments accounts are obviously likely to be affected. In order to maximise the share of company profits accruing to the tax-free Irish subsidiary, an incentive is created for the subsidiary to charge inflated prices on its exports to the foreign parent and/or associated companies, with these in turn supplying imports at artificially low prices to its subsidiary. As a result the growth in the value of manufactured goods exports tends to be increased, the deficit on current account reduced (since unremitted profits of subsidiaries are not included in the current account) and the net capital inflow also lower than it would otherwise be. In addition, the inducement given by the tax relief scheme to repatriation of current earnings in capitalised form suggests that part of the dividend or profits outflow will be incorporated in the balance of payments as a capital rather than a current item.

[44] In the case of this particular provision, Ireland is treated as a less developed country (LDC) by the U.S. tax law. Since 1965, our status has been that of a developed country in so far as the application of the interest equalisation tax is concerned. It may be added that, in order to avail of LDC concession, the subsidiary has to keep a certain of its reinvested earnings in "active" assets, otherwise its profits will be deemed for tax purposes to have been distributed. A wider ranger of assets is considered "active" for the purposes of the tax code in the case of an LDC corporation.

[45] In Ireland's circumstances, the presumption that locally raised loans will not be matched by a capital inflow is not altogether acceptable since loans financed through the non-associated banks in Ireland will often cause these banks to acquire more funds abroad from or through the agency of their foreign parent. The difficulty of distinguishing between capital brought into the country for "productive" purposes of this kind and capital inflows destined to finance consumer spending raises some problems for credit policy in this country. In this connection, we may note that the Central Bank's credit guidelines enjoin the non-associated banks to permit *no* change in their external positions between April 1971 and April 1972.

The package of incentives to new industry appears to be exceedingly generous. Support for this view has come recently from a valuable study completed by MacCarvill in which Ireland's industrial incentives are shown to yield significantly higher net (discounted) benefit to the entrepreneur than those of British and other European countries.[46] In conducting his comparison, MacCarvill was careful to specify a large number of hypothetical projects each with different capital-gearing and earning/cost profile, but finds the results of his study are relatively insensitive to changes in the particular profile assumed.[47] Ranking countries by net discounted benefit for each project, the author shows that: (a) Ireland (Designated Areas) heads the list in all cases, with Northern Ireland coming a close second, (b) Britain, Spain, Portugal and Italy have levels of incentives 30 to 40 per cent below Ireland's and (c) E.E.C. countries appear at the bottom of the list. Needless to say, however, financial inducements are not the only important consideration when assessing the government's role in attracting industry. State expenditure on infrastructural facilities—roads, water, energy, etc.—would also have to be taken into account in a fully comprehensive study.

What the foregoing discussion has shown is that the financial cost of our industrial incentive scheme, while rising rapidly in recent years, can still in no sense be described as imposing a crippling burden on the national exchequer. The combined cost of fixed asset grants and export tax relief in 1970-71 amounted to slightly more than £30m. (including Shannon)—roughly the same amount as the dairy produce subsidy of that year. In addition, it must be remembered that, transfer pricing practices will tend to inflate artifically the profits of foreign subsidiaries and hence the amount of tax lost. More generally we may note that the concept of tax "lost" has no strict apriori relationship with economic cost. Without the tax incentives, the firms may not have come to Ireland in the first place, with the resources they now employ being left idle or emigrated. While a thorough investigation of this matter cannot be undertaken here, it is revealing to compare the present financial cost of the incentive scheme with the economic cost of protection which in the mid-sixties was estimated at £31m.—£37m. per annum.[48] The present industrial incentive scheme, however, has one quite distinctive distributional implication—a large slice of the total total amount "lost" or expended goes to non-nationals.

[46] P. D. MacCarvill, *The Promotion of Direct Foreign Manufacturing Investment: A Systems Approach*, unpublished M.B.A. thesis, University College, Dublin 1971.

[47] No experimentation on the effect of altering the assumed discount rate of 10 per cent and time horizon of 10 years is reported however.

[48] McAleese, *op. cit.*, p. 51 and *Budget 1971*, Table V. Fixed asset grants are capital expenditure items, a factor which tends to exaggerate their size in relation to the other two current items mentioned in the text. As the discounted value of rent subsidies on the £4·5m. capital expenditure on industrial estates and advance factories is unlikely to exceed £1m., its addition would have no appreciable affect on the total industry grants figure.

Reinvestment Rates and Capital-bias of New Enterprises

Two features of IDA sponsored enterprises have attracted criticism recently. First, it has been asserted that the growth rate of foreign firms once the original plant is established "tends to be relatively modest in Ireland and the main source of major expansion has to come from repeated injections of new enterprises from overseas".[49] The main factor bringing about this situation is the wide dispersal of and the absence of inter-linkings between the new foreign enterprises. A second criticism has been directed towards the alleged capital-using bias of the two-tier grant system which encourages relatively capital-intensive industries to establish operations in the Designated Areas.[50] It is, perhaps worthwhile investigating both these criticisms in greater detail.

From the IDA's list of Principal New Industries with Foreign Participation, it was possible to identify all those foreign firms which undertook significant expansion of their enterprises since their establishment. Ideally, of course, we would like to exclude all expansions which were an intrinsic part of the initial project and include only those expansions which occurred as a result of an independent reassessment of the firm's requirements. The dividing line between the two types of expansion is not always easy to draw, however, and the number of expansions listed by the IDA may include some projects which were scheduled originally to proceed in two stages. Bearing this limitation in mind, we find that 47 expansions were undertaken up to September 1970 considered in relation to 277 IDA sponsored foreign firms in operation at that time. Since a period of time must elapse between the firm's initial establishment and its undertaking an expansion a fairer basis of comparison would be the number of firms operating in 1968. In support of this view we may mention that all of the expanding firms were established in or before that year. On this basis, therefore, 47 out of 230 or 20 per cent of IDA-sponsored foreign firms operating in 1968 undertook a significant expansion. Of these only five expanded into a different location,[51] the remainder enlarged their production facilities *in situ*. A further point of interest is that half (23) of the expanding firms were located in the Designated Areas.

[49] See Jim Northcott, "New Patterns of Development", *Journal of the Statistical and Social Inquiry Society of Ireland*. Vol. XXII Part II 1969-70, p. 187.

