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## **Can the American dream continue here?**

Alan Ahearne

Seven years have passed since former Tánaiste Mary Harney famously suggested that the Irish, though geographically closer to Berlin than Boston, are spiritually probably a lot closer to Boston than Berlin. Since then our economic ties to both the EU and the United States have strengthened. This increased integration with the world's two largest economic blocs has in large part reflected the activities of US multinational companies located on these shores. For many of these companies, Ireland plays a key role in their global business model and serves as a hugely successful platform for exports to the rest of Europe. In turn, inward foreign direct investment has proved critical to this country's rapid economic development.

The facts on the contribution of US firms to the Irish economy are striking. Ireland is host to no fewer than 600 US companies. These Irish operations employ more than 100,000 people, and estimates suggest that an additional 250,000 jobs are directly supported by these firms. Over three-quarters of our manufacturing exports are accounted for by US firms, with the bulk of these exports going to other EU countries. US firms last year paid an eye-popping €2.4 billion in corporation tax to the Irish Exchequer, amounting to one-third of the total corporation tax take.

If anything, our reliance on export-oriented multinationals located here is set to grow. For the past few years, Ireland's economic growth has been driven largely by spending that is sensitive to interest rates, such as construction and consumption of durable goods. The problem is that when interest rates rise (as they are now), spending of this type slows (as it is now). This slowing can often be dramatic. Having ridden on the back of interest-sensitive spending for nearly half a decade, we now need to change horses. If all goes well over the next few years, Ireland will again enjoy a period of export-led growth—and US firms located here will probably be at the forefront of that expansion. But if exports don't grow robustly enough to fill the gap left by the downshift in construction and consumption, then the Irish economy could struggle.

Fortunately, the recovery in the euro area economy should give a boost to Irish exports. As European business spending increases and consumers in Germany at last begin to loosen the purse strings, demand for goods and services produced in Ireland will strengthen. Recent large investments in Ireland by companies such as Google will mean that a greater share of these exports will comprise higher-value-added products and services.

In addition, the international fragmentation of production associated with globalisation and rapid advances in technologies should continue to benefit the Irish economy. More of these innovations will originate in Ireland, consistent with our ambitions to become an increasingly knowledge-based economy. Our recent success in attracting global research and development activities of companies such as Cisco, IBM, Intel, PepsiCo, and Wyeth augurs well on that score. But such activities require high-quality engineering and science graduates. The high failure rates in maths and science subjects in the Leaving Cert and several years' decline in CAO points for certain courses in the technological sector are worrying trends. Providing the brain power to fuel the knowledge-based economy will be a major challenge for the entire education system from pre-school to fourth level.

There are others reasons to be concerned. Production costs in Ireland have been rising at an unsustainable rate in recent years. A worrying gap has emerged between growth in wages and productivity, which poses a threat to profitability and future investment. The costs of other inputs have also soared, especially electricity and other utility charges. Ireland currently has the second highest inflation rate in the euro area, next only to catch-up country Slovenia. Any further losses in competitiveness may be difficult to reverse.

Moreover, it is not just the high level of costs that threatens our economy, but also expectations of high inflation in the future. Decisions by corporate leaders about where to locate global operations take into account projections of future costs. These forecasts are often produced using recent trends and extrapolating forward. In this regard, it is crucial that policymakers soon provide businesses with a credible plan to reduce inflation. It will be especially important to convince corporate leaders that Ireland has a wage formation process that is responsive to changing economic realities.

Another challenge relates to the intense global competition for mobile capital. Developing countries such as China, India, and new EU members in eastern Europe offer global companies well-educated workers at relatively low cost. Developed countries such as Germany, Spain, France, and the UK have made moves toward lower rates of corporation tax, aimed at wooing mobile investment. These efforts have seen the average corporation tax rate in the EU decline to a record-low level, eroding Ireland's advantage in this crucial area. Rightly, the Irish government has fiercely fought proposals from Brussels to harmonise corporate taxes across the EU.

Interestingly, the subsidiaries of US multinationals located in Ireland also appear to be under increasing competition from sister operations back in the United States. The dollar's tumble against the euro earlier this year has increased the cost (measured in dollars) of any expense that is priced in euros, including wages at Irish operations. On the other hand, to the extent that selling prices charged to European customers are set and invoiced in euros, the drop in the dollar has boosted dollar revenues. As a result, US firms in Ireland can naturally hedge against movements in the dollar. As long as a sufficient amount of the operation's sales are priced in euros, any increase in costs as a result of a falling dollar will be offset by increases in revenues, leaving operating profits unaffected by currency movements.

To a large degree, the presence of US multinationals in Ireland reflects their desire to be global companies. This allows multinationals to reap the substantial benefits of having a meaningful presence in every major region in the world. Among other advantages, global companies can exploit their presence around the world to reduce costs (for example, by outsourcing to low-cost locations such as eastern Europe), reduce the risk of costly disruptions to the supply of intermediate inputs, and use local knowledge to hone competitive strategies and build sales.

For US companies, Ireland has served as an extremely attractive gateway to Europe. Our economy has prospered as a result. In an increasingly competitive and complex global economy, we must continuously adapt to remain attractive. This is our greatest challenge.

Alan Ahearne is a former Federal Reserve economist. He currently lectures in economics at the Cairnes School of Business and Public Policy at NUI Galway and is a Research Fellow at Bruegel, the Brussels-based think tank.