

# **IRELAND'S ECONOMIC PERFORMANCE: A VIEW FROM THE MNCs**

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## **Multinationals in Ireland**

Foreign-owned firms are very important to the Irish economy. Almost 1,200 foreign MNCs employ about 120,000 people in Ireland on a permanent basis, equivalent to over 11 per cent of all private sector employment. Exports from these firms amount to almost 50 per cent of Irish GDP. The equivalent figure for the UK is in the region of 25 per cent. Forfás (1998) shows that these firms had turnover of £25.7 billion in 1996 and spent £10.4 billion in the economy. These figures are growing at over 20 per cent each year. Almost 24 per cent of this expenditure is in the form of wages and salaries, with 43.5 per cent being spent on Irish services.

The MNC sector has been credited with providing a vital impetus to the recent performance of the economy (Forfás, 1996; Gray, 1997; NESC, 1998). Barry and Bradley (1997: 1-3) trace the development of MNCs in Ireland and argue that:

Much of the history of the Irish economy . . . can be explained in terms of the quite phenomenal growth of export oriented FDI in manufacturing. . . . The combination of geographical and compositional shift — to regions with faster growth and to goods with higher income elasticities — gave a long-term boost to the Irish growth rate, though this was masked at times by world recessions and domestic policy errors.

Gorg and Ruane (1997) show that the importance of FDI has been greater than its direct impact on output and employment and has facilitated industrial restructuring and sectoral adjustments in the econ-

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omy while maintaining exchange rate stability, aggregate job levels in manufacturing and regional dispersion. They credit a widespread consensus and continuity in overall policy — although there have been subtle and important shifts within this policy — as important factors. Duffy et al. (1997) agree that all Irish governments since the 1960s have consistently followed a policy of attracting FDI.

Clearly, therefore, foreign firms are very important to the performance of the Irish economy. But is the reverse also true? How important is the Irish economy and Ireland's economic performance to the multinationals? Clearly, Ireland's importance as a source of local demand will be limited due to its size. In addition, the importance in recent decades of the US as a source of FDI means that MNCs in Ireland are likely to have a high propensity to export, particularly to the EU (Taggart, 1997). As a result, the focus of any examination of dependence must be on supply conditions. This approach is encapsulated within the concept of national competitiveness as commonly applied.

Different aspects of the impact of national characteristics on MNC performance have been examined in various countries. Amongst others, Hood and Young (1988) focused on the impact of membership of the EU and openness to international trade on MNC location decisions. Others such as Cantwell (1991) identified the importance of agglomeration effects in influencing decisions. Work by Taggart (1991) on pharmaceutical firms supports Cantwell's conclusions in relation to the location of plants. Molero et al. (1995), in a study of foreign firms in Spain, found that a range of domestic factors had influenced the locating of facilities there. Lundvall (1992) identifies the importance of a strong national system of innovation and the possibility that this may also operate at sub-national levels, while the work of Fransman (1995) shows that national policies may be successfully modified to accommodate the demands of an integrated global economy. Irish research has tended to focus on policy issues and on the importance of the MNCs to the economy. As a result, despite their importance in Ireland, there has not been a great deal of research outside the state agencies to identify the key issues of importance that attract the MNCs to produce here. In addition, the issues that the managers of these firms consider to be the most important determinants of their performance in Ireland are unclear.

The implicit acceptance that the reliance is two-way is reflected in Irish economic policy and in numerous calls for interventions and actions on a range of issues. This paper explores the extent to which developments in the Irish economy are important to the performance of

the MNCs located here. The next two sections provide an overview of separate research projects that estimate changes in the competitiveness of the Irish economy and the extent to which these are perceived by the multinationals. An underlying assumption of this approach is that the Irish economy is important to the MNCs. Our analysis of the results of subjective assessment by managers in MNCs questions this assumption.