[50] "The current package of incentives offered in the Irish Republic is somewhat biased towards capital investment rather than labour and thereby, it might be supposed, encourages capital-intensive forms of production . . ." P. N. O'Farrell, "The Regional Problem in Ireland: Some Reflections upon Development Strategy", *Economic and Social Review*, July 1971, p. 459. In fairness, one may note that O'Farrell advances this criticism in a deliberately tentative and circumspect fashion.

[51] SPS (International) Ltd. (Shannon) set up an additional plant in Galway, Becton Dickinson (Drogheda) in Dublin, Irish Picture Mouldings (Donegal) in Glenties. The Kire Manufacturing Company (Kinsale) established workshops in Fermoy and Bandon after running into a labour bottleneck in their original location. General Electric opened a second subsidiary, Ecco Ltd. of Dundalk, three years after the establishment of its first subsidiary EI Co. Ltd. of Shannon in 1963. See *Principal New Industries with Foreign Participation*, The Industrial Development Authority, September 1970.

To assess the quantitative importance of these expansions, estimates of capital expenditure thereby incurred were compared with the total capital expenditure of foreign firms of £122m. during the last decade (as given in Table 5). Figures for grants approved in respect of each expansion were obtained from past annual reports of the IDA and An Foras Tionscal and, with the aid of the 1970/71 IDA *Annual Report*, these figures were scaled down to yield estimates of grants actually paid.[52] To obtain estimates of capital expenditure, grants paid are converted by means of the average grant rate (the relevant rate being that of the Designated Area if the expanding firm is located in a Designated Area and likewise, *mutatis mutandis*, for a firm located in a non-Designated Area) to total fixed assets expenditure and one-third of the ensuing total is assumed to constitute working capital requirements.[53] The outcome of these computations is as follows: total capital requirements in respect of expansions is estimated as £12m. or 10 per cent of total capital expenditure by IDA sponsored foreign firms over the last decade. We further estimated that the capital inflow implied by these expansions amounted to roughly £6m.[54]

While the number of firms which decided to expand production capacity over the level initially envisaged is thus by no means insignificant, the amount of capital investment such expansions have required constitutes a small fraction of total capital investment by foreign firms. The view that the main source of growth has been the "repeated injection" of new overseas firms is therefore vindicated. Whether this will continue to be the case in future is much less certain. As the number of foreign firms increases, the impact of their combined reinvestment decisions on the total capital investment of foreign firms may also be expected to increase relative to that of new firms.

Turning to the second objection to IDA policy, it is said that the new industry capital grant system gives special encouragement to capital-intensive industries. Certainly, in a perfectly competitive capital market, the effect of capital grants is to shift the factor price line in a way which gives firms in *every* industry an incentive to employ more capital intensive methods of production. To postulate that capital-intensive industries *per se* are favoured relative to other industries, of course, requires much more restrictive theoretical assumptions.[55] The point to be emphasised,

[52] The IDA report contains a figure for cumulative grant approvals and grant payments for each grant-aided firm. In estimating grants paid on expansions, we assumed that grants approved on the initial project were fully paid, thus implying that any unpaid grants related exclusively to expansions.

[53] See above for discussion of working capital as a proportion of total capital. The average grant rates are taken from Table 6.

[54] The implied capital inflow capital expenditure ratio is lower than that estimated for total new industry because of the higher proportion of industries in non-Designated Areas in the latter calculation.

[55] This is a general equilibrium proposition whose validity can easily be established in the context of the conventional two-good-two-factor model of production and trade but which, under less strict conditions, would prove considerably less robust'

however, is that once imperfections are allowed in the capital market, conventional generalisations as to the likely effect of capital grants become increasingly difficult to support. In such circumstances, the grant system could well have the effect either of encouraging large, but not necessarily capital-intensive, industries or of attracting enterpreneurs who because of their limited financial resources find even small supplies of capital difficult to obtain.

In the light of these arguments, an examination of the Irish experience may be of some interest. From Table 6, it can be observed that the average grant payable of 53·5 per cent on fixed assets in the Designated Areas during the years 1952-70 exceeds the corresponding average of 40·2 per cent in the non-Designated Areas by roughly one-third. Given this fact and assuming a similar new industry-mix in both areas, grants per job could be expected to be at least one-third higher in the Designated Areas. To the extent that the higher grant rate encouraged capital-intensive industries and/or methods of production, the cost of creating jobs in the Designated Areas would be inflated still further. However, as Table 6 shows, the average cost per job created in the Designated Areas (£1,057) over the whole period 1952-70 is actually *less* than that of non-Designated Areas (£1,119). The situation is reversed if the period 1952-67 is taken, but the differential between Designated and non-Designated Areas amounts to only 12 per cent.[56]

On the basis of this extremely limited investigation, therefore, there is no immediately apparent evidence that the capital grant differential results in greater capital intensity of new industry in the Designated Areas *vis-à-vis* the rest of the country. Whether the grant system encourages capital-intensive methods of production in the country as a whole is a different question. Attempts to measure the degree of bias created by investment incentives in the U.K. have come up with inconclusive results.[57] Obviously, before issuing any policy prescription in the Irish context, serious research would have to be undertaken into the type of industry attracted to this country, with special attention being paid to the consequences of capital market imperfections, two of which were mentioned above. Hence, the advocacy of a short-term labour cost subsidy for new industries in order to remove "the current capital bias of the grant structure" must be treated with considerable reserve.[58] Apart altogether from the question of whether the bias has any practical importance, it is not clear how far an explicitly short-term factor price subsidy can succeed

[56] Admittedly, grant approved per job varies considerably from year to year. But annual data from the *Survey of Grant-Aided Industry* (Table 25) would lend no unambiguous support to the proposition that grants per job are higher by more than one-third in the Designated Areas. Of course employment at full production is estimated by the firms themselves and hence liable to substantial upward bias, but this should not affect the relative position of the two areas.

[57] See for instance Michael Chisholm "On the Making of a Myth? How Capital Intensive is Industry Investing in the Development Areas?", *Urban Studies*, Vol. 7, No. 3, 1970.

