Research Notes

The Effect of Redomiciled Plcs on GNP and the Irish Balance of Payments

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Introduction

Over the last few years a number of companies have relocated their headquarters to Ireland without generating any real activity in the economy in terms of employment or purchases of domestic inputs. These companies, referred to technically as redomiciled plcs, hold major investments elsewhere in the world but they have established a legal presence in Ireland. This means that their profits are paid to them in Ireland even though, under double taxation agreements, their tax liability arises in other jurisdictions. While they receive large profits in Ireland, because they are head quartered here, they pay out only some of these profits to their shareholders abroad when they declare a dividend. The retained earnings in Ireland enhance the value of the companies. As a result, the recorded inflows into the economy which these firms generate are much larger than the recorded outflows[1]. However, the benefits of the retained profits of redomiciled plcs are attributed to their foreign owners – there is no benefit to the Irish economy. Nonetheless, this has the effect of raising the measured current account surplus in the Balance of Payments and increasing the level of nominal GNP arising in Ireland.

National Accounting Treatment

The treatment of these redomiciled plcs in the national accounts differs from the treatment of the profits of many of the multinationals already operating in the Irish economy in the manufacturing or services sector because, crucially, these latter multinationals are not head quartered in Ireland. These latter multinational firms also generate very substantial profits in Ireland; however, these profits are entirely attributed to their foreign owners. They also generate major activity in the economy through employment, payment of tax and purchase of Irish goods and services. Even if the profits of the multinationals operating in manufacturing or services do not flow back out as dividends, but are instead retained as earnings, they are still treated as an outflow in the current account of the balance of payments (as reinvested earnings). Thus, while the profits of these companies raise GDP, the "reinvested earnings" are deducted to calculate GNP. This means that the substantial benefit to the Irish economy which arises from the activities of these companies as employers or taxpayers is fully accounted for but the

[1] This does not preclude a change in behaviour by these firms at some future date.

profits, which are due to their foreign owners, are excluded from GNP and the current account balance.

As discussed in the winter 2012 *Quarterly Economic Commentary,* redomiciled plcs, which are engaged in investing in global financial assets, have grown very rapidly in importance from a relatively low level in 2008. This growth may have been partly driven by expectations of changes in the tax code in other jurisdictions. Whatever the reason, they are now exerting a major impact on the Irish national accounts and on the current account of the balance of payments.

TABLE 1 Net Profit Flows for Redomiciled plcs., € million

	2009	2010	2011	2012
Undistributed Profits	1563	5177	5715	7396
As % of GDP	1.0	3.3	3.6	4.5
As % of GNP	1.2	4.0	4.5	5.5

Source: Author's calculations based on CSO Balance of Payments data and consultations with the CSO

Set out in Table 1 is an estimate of the undistributed profits of these companies between 2009 and 2012. As can be seen from the Table, from 2009 onwards there was a dramatic rise in the profits of these companies. While the dividends paid out have averaged just under 30 per cent of the total, these retained earnings are very large. As shown in Table 1, by 2012 they amounted to 5.5 per cent of GNP.

FIGURE 1 GNP adjusted for undistributed profits of redomiciled plcs.

