Meeting by CSO with Irish Fiscal Advisory Council (IFAC) and Department of Finance (DoF)
15 July 2016
CSO, Ardee Road

Attendees
CSO: Michael Connolly, Ruth O'Shaughnessy, Gordon Cavanagh, Michael Brennan
IFAC: Thomas Conefrey, Andrew Hannon
DoF: Laura Whymes, Ian Power, Feargal O'Brolcháin

Questions set by IFAC:

1. **Capital stock increase 2015:** What are the main drivers of the increase?
Answer
Mostly from company relocations, aircraft leasing is of lesser significance. Some of the sector detail in the CSO's Estimate of the Capital Stocks of Fixed Assets, of stocks and the associated depreciation, scheduled for publication by end-year, will need to be suppressed.

There are primary and secondary confidentiality issues to consider in what level of sector detail to provide, to prevent other companies in a given sector from being able to identify the data of competitor(s). The CSO cannot confirm that the capital stock increase is confined to any one sector.

2. **Offsetting effect of services imports has previously occurred but not in 2015?**
Answer
Yes, this is the case for the companies involved in the 2015 results. Contract manufacturing can happen without royalties being recorded in intermediate consumption.
Note also that company relocation can be in the form of a direct investment enterprise.

3. **Timing issues between exports and imports**
Answer
No, this is not the case.

4. **Timing of change in exports level**
Answer
The impact of the changes occurred in the main in Q1 2015. Their inclusion coincided with the CSO's annual benchmarking of the national accounts; we typically do not introduce changes in the intervening quarters (QNA results). Moreover, the CSO held several meetings over a number of months with the companies involved to get a fuller understanding of their corporate restructurings.

Other circumstances arise over the course of the year to affect company decisions e.g. the ongoing issue of BEPS and the pending closure of the "double Irish" scheme.

Note that the NIE results, in Table 1, include the variable Net National Product (NNP) which excludes the depreciation effect associated with the change in capital stocks.

5. **Q1 2016 decline in underlying capital investment**

Answer
Such capital formation has rebounded strongly since 2013/'14 from a low base and the decline can be viewed in that context. There isn't evidence to suggest from this quarterly result of any major diminution in the future of transactions in intangibles. From any given quarter to the next, such transactions can be "lumpy". The "on-shoring" of intangibles is likely to continue, reflecting the influence of BEPS.

6. **Re-domiciled plcs:** update on their current account impact?

Answer

Previously, the CSO indicated that the investment on equity credit reported in the quarterly BOP Table 2a was a good guide to the effect of re-domiciled plcs on the current account as such entities for a time dominated this variable. This, however, is no longer the case. The CSO is discussing how to provide information on re-domiciled plcs specifically but again there are confidentiality constraints to be considered.

7. **Adjustments to current account:** calculating an underlying estimate.

Answer
The CSO cannot suggest routes to follow, without breaching confidentiality.

8. **Depreciation:** details behind increase in 2015.

Answer
The CSO can confirm that the increase in mainly driven by MNEs. A time series for foreign- owned firms only is not possible. Some sectoral information will be provided in the "multinational" national accounts release planned for September 2016.

9. **Exports deflator:** what is used for goods and contract manufacturing?

Answer
The same deflator is used for merchandise exports and goods produced via contract manufacturing.

10. **GVA by sector and MNE release:** planned publication schedule?

Answer
This information, with suppression as necessary, will be provided in the releases planned for September 2016.

Questions set by DoF:

1. **Contract manufacturing: measured by proxy as the difference between merchandise trade and BOP trade, what are the drivers?**

Answer

There are new entities with newly-registered production, rather than from existing MNEs. Depreciation of assets as boosted GNP; had more profit been recorded, the profit would be reflected in factor income outflows, which would have reduced the scale of GNP growth.

Why is the depreciation associated with the R&D-related (intellectual property) assets not a factor outflow? Prior to ESA 2010, such assets were outside the asset boundary but now they are within it and the depreciation forms part of national income.