[58] O'Farrell, *op. cit.*, p. 479.

in influencing an inherently long-run decision about optimal factor proportions. Secondly, the implied undesirable consequences of the alleged capital-intensive bias would have to be spelt out more clearly before recommending its removal. Finally, the argument takes no account of the considerable discretionary powers exercised by the IDA in awarding grants to projects with different capital/labour ratios.

The Determinants of Direct Investment Flows

Theoretical explanations of direct foreign investment flows lay considerable stress on the foreign firm's exclusive possession of an industry-specific package of technical and marketing knowledge and entrepreneurial capacity.[59] In the case of manufactured goods, this quasi-monopolistic advantage can be exploited in foreign markets by exporting from the home country, but returns are adversely affected by tariffs and transport costs. An incentive to transfer production to the foreign market is also frequently created by the low efficiency-wages of the host country.[60] Provided these and other positive forces are sufficient to offset the disadvantages of alien status (e.g. ignorance of local mores, danger of expropriation, uncertainty as to quality of labour force etc.) direct investment will be worthwhile undertaking and foreign subsidiaries will be established. Although developed primarily in the context of direct foreign investment in new manufacturing enterprises, the theory can, with suitable modifications, be applied to foreign takeovers of already existing plants and foreign direct investment in services, property and the extractive industries. In each instance the fundamental motivating force—the necessary condition for specifically *foreign* investment to occur—is the possession of expertise which the recipient country's entrepeneurs lack or are unable to exploit. Needless to say this is just a necessary condition. It may not be sufficient to elicit investment flows unless accompanied by acceptable (to the investor) levels of efficiency wages, transport costs, market accessibility, and governmental financial incentives etc.

The only section of Ireland's direct investment inflow to have been studied in recent years is direct investment in new industry. Thus, as already mentioned we know very little about the extent or rationale of foreign takeovers of Irish concerns and foreign investment in distribution and other services. We are therefore obliged to focus our main attention on industrial investment, having particular regard to the part played by policy instruments such as tariffs and financial incentives in attracting such investment.

[59] S. H. Hymer, "The Efficiency (Contradictions) of Multinational Corporations" *American Economic Review*, May 1970. H. G. Johnson, "The Efficiency and Welfare Implications of the International Corporation" in C. P. Kindleberger (ed.), *The International Corporation*, M.I.T. 1970. R. E. Caves, "International Corporations: The Industrial Economics of Foreign Investment", *Economica*, February 1971.

[60] Efficiency wage is the wage rate after allowing for labour quality differentials. See Raymond Vernon, "International Investment and International Trade in the Product Cycle", *Quarterly Journal of Economics*, May 1968.

The role of tariffs as a determinant of direct investment flows has been the subject of much research in recent years. Interest has centered on the question of whether and to what extent U.S. firms were induced to establish manufacturing plants in the E.E.C. in order to avoid the Common External Tariff (CET). The evidence at the time of writing suggests that tariff discrimination played a minor role relative to the internal market-widening effect of the E.E.C. on direct investment flows from the States.[61] Although, as is well known, attempts to "jump" the tariff wall by setting up plants behind it occurred in Ireland during the thirties, it is highly unlikely in view of this country's commitment to substantial trade liberalisation by 1976, that present levels of Irish protection provide any significant incentive to foreign entrepeneurs to service the Irish market by producing here rather than abroad. Free access to the U.K. market, on the other hand, might appear as an important advantage for non-U.K. foreign investors, but it is by no means certain that the majority of non-U.K. manufacturing plants are designed to service the British market. As Table 8 shows, the proportion of the *increase* in manufactured exports sold in the U.K. has fallen during the last decade, from 86 per cent in 1950-59 to 59 per cent in the period 1959-70.[62] By contrast, the combined share of the E.E.C. and other O.E.C.D. countries in the increase in Ireland's manufactured exports was 7 per cent in 1950-59 as against 29 per cent in the 1959-70 period. Many of these exports were subject to import duties. Indeed, we have estimated that 81 per cent of our manufactured exports to the E.E.C. are liable to C.E.T. of 8 per cent or greater, and 26 per cent to a CET greater than 12 per cent.[63] These calculations, performed on the basis of 1970 CET and export levels, suggest that Ireland's attraction to foreign investors consists of far more than mere accessibility to her neighbours' markets. The impression is further strengthened when one considers the absence of any obvious transport cost savings by locating in Ireland.

Responses to questionaires with the "why did you decide to come here?" theme are liable to be misleading for a number of reasons, not least that of retrospective rationalisation on the part of the foreign investors being interviewed. Although acutely aware of this problem, the authors of the *Survey of Grant-Aided Industry* are able to conclude that:

[61] Cf. A. E. Scaperlanda and L. J. Mauer, "The Determinants of U.S. Direct Investment in the EEC", *American Economic Review*, September 1969 and "Errata" in the June 1971 issue of that journal.

[62] The removal of British tariffs on Irish textile exports in 1966 under the terms of AIFTA may have inflated the U.K's share in the last half of the decade; while the 1967 devaluation must also have exercised an effect on the data. Breaking the period into two, 1959-64 and 1964-70, however, scarcely affects the conclusions. During the years 1959-64, the proportion of the increase in export sales sold in the U.K. amounted to 58·4 per cent as against 59·6 per cent in the succeeding six years.

[63] The C.E.T. was converted into average tariffs corresponding to each four-digit S.I.T.C. item and the relevant export values listed beside its corresponding tariff. Further details of this calculation will be given in a forthcoming article.

TABLE 8

ABSOLUTE AND PERCENTAGE INCREASES IN MANUFACTURED (SITC 5-8) EXPORTS BY TRADING AREA, 1950-59 AND 1959 70

Area	1950-59 £'000	% of Total Increase 1950-59	1959-70 £'000	% of Total Increase 1959-70	1950-70 £'000	% of Total Increase 1950-70	Absolute level of Exports 1970 £ million
U.K.	16,180	85·8	75,682	59·3	91,862	62·7	95·4
E.E.C.	443	2·4	18,080	14·2	18,524	12·7	18·9
Other O.E.C.D. (excluding Japan)	969	5·1	19,525	15·3	20,494	14·0	20·7
E.F.T.A. (excluding U.K.)	77	0·4	4,069	3·2	4,146	2·8	4·5
All Other Areas	1,194	6·3	10,293	8·0	11,486	7·8	11·8
Total	18,863	100·0	127,649	100·0	146,512	100·0	151·3

SOURCE: Computed from *Trade and Shipping Statistics* and *External Trade Statistics.*

NOTE: Figures exclude Shannon.