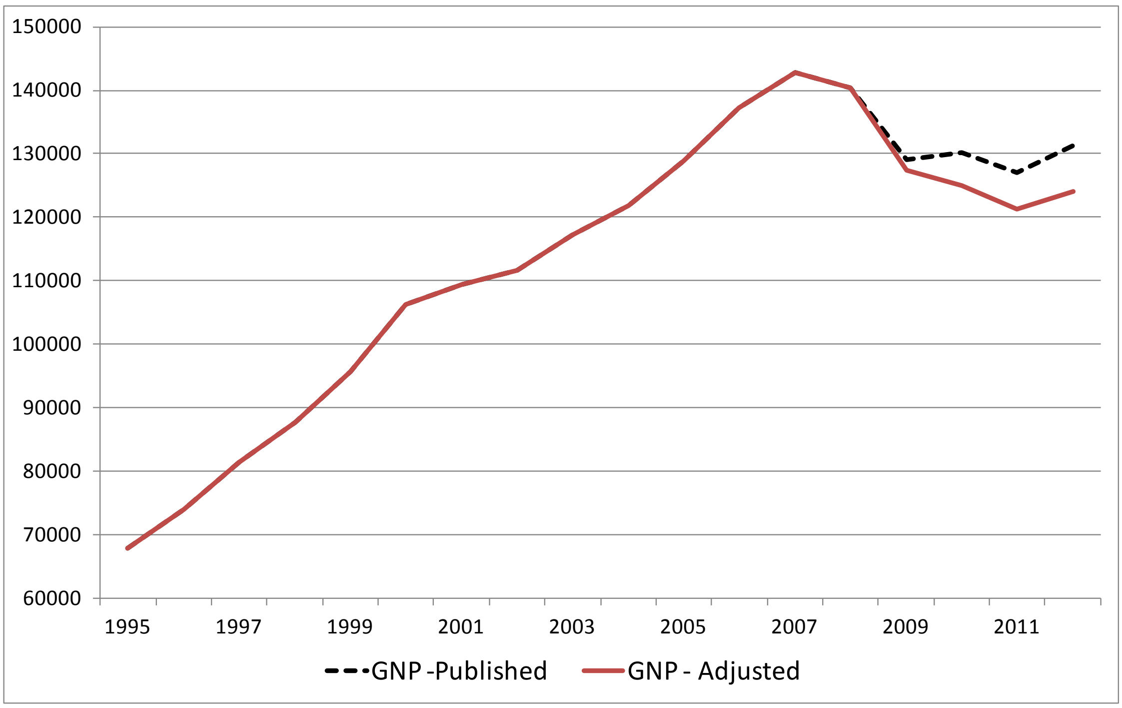

TABLE 2 Effect on Current account and real GNP

	2009	2010	2011	2012
	% of GNP			
Current account before adjustment	-2.8	1.4	1.4	6.1
Current account after adjustment	-4.1	-2.7	-3.2	0.6
Difference, percentage points	1.2	4.1	4.6	5.5
	Growth Rate, %			
GNP, volume, before adjustment	-8.1	0.9	-2.5	3.4
GNP, volume, after adjustment	-9.2	-1.9	-3.0	2.3
Difference, percentage points	1.1	2.9	0.5	1.1

Source: Author's calculations based on CSO Balance of Payments data and consultations with the CSO.

The change in the undistributed profits as a share of GNP is a measure of the extent to which the measurement of GNP has been inflated by the activity of these firms over the last five years, without a compensating reduction affecting GNP through increased factor outflows. As shown in Table 2, while the latest national accounts estimates for 2012 suggest that GNP grew by around 3.4 per cent on the previous year, if allowance is made for the undistributed profits of the redomiciled plcs, the growth rate would be around 2.3 per cent. With very substantial growth in 2010 in these undistributed profits, the growth rate of GNP for that year, which is shown in the national accounts as having been just under 1 per cent, would be transformed into a fall in GNP of around 1.9 per cent when these payments are taken into account. Because all of the flows into and out of Ireland occur as factor income there is no impact on the figures for GDP.

Figure 1 shows the path of GNP as published and the path as adjusted for the undistributed profits of redomiciled plcs. When this adjustment is made it can be seen that output fell more rapidly than had previously been thought in 2010, with a further fall in 2011. It is only in 2012 that a turnaround occurred when the economy saw a return to quite significant growth in underlying GNP, as well as in GNP as conventionally measured.

There is also a corresponding implied adjustment needed in the official current account figures, as shown in Table 2. This would imply that, instead of having a current account surplus of around 6.1 per cent of GNP in 2012, the underlying surplus was closer to 0.6 per cent of GNP.

When these undistributed profits or retained earnings are taken into account, it makes a big difference to the headline numbers for Ireland for 2012. A current account surplus of close to 6 per cent of GNP would imply that there was considerable scope for domestic demand to increase in the future, once deleveraging ends. However, if the true figure is closer to 0.6 per cent of GNP the scope for such an increase in domestic demand in coming years is more limited.

The fact that the underlying value of GNP is also lower than measured in the national accounts means that the burden of debt, when expressed as a percentage of GNP, is higher than we had thought.

A final implication of these data is that the large retained earnings of the redomiciled plcs raise Gross National Income – the base on which Irish contributions to the EU Budget are calculated. Thus, while these companies confer no significant benefit on the Irish economy in terms of employment or taxes, they do give rise to a higher EU budgetary contribution.