### **Ireland's Competitiveness**

Globalisation and the recognition that those countries that have engaged successfully in international trade in recent decades have also been growing the fastest have led to an increasing emphasis on the importance of achieving international competitiveness. This is an international development and has received considerable attention in Ireland. At the same time, a small industry has grown around measuring competitiveness and identifying, for individual countries, the areas in which they are achieving results and those areas where problems remain. International reports show that Ireland continues to build on the competitive base established in recent years and, starting from a position in the mid-20s a decade ago, is now among the 10 most competitive economies.

The two best-known annual reports are produced by IMD (IMD, 1999) and the World Economic Forum (WEF, 1999). The findings of both are quite similar and indicate that, while Ireland has made progress throughout the 1990s, the rate of progress has slowed and certain domestic problems will inhibit future advances. Both reports are compiled on the basis of analysis of published data and surveys undertaken by the respective bodies. The World Economic Forum ranks 59 countries according to a wide range of criteria. Ireland has risen one place to 10th in the ranking since 1998. Singapore remains the most competitive location by some distance, with the United States moving ahead of Hong Kong into 2nd place. Taiwan and Canada make up the remaining top 5 places. Ireland scores high in the categories of government, technology, finance and labour. However, it is a lot less competitive as a result of deficiencies in infrastructure and certain restrictions on interaction with the global economy. The extent of the infrastructural problem is indicated by the fact that the WEF rank Ireland 42nd for railroads and 48th for the cost of domestic air travel among the 59 countries included.

Moderate wage agreements mean that Ireland has managed to retain its labour cost competitiveness. However, there is evidence that

relatively high non-wage costs and restrictive hiring and firing practices reduce our competitiveness. Events in recent years have also begun to undermine confidence in political institutions, although government policies are regarded as pro-business. Ireland scores strongly in terms of macroeconomic performance, but an indicator of microeconomic competitiveness places Ireland in 17th place. In addition to deficient infrastructure, poor product design and a lack of innovation continue to inhibit the growth of value-added production. The importance of this analysis arises from the fact that macroeconomic results are outcomes and should be seen as indicators of past success. However, the variables in the microeconomic index are inputs and are therefore indicators of the potential for performance in the future.

The work of these research institutes has influenced economic thinking and policy in Ireland in recent years. The National Competitiveness Council undertakes similar research, but in more detail as its focus is exclusively on Ireland (National Competitiveness Council, 1999). In all these cases, there is a clear assumption that the broad range of economic policies and the overall performance of the economy is important to the firms that operate here. This approach has also influenced the research covered in the next section. However, the unusually important role of MNCs in the Irish economy means that this assumption requires closer examination.

### **Surveys of MNCs in Ireland**

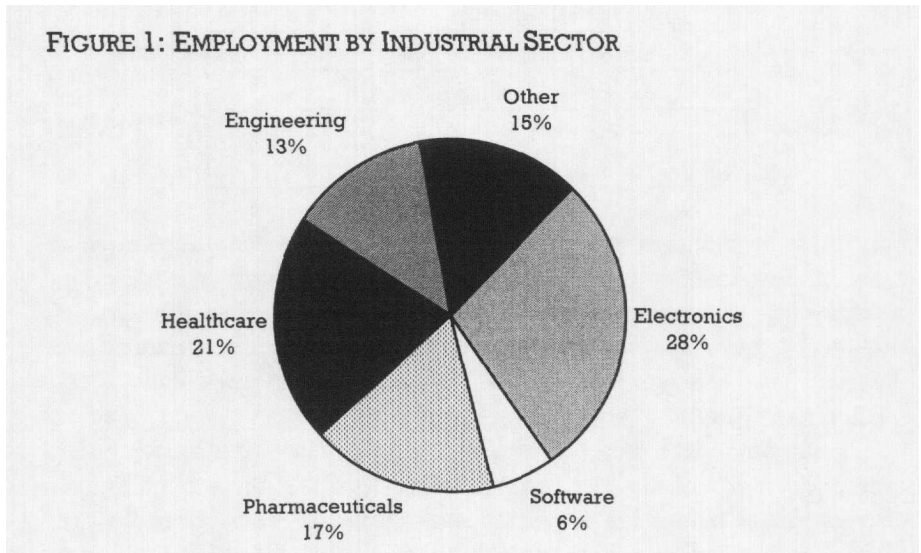
This section summarises the findings of a survey of the largest manufacturing MNCs operating in the Irish economy, carried out in 1998 and repeated in 1999. The purpose of the survey was to obtain information on the factors that are important for the continued competitiveness of the Irish economy as perceived by the most important foreign firms operating here. This section provides a brief overview of findings. Further details are contained in Hannigan (1999).