> When grants and export profits tax relief are considered together, these two forms of state aid appear to have been more successful than any other factor . . . inducing foreign industrialists to provide new employment opportunities within the country (p. 61).

This conclusion is of considerable interest especially in the light of the directly contrary results of location studies elsewhere. Law, for example, finds from his survey of industrial location decisions in Northern Ireland that "financial assistance was more often regarded as an attractive additional reason for setting up a factory in the Province than as one of the major determinants".[64] In a study of industrial movement in the North of England, Townroe found that most of the respondents to his questionnaire adhered to the view that the choice of location be determined on the basis of long run suitability of the site rather than on the basis of "artificial" financial inducements.[65] A related point, much stressed by Townroe, is that the number of different locations examined by those making location decisions can often be no greater than two or three. The cost of acquiring information frequently deters businessmen from undertaking a full exploration of the various alternative locations which could be chosen.

Next in importance to official assistance, the *Survey* found, was the availability of labour. While some ambiguity surrounds the meaning of labour "availability" the advantage thereby conferred must be related to the wage at which the desired labour supply is forthcoming i.e. the efficency-wage must be low relative to that of the investing country and/or feasible alternative locations. Although comparison between unskilled wage rates in Ireland and in Britain suggests an advantage on Ireland's side, three points may be noted. First, absenteeism by males, especially in rural areas, and high rates of female turnover (perhaps due to the low participation rate of married women) create manpower problems for some enterprises. Secondly the Irish/British unskilled labour differential is gradually being narrowed-indeed the aim of our industrialization programme is precisely to raise standards of living (and hence real wages) at least to the British level. Thirdly, Irish skilled labour wage rates are as high and in some instances higher than comparable British rates. These factors suggest that the efficiency-wage may not be all that lower in Ireland than in Britain. The greater availability of labour here at the efficiency wage, on the other hand, would obviously prove attractive when full employment obtains in the British economy. The exact nature of Ireland's presumed labour market advantage, therefore, is not always easy to discern and needs further careful investigation.

Market accessibility and availability of local raw materials were ranked third and fourth in importance as incentives to entrepreneurs setting up in Ireland. The former advantage has already been discussed and the

[64] David Law, "Industrial Movement and Locational Advantage", *The Manchester School*, May 1964, p. 136.

[65] See P. M. Townroe, *Industrial Location Decisions*, University of Birmingham, Centre for Urban and Regional Studies, Occasional Paper No. 15, 1971.

latter advantage relates primarily to new enterprises (many of them joint ventures) in the food-processing sector. Inevitably, there are also cases where political and cultural factors seem in the final analysis to be the determining factor in bringing industry here.

On apriori and empirical grounds, therefore, we can conclude that Ireland's major advantages consist of our financial inducements and, to a much smaller extent, our low-efficiency wages, the latter affecting not only direct labour costs but also the costs of ancillary services necessary for the operation of the plant.

The theory of direct investment attempts to explain the cause and direction of international capital flows. Merely to establish that the level of foreign capital stock in a particular country is less than optimal, however, helps in no way to determine the rate at which the gap between the desired and actual stock level is closed.[66] Theory indicates that an increase in financial inducements or a relative reduction in the efficiency-wage will, *ceteris paribus*, exert a positive influence on the foreign investment inflow. However, neither theory nor empirical work has yet been able to provide any firm quantification of the responsiveness of the investment inflow to changes in the independent variables. Any attempt to explain the rate of foreign investment would obviously have to take into account the rate of growth of the investing and recipient country's market. In Ireland's case, an important determinant of investment in manufacturing is likely to be the rate of growth in export markets or the investing country's markets (often they are the same).[67] R. S. Howard's study of industrial movement in Britain lends authoritative support to this view. During the sixties, he discovered that growth in the parent company's sales was the crucial factor inducing the company to expand into a different location. Most interregional movement, he found, consists of the setting up of additional branches rather than transfers.[68] The rate of foreign investment in services (distribution, property, banking etc.), on the other hand, is more likely to be determined by the recipient country's economic performance.

SUMMARY AND CONCLUSION

Since 1947, Ireland has benefited from a persistent net inflow of capital from abroad. The cumulative net inflow rose from £171m. during the years 1947-58 to £357m. during the years 1959-70. In constant price terms, of course, the contrast between the two periods is much less pronounced:

[66] Often the problem is avoided by assuming instantaneous capital adjustments, as for example in M. C. Kemp, *The Pure Theory of Trade and International Investment* (Prentice-Hall: New Jersey) 1969.

[67] This runs counter to the usual presumption that market size and market growth in the recipient country is the crucial factor, but is a logical consequence of the small size of the Irish market and the export orientation of direct manufacturing investment in this country.

[68] R. S. Howard, "The Movement of Industry: Its Role and Generation", paper read to Regional Studies Association Conference in Cambridge (England) September 1971. A "transfer" occurs when the opening of a new branch in one area is associated with a plant closure in another area.

the later period inflow then exceeds the early period inflow by 58 per cent.

If, instead of the capital inflow, the cumulative current balance of payments deficit is considered, we arrive at the surprising conclusion that the cumulative deficit in real terms was actually higher in the period 1947-58 than in the succeeding period 1959-70. Put in another way, it thus appears that net real foreign disinvestment was actually *greater* in the early post-War period than in the last eleven years.

By international standards, Ireland can be described as a "moderate" capital-inflow country, although relative to countries to comparable size and at a roughly similar stage of economic development, our capital inflow over the last decade could be described as slightly above average. Nevertheless, countries such as Israel, Cyprus, Greece and Mexico have experienced capital inflows well in excess of Ireland's.

A remarkable feature of the period 1959-70 has been the steady increase in the level of external reserves, in contrast to the decline in the 1947-58 period. The external reserves ratio (i.e. reserves as a percentage of merchandise imports) has, however, fallen considerably since the War, but still remains high in comparison with most other countries.