The change to imports of royalties in 2015; companies already operating here have brought onshore their royalties expenditure.

The CSO is not using the merchandise trade data to impute levels of merchanting and/or contract manufacturing. We ask companies directly for this information. The industrial production & turnover data is a good indicator of the full level of activity. It is split into "modern" and "traditional", the latter a good proxy for the indigenous economy.

2. **Intangibles asset investment and imports of R&D; change by different amounts?**

The lack of symmetry reflects the fact that some intangibles, such as goodwill and branding, are excluded from the asset boundary. They are instead recorded in the BoP capital account.

Other issues

The CSO confirmed that the institutional sector accounts are aligned with the NIE and will provide a split of capital investment by households and industries.

For the saving data measures in the sector accounts and the NIE, the CSO will continue to provide a 'walkthrough' from one to the other.

The CSO confirmed that the purchase by an Irish company of an IP (intellectual property) asset from abroad is recorded as a transaction and reflected in the BoP and Capital Formation results.

Sound bite

Eurostat is aware of the recent upwards revision to Irish GDP for 2015, published by the CSO on 12 July 2016.

Based on the preliminary information provided by the CSO, including data, the revision is plausible. Eurostat will therefore publish the new data in the coming days.

Eurostat will examine the methodology used in this revision in more detail by September, as part of the regular procedure which applies to all Member States.

On the record

This revision can been seen as an effect of increasing globalisation. It is primarily due to the relocation to Ireland of a limited number of big economic operators.

Q & A for on the record follow-up [optional]

- **Will there be an impact at EU/euro area level?**
  Yes, but of much smaller scale. The Irish economy accounts for around 2% of the euro area total.

- **Is this a one-off effect, or a permanent one?**
  This is in effect a level shift. Irish GDP is now significantly higher than it was in 2014, and future changes in GDP will be from this higher level.

- **Could this happen again?**
  Yes. As a consequence of globalisation, this could happen again if huge multinationals move their business around Europe or the globe. Indeed in the case that the move took place between two Member States, then there would be an offsetting double effect – an increase in GDP in one and a matching decrease in the second.

- **Is this like the 2006 revision of Greek GDP, which was eventually reduced by Eurostat?**
  No. The 2006 revision of Greek GDP involved a large number of changes in areas where there were a lack of hard data and the need to make assumptions and estimations. This Irish revision involves a small number of very large operations, for which hard data is available.

- **Can you give more details of the companies involved?**
  No. Due to statistical confidentiality rules we can give no further details.

- **How can Eurostat verify the figures if they are confidential?**
  The CSO have confirmed that Eurostat will have access to the data it needs to carry out its examination. This access will of course be subject to strict confidentiality.

- **Will this have an impact on Irish debt and deficit figures?**
  This upwards revision to GDP will have an impact on any indicator which is presented as a ratio to GDP, such as general government debt and deficit ratios. In the absence of any other changes, such ratios will fall as a simple mathematical result of an increase in GDP. It is however too early to speculate on the exact changes to the value of any specific indicator, as these will depend not only on the change in GDP (the denominator), but also on possible changes in the numerator.

- **How soon will these new figures be incorporated in Eurostat databases?**
  As quickly as possible in the coming days, initially for quarterly data and then for annual data. Due to statistical confidentiality issues, Eurostat will follow the Irish authorities in not publishing a full set of breakdowns where these could reveal any individual companies concerned.