The main criterion for inclusion in the survey was that firms should be Irish-based subsidiaries of foreign-owned firms that also have plants outside Ireland. Only units engaged in manufacturing were included. The firms were selected on the basis of turnover at their Irish plant in 1997. The respondents were mostly either the Chief Executive or equivalent or the Financial Controller of the Irish operation. Eighty-seven firms participated in the 1999 survey. These firms employ 36,500 people, equivalent to about 30 per cent of employment in all foreign-owned industry and about 12 per cent of employment in all

manufacturing industry in Ireland. Over 92 per cent of employees are full-time and about 26 per cent have third-level qualifications. Almost 75 per cent of firms have experienced difficulties recruiting in the past year.

Participating firms operate in a range of sectors, as shown in Figure 1, but the largest single source of employment is the electronics sector.

FIGURE 1: EMPLOYMENT BY INDUSTRIAL SECTOR



Firms in the healthcare sector are the largest with average employment just over 600. The smallest are the pharmaceutical firms, with an average just under 300, while other sectors employ around 430 per firm. Total annual turnover in participating firms is in excess of £8.5 billion. Average turnover is just under £100 million but is only about £50 million for electronics firms, compared to £130 million for pharmaceutical firms. Almost 90 per cent of turnover is exported, with 84 per cent of firms each exporting over 95 per cent of their output.

Participants were asked to evaluate the importance of 30 factors that influence the competitiveness of their firms. The ten most important factors are shown in Table 1.

TABLE 1: TEN MOST IMPORTANT FACTORS FOR COMPETITIVENESS

1.	The education system
2.	Labour force availability
3.	Labour force flexibility
4.	Telecommunications infrastructure
5.	Corporate taxation
6.	Industrial relations
7.	Labour force skills
8.	Air and sea transport infrastructure
9.	Wage costs
10.	The rate of inflation

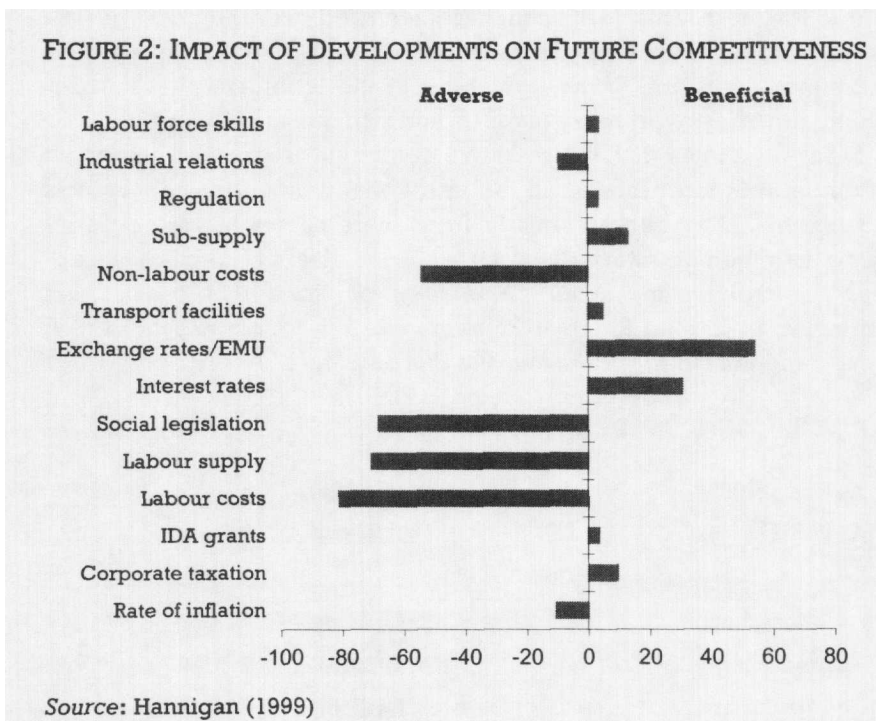
Labour-related issues are by far the most important determinants of competitiveness, filling six of the top ten places. Factors that affect the quality of the labour available are of the greatest importance. Corporate taxes, the transport and telecommunications infrastructure and inflation were also very important. Neither firm size nor sector of operation significantly affects this ranking.