Turning to the composition of the net capital inflow, we find that net foreign borrowing by government and state-sponsored bodies accounts for 37 per cent of the inflow, although admittedly this figure is much inflated by the large borrowings in 1969 and 1970. One-third of the net capital inflow over this period is recorded as direct investment inflow. The remaining 30 per cent is attributable to miscellaneous items such as changes in the net external assets of the non-associated banks, portfolio transactions, life assurance premiums etc. A partial breakdown of the gross *direct* investment inflow was also attempted. According to our estimates, the amount of foreign capital brought directly into this country by new foreign manufacturing enterprises does not exceed £84m. less than a quarter of the total *net* capital inflow 1959-70 and presumably an even smaller proportion of the *gross* capital inflow. This fact should warn us against overestimating the impact of new industry investment on the inflow of capital from abroad.

Data limitations precluded any further investigation of the composition of the capital inflow. Improvements in the quality and coverage of Ireland's capital account transactions are obviously needed. The CSO are examining the possibility of introducing a capital survey which would monitor direct investment transactions more closely than has hitherto been possible. In addition improvements in the structure and content of balance of payments statistics may be expected to follow from the investigations being carried out under the aegis of the Committee on Statistical Priorities.

The implications of direct overseas investment in new manufacturing enterprises have attracted increasing attention in recent years. The importance of overseas investment to Ireland is underlined by the fact that 74 per cent of the investment by IDA-sponsored enterprises during the sixties was foreign-owned. Investment by U.S. companies constituted 34 per cent of the total, followed by Britain with 29 per cent. Germany with 10 per cent and all other countries with the remaining 27 per cent.

As in many other countries we find that foreign plants tend to be larger in size and more export-oriented than comparable domestic enterprises. Although 20 per cent of firms established before 1969 had undertaken major expansions of their plants, most new manufacturing investment (perhaps up to 90 per cent in value terms) still takes the form of the creation of new plants rather than additions to already existing ones. The operation of the export-tax relief scheme in conjunction with their respective country's tax code gives American and British firms a powerful incentive to reinvest rather than repatriate profits earned by their Irish subsidiaries, but the reinvestment does not necessarily have to be in the Irish subsidiary.[69]

An attempt was made to estimate the cost of the financial inducements offered by the government to new foreign-owned manufacturing enterprises. According to our estimates, they received £32m. in grants and £20m. in tax remission (due to the operation of export tax relief) since 1959.[70] While the figures are necessarily rough, they indicate clearly the relative inexpensiveness of the export tax relief scheme to date.[71] Furthermore, not all of the concession accrues to the foreign firms; a certain part, which we are unable to quantify, probably consists of a transfer of tax revenue from Ireland to Britain and the United States. A study by MacCarvill indicates that Ireland's system of financial inducements is extremely generous relative to other European countries, although only marginally more attractive than that offered by Northern Ireland.

The conventional analysis of the gains to the host country from specifically foreign investment provides little assistance in evaluating the benefits of new foreign industry in Ireland. These gains depend on the non-appropriation by the foreign subsidiary of the full social product resulting from the capital, managerial skills and technical knowledge that it transplants to the host country. Typical leakages are: (a) manpower training and (b) productivity increases more or less forced on domestic industries in order to compete with the foreign subsidiaries. It may be doubted if either of these factors is crucially important in the Irish context. Much of the training costs incurred by foreign firms is covered by State grants and in some cases the requisite training is provided directly by the Government itself. The "demonstration" effect of foreign firms is also of limited importance owing to the non-existence of directly competing domestic firms. The banks are an outstanding exception to prove the rule. Spillover

[69] Figures supplied to the author by the United States Department of Commerce indicate that $40m. out of $41m. earned by U.S. subsidiaries in Ireland in 1969 was reinvested. Provisional figures for 1970 reveal an exactly similar pattern.

[70] Figures calculated from Table 7 for period 1959-71 inclusive. Total grants are multiplied by 0·74, total export tax relief by 0·50, to estimate the share of these concessions attributable to foreign firms. These figures exclude Shannon.

[71] Whether this will remain the case is another matter. On the one hand, the cost of the tax relief scheme, as Table 7 shows, has expanded rapidly in the last few years. On the other hand, the number of firms which have ceased to be eligible for full tax relief will be increasing from now on. Another point worth noting is that transfer-pricing practices by multinational enterprises will if anything always tend to increase the amount of apparent tax lost.

productivity effects are also curtailed by the small degree of interdependence between different Irish industries. Payment of corporation taxes is another frequently-cited benefit of foreign investment, obviously inapplicable to Ireland in the short-run.

In the final analysis, the fundamental benefit conferred on the Irish economy by foreign firms is that without them industrial growth would not have occurred to anything like the same extent during the last decade and a half. Instead of being seen, as they are in Europe and Britain as competing with domestic firms in demand for labour and other resources, foreign subsidiaries may fairly be regarded here as offering employment and availing of infrastructure facilities which would otherwise not be used. The justification for financial inducements could therefore be based on three distinct but not mutually exclusive arguments: first that money costs do not accurately reflect opportunity costs: secondly, on infant-industry grounds, that new firms are burdened with exceptionally high operating costs during the first few years after establishment, as suitable labour is sought and recruited and managerial procedures appropriate to the new environment are devised;[72] and thirdly financial inducements may be necessary because new firms especially those establishing in this country for the first time, require a special incentive to induce them to acquire information on the facilities available in this country and to make a realistic appraisal of the degree of risk and inconvenience involved in investing here.[73] Studies of location decisions suggest that such inducements are indeed necessary since many firms make their choice of location on the basis of a very limited knowledge of alternatives. It is worth noting that if the infant industry argument is to apply, the foreign firm must after a few years find it worthwhile staying in the country even if the grants and tax concessions were withdrawn—a point of particular relevance to questionnaire evaluations of the importance of financial inducements in attracting industry. The fact that most reputable firms will wish to locate only in places where they feel their long run prospects are favourable after all grants and tax relief are exhausted does not necessarily imply that these concessions are unnecessary or redundant.[74]

The nature of a large proportion of Ireland's foreign direct investment in recent years is such as to avoid much of the obloquy surrounding foreign control of industry elsewhere in the world. First, the national composition of foreign ownership of new industry is quite diverse and none of the resentment found in Latin America or Europe by virtue of one

[72] The author breaks with tradition here: in Irish mythology, the infant-industry argument applies only to Irish firms.