Participants were asked to rate the performance of the Irish economy under each of the 30 headings given. In 1998, there was a close correlation between the importance assigned to each variable and Ireland's performance in regard to that variable. Ireland continues to perform well in regard to many of the most important issues. However, performance with regard to labour force availability and wage cost has disimproved considerably. This reflects the tightening of the labour market and means that the availability of under-utilised labour resources will be a lot less of an impetus to future growth. Performance in regard to inflation has slipped but EMU, lower interest rates and exchange rate stability have benefited competitiveness. Performance remains weak in regard to certain aspects of employment regulation and transport. The overall rating of Ireland's performance was very consistent across industrial sectors and firm size despite the fact that some sectors have been performing better than others.

Employment is expected to rise in 45 per cent of firms over the next year while 11.5 per cent are expecting to reduce employment. The software and pharmaceutical sectors foresee the highest growth with over 60 per cent of firms expecting to increase their employment. However, only 15 per cent of firms in the longer established food and textile sectors expect to be recruiting, while 40 per cent are expecting to reduce employment over the next year. Turnover is

forecast to rise by 8.8 per cent on average over the next year, compared to 9.2 per cent in the 1998 survey. Electronics and healthcare firms expect higher growth in the region of 12 per cent. However, 15 per cent of firms expect zero or negative growth, compared to 9 per cent in 1998.

Firms were asked their opinion on the impact of likely developments over the next year on their firm's competitiveness. In 1998, firms had been mildly pessimistic overall regarding the impact of imminent developments on competitiveness. Figure 2 shows the difference between the percentage of firms that expect a positive impact on competitiveness and the percentage that expect a detrimental effect as a result of each development.



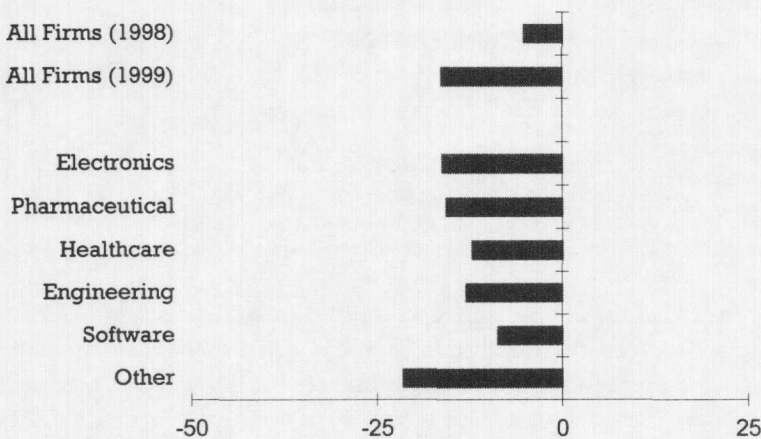
The tighter conditions being experienced in labour markets are beginning to impact on competitiveness and firms are concerned about increasing labour cost and difficulties accessing labour resources. General cost increases are also a source of concern. As in 1998, firms continue to be very concerned about the impact of EU social legislation on their competitiveness. These adverse factors are partially offset by the beneficial effects foreseen as a result of EMU, lower interest rates and greater certainty regarding corporate taxation. Firms oper-

ating in Ireland in excess of 25 years are most concerned about competitive losses over the near future. However, this is mostly as a result of the sectors in which these firms operate. In general, firms in the food and textile sectors foresee low growth and a loss of their competitive base. Software firms are most optimistic in outlook, although growth this year is expected to be lower than in 1998.

An indicator of confidence was also calculated. By construction, this indicator must lie in the range  $\pm 100$ , with zero indicating a neutral view of developments. The extreme values would only result in the unlikely event that all firms believed all developments would have the same effect on competitiveness. In 1998, firms were mildly pessimistic regarding the impact of developments in the immediate future on competitiveness. This pessimism has intensified over the year with the confidence indicator falling from  $-5.2$  to  $-16.2$  in 1999. This intensified pessimism is all due to the tightening of the labour market and resulting concerns over the availability and rising cost of labour.

Figure 3 shows that the negative sentiment is present across all sectors and is most intense in the traditional industries such as food and textiles. Managers in smaller firms were somewhat more pessimistic than their counterparts in larger firms. Fears of rising costs appear to explain this result. Managers of firms that have been producing in Ireland for over 25 years were the most pessimistic. A broad range of factors contributes to this outcome.

FIGURE 3: CONFIDENCE INDICATOR



Source: Hannigan (1999)

This indicator provides a single numeric measure of firms' confidence that can be recalculated at regular periods to identify, in advance, the likely impact of developments on competitiveness.

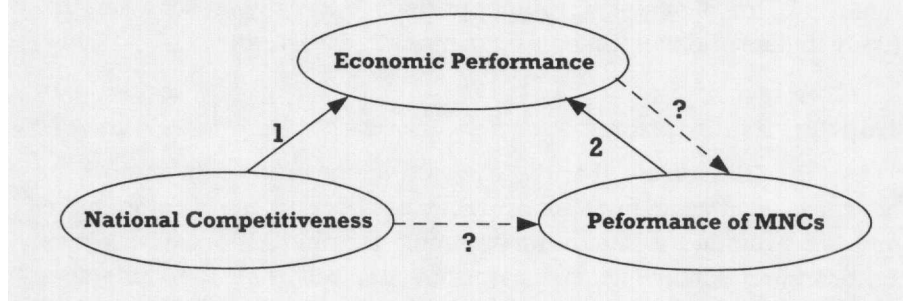
### **Implicit Assumptions**

These results indicate that there would seem to be something of a consensus that while the Irish economy has become more competitive and has provided a benign environment for multinationals, this may be changing somewhat. This assessment is based on the subjective views of managers in MNCs and other informed agents in the case of the international surveys. So what does this actually mean, if anything, for the MNCs operating in Ireland?

In fact, there are a number of implicit assumptions regarding causal relationships in the economy underlying this work and the idea that it is appropriate for policy to respond to these findings. The first is that national competitiveness, as measured by the WEF and IMD, has an impact on economic performance. In fact, this assumption is valid by definition, since the factors that are measured as part of the assessment of competitiveness are those that are known to determine performance. The second is that the performance of MNCs has an impact on economic performance. There can be little doubt, as discussed above, that this is true for Ireland. However, the relationship at the centre of the analysis in this paper concerns whether national competitiveness is an important determinant of the performance of the MNCs. If not, then policy conclusions may not follow automatically from the competitiveness rankings.

The relationships of interest are stylised in Figure 4. National competitiveness and the performance of the MNCs are related to the performance of the economy (Arrows 1 and 2). The causal relationship from Irish economic performance to the performance of the MNC sector is a lot less certain. MNCs do not rely to any extent on demand in Ireland. As a result, the MNC sector performed well in Ireland, even through the 1980s when Irish indigenous industry went through a major shakeout. But does national competitiveness drive economic performance through influencing the performance of the MNCs?

FIGURE 4: CAUSAL RELATIONSHIPS IN THE ECONOMY



The survey described earlier was analysed to see if there was any evidence to support the assumption that national competitiveness, as commonly measured, is a key determinant of the performance of MNCs located in Ireland.

### Forecasts and Performance

Most of the survey results summarised earlier rely on subjective perceptions regarding the existing situation and the effect that imminent events will have on performance. It is worthwhile considering to what extent managers may be in a position to reach an accurate conclusion when faced with a request such as this. To get an idea of their ability in this regard, the survey was analysed to identify the extent to which expectations were subsequently proven to be well founded. Managers were asked to forecast the expected rise in their firm's turnover in the following 12 months. The majority of forecasts in 1998 indicated an increase in turnover in the 5 to 15 per cent range. However, these proved to be remarkably inaccurate when compared to the actual increase in turnover, as recorded by these firms in the 1999 survey.