[73] As John Blackwell pointed out to the author, there is an analogy between the "search" costs incurred by a worker seeking a new job and the costs to a firm of choosing a new location. The former has been subjected to careful analysis in a recent study of labour market behaviour. See Dale. T. Mortensen, "Job Search, the Duration of Unemployment, and the Phillips Curve", *American Economic Review*, December 1970.

[74] Another point worth bearing in mind is the competitiveness of the market for new investment. The level of incentives in this country is very much circumscribed by that offered elsewhere, particularly in Northern Ireland and the underdeveloped regions of Britain.

nation's predominance in direct investment inflows has made its appearance in Ireland. Secondly, due to tax-free profits on exports, controversy over tax-dodging through legally dubious transfer pricing practices between foreign subsidiaries and their parent company or other subsidiaries abroad is obviated (for another decade, at any rate). Thirdly, xenophobic resentment against the high profits earned by foreign firms, such as occurred in Australia some years ago when the Australian branch of General Motors published its accounts, has by and large been avoided, partly for the (not commendable) reason that foreign subsidiaries in Ireland are not required to provide information on their profitability and partly because, if any supernormal profits are being earned, they would typically be at the expense of foreign rather than domestic consumers since most of total sales by foreign subsidiaries are exported.[75] Finally, being export-orientated, foreign manufacturing firms in this country automatically avoid two accusations commonly encountered elsewhere in the world: the first is that the repatriation of dividends creates balance of payments problems, the second is that the superior (financial etc.) resources of foreign enterprises gives them an "unfair" advantage over their locally-owned counterparts.

From an economic welfare point of view, the type of foreign investment most likely to do harm is the establishment of foreign owned monopolies servicing the home market. Assuming the existence of no countervailing dynamic gains, the conventional monopoly losses are aggravated by unfavourable distribution effects and an outflow on the balance of payments account as monopoly profits are repatriated. Present legislation in Ireland is ill-equipped to deal with monopoly situations of this kind, partly perhaps because the policy of industrial protection was seen as inevitably involving the creation of monopoly, given the small size of the Irish market. As a result, the work of the Fair Trade Commission has so far been confined to the distribution sector and, although it has power to investigate a proposed merger, the Commission has no power to do anything further about it.[76] Legislation is at present being considered which, it is hoped, will considerably strengthen the hand of the government by giving the Minister of Industry and Commerce power to decide whether a proposed merger is acceptable and to enforce disinvestment in the event of an undesirable merger having already taken place. Such legislation, in conjunction with appropriate fiscal policy, should be sufficient to ensure

[75] The granting of tax exemption to foreign mining interests has provoked much criticism recently. The economics of an extractive industry, however, differs from that of manufacturing industry, since in the former case a national asset is being depleted and it seems reasonable for the Government to demand some form of compensation.

[76] The importance of existing legislation came to the fore in 1970 when Ready Mixed Concrete, a British company, made a bid for Roadstone Ltd., which, if successful, would have given it a commanding position in the ready-mixed concrete market in Ireland. It was the creation of a near-monopoly position, rather than the feeling that certain key sectors of the Irish economy should be preserved in domestic control, which in my view constituted the most salient argument against the proposed merger. In any event, there was nothing the government could have done to prevent the merger under present legislation.

that the potential economic disadvantages of foreign investment inflows are kept to a minimum.

A final point relates to the limitations of this paper. First, there is the question of stability of the capital inflow. Are capital flows sensitive to domestic demand conditions and/or to domestic credit conditions relative to those in the U.K.? If so, in a stabilising or destabilizing manner?[77] Secondly, the long-term balance of payments implications of the inflow must be examined. Although it may surprise some, current outflows in the form of repatriated profits, dividends and interest have increased *less* in absolute terms between 1960 and 1970 than corresponding inflows.[78] As matters stand in 1970, income from capital held abroad by Irish residents (including income from external reserves) amounts to £57m. compared with income from Irish capital held by non-residents of £38m. While adhering to the view that the *current* account implications of the capital inflow are not likely to be quantitatively important for some time to come, the issue still deserves detailed study. The case of Latin America, where outflow of profit and interest exceeds the gross inflow of private capital plus net government aid, gives some impression of the potential growth of these outgoings.[79]

[77] The issue is discussed briefly in a most interesting fashion by Kennedy and Dowling. *op. cit.*, pp. 43-44.

[78] The figures are as follows. Income from capital: *inflow* £30·9m. (1960); £56·9m. (1970); *outflow* £18·7m. (1960), £37·7m. (1970). SOURCE ISB. September 1971.

[79] See Oscar Braun, "Trade and Investment", p. 309 fn. in Dudley Seers and Leonard Joy, *Development in a Divided World*, Penguin Books, 1971.

DISCUSSION

Mr. John Ryan, I listened to Dr. McAleese's paper with great interest. I think that all of us who are concerned with Irish economic development are in his debt for the very clear and professional way in which he has shed further light on the important subject of the flow of funds into and out of the Irish economy. In the process, he has shown the considerable gaps in our present information.

In my day-to-day work I am concerned mainly with the financial problems of individual firms. In looking at the advantages and disadvantages of encouraging or discouraging capital inflows, I think there is something to be learned from the experience of individual firms. There is always a dilemma involved in seeking outside participation in the financing of a firm; there is a balance of advantage and disadvantage which each firm must strike for itself. The rate of growth can be increased by raising external finance but there is a price to be paid. If loan capital is raised, the firm undertakes obligations in relation to interest and repayment of capital. If equity subscription is sought, problems of loss of control arise.

With increased mobility of capital likely to follow from membership of the E.E.C., inflows and outflows of funds may be expected to increase. I am glad to learn of plans to monitor direct investment transactions more closely. I would like more information about the constituents of gross inflow figures, if possible distinguished between subscription for shares and long and medium-term loans. As Dr. McAleese indicates, there can be considerable variations between the capitalisation of firms reflecting the underlying practices and tax situations in the home countries of the promoters. In the long run, the terms on which inflows have taken place are important in relation to subsequent outflows.