This outcome is shown in Figure 5. Two points are worth noting as the start. First, since forecasts tend to be recorded in rounded intervals — for example, 5, 10 or 15 per cent — we would not expect precise forecasts. Second, since this comparison requires a full dataset over both years, and the survey is designed to cover the largest firms in each year, the number of firms involved in this stage of the analysis is reduced by about 50 per cent.

The most noticeable point about Figure 5 is the extent of the divergence between the forecast and the actual outcome. An accurate forecast would lie along the central upward sloping line on the graph. In fact, few even come close. The two outer lines divide the population into three, approximately equal, groups. Firms in the group between

the two lines (which are hereinafter referred to as Group B) are considered to be accurate forecasters. Their actual growth was within 10 percentage points of their forecast. Above these are the pessimists — Group A. Their forecast was more than 10 percentage points less than the outcome. Group C — the optimists — achieved an outcome more than 10 percentage points below expectations. Even a brief glance at the graph indicates that many firms were widely inaccurate in their expectations.

FIGURE 5: PERCENTAGE CHANGE IN TURNOVER 1997-98

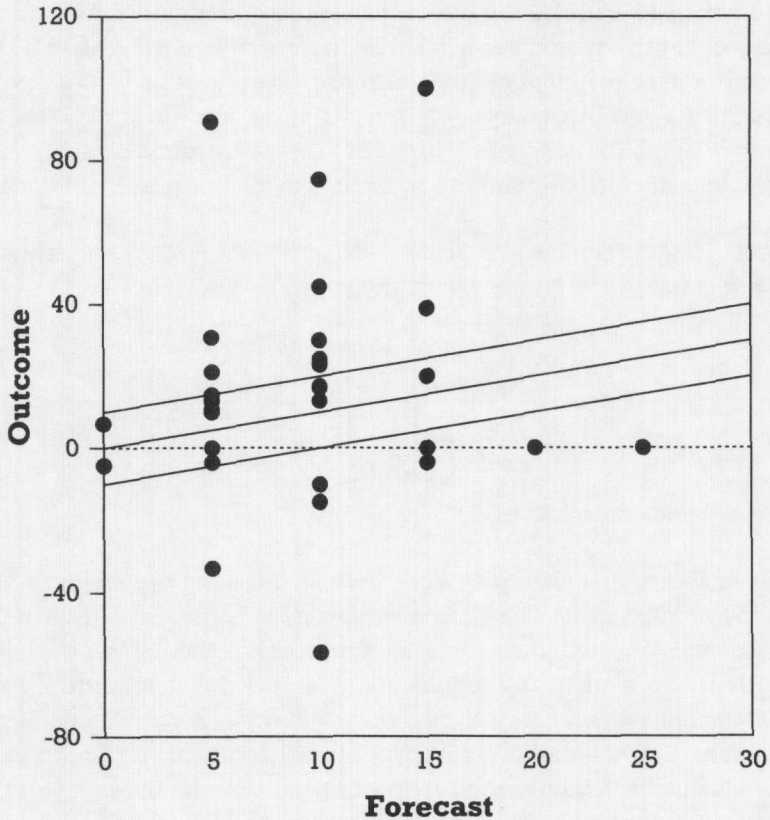


Table 2 shows the average forecasts for firms in each group. It is noticeable that the highest forecasts in 1998 came from the “optimistic” firms. It is also worth noting, at this stage, that the greatest increase in expected growth in 1999 comes from those firms whose forecasts proved to be accurate in 1998-99.

TABLE 2: AVERAGE GROWTH FORECASTS

	1998	1999
<i>Group A</i>	9.5	10.0
<i>Group B</i>	6.3	16.7
<i>Group C</i>	13.9	10.4

Source: Author's calculations

Data obtained elsewhere in the survey make it possible to check for consistency in this characterisation of firms. As detailed above, firms were asked to indicate the effect that certain imminent developments in the economy would have on their competitiveness. Table 3 compares the average expectations of these three groups in this regard. To make for easier observation, these figures are a transformed representation of the answers. However, the ordering has been maintained and the higher numbers indicate a more optimistic outcome.

TABLE 3: INDICATORS OF HOW MNCs VIEW PROSPECTS (LOWER NUMBERS INDICATE GREATER PESSIMISM)

	1998	1999
<i>Group A</i>	5.96	4.27
<i>Group B</i>	19.61	18.52
<i>Group C</i>	21.74	4.85

Source: Author's calculations

Table 3 shows that Group C were indeed the most optimistic in their outlook in 1998 while Group A were the most pessimistic. An ANOVA test on the original data showed the variation between the three groups to be statistically significant. This is additional evidence for the characterisation given to this group. However, there is no significant change in the expected impact of developments in the economy on performance for the accurate forecasters, despite the fact that their expected growth in 1999 is much higher than in 1998. Neither is there any change in the expectations of the "pessimistic" group.

So how is this to be interpreted? Two alternatives are possible. The first is that the optimistic firms in Group C belatedly recognise the importance of developments in the economy on their performance. They learn from their mistakes and revise down their forecasts for the coming year to coincide with the less benign economic environment that was identified earlier. This would support the idea that develop-

ments in the economy are important in determining performance. However, this is an asymmetric explanation, since it implies that the Group A firms don't learn in a similar manner. They expect the same impact from outside factors and expect similar growth as the Group C firms, despite the fact that this approach led to a substantial underestimation of performance in the previous year.

The alternative explanation uses the fact that the Group B firms — whose forecasts proved accurate in 1998–99 — increase their current forecast although they know that the economic environment in Ireland has not improved. The explanation for this is that developments in the Irish economy are not seen as being particularly important for their growth, while the global demand outlook has improved with the easing of the Asian crisis. Managers of the Group A firms would probably agree with this and take the credit for their out-performance in the previous year. On the other hand, there is an incentive for the Group C firms to become acutely aware of the economic environment as a mitigating factor in explaining their poor performance relative to expectations. The implication of accepting this explanation would be that expected changes in Ireland's competitiveness are not given much weight by managers in MNCs when formulating their expectations of performance in the year ahead.

### **How Important is the Performance of the Irish Economy to the MNCs?**

This paper has reported briefly on some results from the initial years of the annual survey of multinational firms operating in Ireland. It also provided a summary of international reports on the performance of the economy. The paper examined an underlying assumption of much of the research that is undertaken, and that has come to have a considerable influence on Irish economic policy making. This is the idea that developments in the economy, whether they are generated as a result of domestic initiatives or problems, or whether they result from external developments, are important for the continued growth of MNCs located in Ireland.

While inconclusive, certain findings suggest that the performance of the MNC sector may be more independent of the economy than is often supposed. The results suggest that the broad range of developments in the Irish economy may not be particularly important for the performance of the MNC sector. This explanation is in keeping with the known fact that the MNCs located in Ireland did well in earlier periods when the economy was performing poorly and that the upturn in

FDI during the 1990s preceded the high growth and competitive gains of recent years. If this is the case, then many of the arguments forwarded for policy initiatives may not be as valid as is often supposed.

Some points should be remembered before drawing a strong conclusion from this investigation. First, the research is based on a limited sample of firms. Second, it is for one year only and may have short-run validity only. Third, there are important exceptions: the tax rate is important to the MNCs and the availability of skilled labour is a key factor. However, there is little chance of any major change to the tax rates and labour market conditions may not be as important a consideration for an established firm as for a firm considering an inward investment into Ireland. Thus, these factors would not be included in the information set on which performance expectations are formed. Finally, some follow-up research would be required to uncover any differences of approach between those firms that did have accurate forecasts and the other firms. However, the findings so far do not disagree with the proposition that the MNCs are much more important to the performance of the Irish economy than changes in its performance are to the MNCs.

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