I found Dr. McAleese's attempt to establish the level of direct foreign investment in industry very interesting. In looking at capital inflows to finance current assets, I think it is well to recognise that the IDA definition of "working capital" is a balancing figure. From the point of view of capital movements, one would like to know more about the distribution of current assets and liabilities as between the foreign and domestic sectors.

It is with great pleasure that I second the vote of thanks to Dr. McAleese.

Dr. Menton: Like the proposer and seconder of the vote of thanks to Dr. McAleese I would like to compliment him on the excellence of his analysis as well as his courage in tackling a subject which is bristling with so many difficulties.

Dr. McAleese refers at the outset of his paper to data limitations and the obvious need for improvement in both the quality and coverage of Ireland's balance of payments, particularly on capital account. Improvements in structure and content may be expected from the investigations being carried out under the aegis of the Committee on Statistical Requirements and Priorities. I may say, however, that irrespective of committees or commissions the improvement of our balance of payments statement has been a continuing concern of the CSO as long as I have had contact

with them and that stretches over a period of more than twenty years. I feel that despite its imperfections our statement compares very favourably with those of most other countries in regard to quality and coverage.

Dr. McAleese states on page 70 that "the omission of unremitted profits of subsidiaries of foreign firms from the balance of payments has the effect of reducing the official current account deficit and consequently the capital inflow below what they would otherwise be". He also refers on the same page to the practice of treating the "balance unaccounted for" as an item in the current account. I think there is a very good case for this if only because of the limitations of the capital account to which Dr. McAleese draws attention. Certainly, the inclusion of unremitted profits of foreign subsidiaries in the current account and the exclusion of the balance unaccounted for would enlarge the current deficit very substantially unless larger errors were found in the other direction in other components. The U.K. include unremitted profits in their statement. This is the convention recommended in the IMF. The practice here on the other hand is to regard as an outflow on current account only the actual dividends paid by subsidiaries instead of the total profits earned or alleged to be earned, less taxes paid in Ireland. This accords with the U.K. directive for national accounts where undistributed profits are included in savings.

If the IMF convention is adopted and undistributed profits included in the balance of payments statement then the concept of a basic balance i.e. balance on current account plus long-term capital account combined should be adopted. Dr. McAleese has shown how much we rely on capital inflows; this is a good case for the adoption of the basic balance concept. At present in this country the current account deficit is accepted generally as the measure of our imbalance on external account. To adopt the IMF convention and, thanks to a statistical quirk, increase overnight the extent of our imbalance by £20 to £30 million could lead to all kinds of confusion and misconceptions.

Subsuming the question of the treatment of undistributed profits many people—and I number myself among them—consider that the recent figures for the outturn on current account overestimate our deficit position. The continued buoyancy of our external reserves despite heavy current deficits lends some credence to this. For example, the 1971 deficit is of the order of £65 to £70 million despite the fact that external reserves in the twelve months to November last rose by over £90 million. This implies a net capital inflow of some £160 million or more than twice the previous highest figure of £75 million in 1969 shown in Table 1 of the paper. Figures of this order tend to stretch the credibility gap. Dr. Kieran Kennedy in his paper to the CII economic conference last week stated in a footnote to page 4 that "there is a strong suspicion in the minds of many economic analysts that the balance of payments figures in all years understate total exports, specially invisible exports, to some degree".

I have looked at the figures for 1965 to 1970 and found that while merchandise exports rose by 95 per cent in nominal terms and by 58 per cent in real terms, exports of services (excluding factor income) increased

by only 48 per cent in money terms and by 22 per cent in volume.

Dr. McAleese makes an interesting and to my mind rather salutary comment on page 66 of his paper when he points out that in *real terms* (i.e. when both series are deflated by the import price index) the cumulative current balance of payments deficit in the 1959-70 period turns out to be less than the corresponding figure for 1947-59. Some commentators in recent years have tended to be overawed by the size of recent balance of payments deficits in current terms and have called for contraction without bearing in mind first, the fact that in real terms these deficits have not been exceptionally large historically, secondly, that our external reserves have continued to expand rapidly in nominal terms and remain high by international standards and thirdly, that in any event given our external reserves position, what really matters is the purpose for which the deficit has been incurred.

Dr. McAleese's discussion of the determinants of investment flows is especially interesting and highlights a number of points which are relevant for policy purposes. He has set out clearly the issues involved and in some cases has bravely attempted to quantify his arguments. A number of these issues deserve to be followed up and researched in depth.

I should like finally to refer to Dr. McAleese's interesting commentary on re-investment rates on pp. 87-88 of his paper. From one point of view it is disappointing to learn that firms which have set up in Ireland have not subsequently expanded their investment in this country to a significant extent. As a consequence, we have to rely on "repeated injection" of new overseas firms as the main source of growth. Nevertheless this is useful information in that it is clear that considerable effort must be expended in attracting new industry from abroad. No doubt, EEC entry will help considerably in this respect as American and other firms endeavour to get behind the EEC common external tariff.

Mr. Broderick said he wished to be associated with the other speakers in congratulating Dr. McAleese on a very useful and interesting paper. It was not often that a paper relating to the balance of payments was presented and this fact made the present paper a valuable document.

Limitation of data had been mentioned in the paper and by other speakers. It should be pointed out, however, that certain improvements in classifying available data had been made in recent years and that from 1970 a capital inquiry into the transaction of all branches and subsidiaries of foreign concerns operating in the State had been introduced. This would go some way to meeting deficiencies in available data but it was not to be expected that detailed information compiled from this inquiry would be published for a number of years.

Dr. McAleese has suggested that the capital inflows might be underestimated. This, of course, implies underestimation of current account deficits. On the other hand, Dr. Menton, who is an expert on balance of payments, is of the opinion that the current account deficits in recent years are overstated. When two eminent experts differ in their opinions surely it is reasonable for the Central Statistics Office to take the middle

course! Indeed this confirms me in my view that our estimates are reasonably accurate.

As regards the treatment of the undistributed profits, the UN system omits these from the balance of payments while the IMF system incorporates them as flows on current accounts with offsetting flows on capital account. The C.S.O. practice follows that of the UN.

Mr. Ryan drew attention to an outflow of direct investment capital in 1969. In that year there was an unusually large inflow of capital through the non-associated banks and it appears likely that part of this was used for direct investment purposes by subsidiaries of foreign concerns operating here while at the same time they repaid some of their direct borrowing from abroad. This appears to be the most reasonable explanation of the negative entry for direct investment capital in 1969.

In conclusion I would like to again thank Dr. McAleese for his excellent paper.

Mr. John Martin: It is with some hesitation that I make any comments on Dr. McAleese's excellent paper because of my association with it. However, I feel it is possible to be less optimistic about the role of the capital inflow in Ireland especially in the light of the last few years experience.

Dr. McAleese stresses that Ireland was a "moderate" capital inflow country in the sixties but it is surely disquieting that, unlike the other small developed Western European countries in Table 3, there is no tendency for the capital inflow/GDFC ratio to fall in the second half of the decade. This in itself partly reflects the low ratio of investment to GNP in this country but it suggests that we may not be utilising the capital inflows in the most productive fashion because, as a footnote to the paper points out, the usefulness of foreign inflows can be judged by how well the host country expands investment and raises the growth rate.

These points take on further significance in the light of the huge capital inflow in 1971 of about £160m. due to an expected balance of payments deficit of about £70m. and a rise in the reserves of £91m. Taking the C.S.O.'S provisional total for merchandise imports in 1971 and the GDFC estimates for 1970 and 1971 from the Autumn issue of the Quarterly Commentary, it is interesting to note that the capital inflow/GDFC ratio for the period 1965-71 becomes 19·0 compared with 15·0 for the period 1965-70 (see Table 2) and the capital inflow/merchandise imports ratio increases to 10·2 in 1965-71 compared with 8·4 in 1965-70.

These increases are worrying and examination of the absolute figures in Table 1 suggests that a significant change may have occurred since 1969, especially in view of the poor growth rate since then.

With regard to the criticism of IDA sponsored firms that their growth rate, once established here, tends to be modest, Dr. McAleese suggests that his findings support this view. However, it is necessary to make two points here. He estimated that about 20 per cent of IDA firms operating in 1968 made significant expansions involving total capital expenditure of £21m. This is then stated to be 10 per cent of total capital expenditure

by IDA foreign firms over the decade. It would surely have been better to relate this to total capital expenditure from 1960-68 in view of the heavy capital expenditure since then (as evidence by the fact that, out of total grants payments of £29·9m. from 1960-70, £13·5m. came in 1969 and 1970—see Table 7). This makes it clear that the proportion of new investment in expansion to total investment in 1960-68 is certainly greater than 10 per cent—possibly in the region of 15-20 per cent.

This could still suggest that we are far from creating a self-sustaining industrial base but the relevant question is whether our experience with regard to expansion is unique or not? It would be very interesting to know whether Northern Ireland had a similar pattern in the last decade. Thus it would seem a good idea for the IDA to monitor foreign grant-aided firms because if our experience is unique then we must rely on attracting many more foreign firms to achieve our employment targets. Such firms are in limited supply and to attract them to this country might mean having to raise the level of grant payment. However, if a firm, once in production, commits itself to an investment in expansion here then surely the moral is that it finds Ireland a satisfactory and profitable location.

A minor, but by no means, insignificant argument in favour of our financial inducements not mentioned in the paper, is that we must offer some such package to remain competitive with other Western European countries in the market for new industry. The size of grants given here is partly determined by what is available elsewhere and to this extent the amount of grants paid contain a fixed "cost" element which we must offer if we hope to remain attractive for new firms. The wholesale bidding-up of incentives that has occurred in recent years is very disturbing and the EEC Commission is now finally attempting to grapple with this problem.

Finally, may I say that one of the most fruitful results of this paper has been that it has pointed out a number of areas in which further research is needed.

Mr. P. Geary: I should like to begin by congratulating Dermot McAleese on his most interesting paper. There are two issues arising out of the paper on which I wish to comment. The first concerns Dr. McAleese's statement that "the present level of capital inflow . . . is not unprecedently high". The statement is based on the data in his Table 1. They reveal that while the capital inflow ,measured at constant import prices, in the period 1959-1970 was 58 per cent higher than in the period 1947-1958, the total for the latter period was dominated by the years 1947-1952, when 80 per cent of the net inflow occurred. The total for the period 1958-1970 was dominated by the years 1965-1970, when 66 per cent of the net inflow occurred. Thus the precedent for the present rate of net capital inflow to which Dr. McAleese appeals is seen to be the period 1947-1952, a time presumably strongly influenced by post World War II readjustment and the Korean War. That the precedent exists, of course, is not in dispute; the issue is whether the precedent has any relevance to current balance of payments and other problems. In my view its relevance is very limited;

the circumstances which gave rise to it are too exceptional and remote. Any guide to the future behaviour of the balance of payments and the net inflow is much more likely to arise from a close scrutiny of the mid and late 1960s, rather than the years 1947-1952; the highly exceptional nature of those years is clearly revealed in Dr. McAleese's Table 2, where the net inflow is related to gross domestic fixed capital formation, merchandise imports and the current account deficit.

A similar point can be made about remarks arising in the discussion about the size of the balance of payments deficit itself. Again, suggestions that current deficits in recent years are not exceptional should be treated with reserve, as the period 1947-1952 has to be called on in support of statement. This is not, of course, to suggest that the deficits are the "dangerous"; any judgement of that nature would require a full evaluation of the economic policy of the Government.

The second point I'd like to raise concerns the data presented in Dr. McAleese's Table 4. They show that since 1965 a significant increase has occurred in the amount of foreign borrowing by the State sector, which includes State sponsored companies. The increase has been very marked in 1969 and 1970 when over 50 per cent of the net capital inflow was accounted for by the State sector. Of this amount, three-quarters was due to borrowing by the State companies. This raises the questions as to why this significant change has occurred and as to whether the Government has any rational portfolio policy. For example, is the change due to lower foreign interest rates, or have Irish people and institutions become reluctant to lend to the State sector? Optimism that we are witnessing a considered, well judged change in policy is tempered by the fact that the first major foreign borrowing of the 1960s was the 1966 Deutchemark loan, which high interest rates and predictable revaluations have elevated to the status of a major folly.

A final remark concerns points raised in the discussion about the very large net capital inflow in 1971. Without information as to what extent the inflow has been affected by short run movements of funds relating to the currency realignments of the second half of 1971 it seems unwise to draw too many conclusions.