More elements– FOR INTERNAL USE ONLY

[Redacted]

Contact point(s)

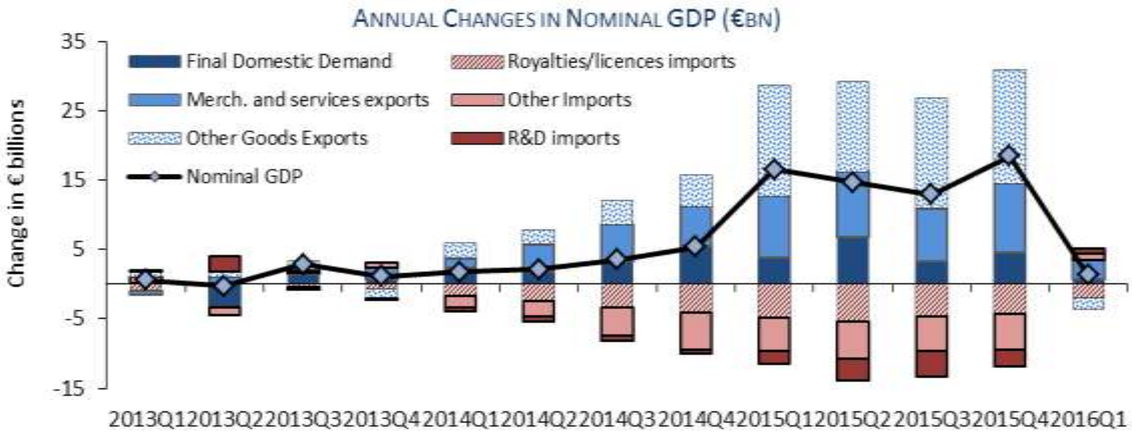
Tim Allen - Eurostat
Silke Stapel-Weber - Eurostat

IFAC Questions for Meeting with CSO, 15 July 2016

1. Regarding the €300 billion increase in the capital stock in 2015, could you provide a breakdown of the most significant drivers of the increase. Inversions/corporate restructurings and aircraft leasing were mentioned at the press briefing. Could we get an idea of the relative importance of the different factors please? What proportion of the capital stock is now aircraft?

2. Trade data would suggest goods exports were €111bn in 2015, while the national accounts figure is €195bn. This €84bn gap for 2015 compares to €22.3bn in 2014. Previously we have seen big increases in contract manufacturing; however these tended to be accompanied by corresponding increases in service imports, particularly royalties so that contract manufacturing was said not to exert any major influence on overall GDP. This offsetting through higher imports did not occur in 2015 as shown in the chart below which contributed to the very large positive contribution to net exports from contract manufacturing in 2015 (with a related impact on the current account of the BOP).

   Could you explain the nature of the contract manufacturing activity in 2015, in particular why the increase in exports from contract manufacturing do not appear to be offset by related imports as had been the case in the old QNA data. Will the CSO update the note on contract manufacturing which gave the value impact of this practice?



3. Related to (2), is there a possibility that timing issues are impacting the current figures for imports so that we could see higher imports in future quarters related to the very big increase in exports in 2015?

4. Looking at the QNA, the level shift in exports in 2015 appears to have occurred entirely in Q1 2015. Did the impact of all the various corporate restructurings/aircraft leasing etc all materialise in Q1? Some more information on the timing of the capital stock and subsequent output and export changes in 2015 would be helpful.

5. Underlying (excluding planes) machinery and equipment investment fell by 11 per cent on an annual basis in Q1. Could you provide any more details on the factors behind this drop.

6. Redomiciled PLCs: could you provide an update on their impact on the current account in 2015 (Chris mentioned this at the press briefing but I lost my note of the figure he quoted!).

7. What adjustments would you recommend making to the Current Account of the Balance of Payments to get the underlying picture (excluding redomiciled PLCs etc)?

8. Could you provide some more details on the big increase in depreciation in 2015. Is the majority of the increase in depreciation attributable to the assets of MNEs? Would it be possible to get a time series for depreciation attributable to foreign-owned firms?

9. How is the deflator for exports from contract manufacturing estimated? Would the deflator for goods exports as measured in the trade statistics be similar to the deflator on goods exports produced via contract manufacturing.

10. The detailed data on GVA by sector is very useful. Could you provide some information on when the new data will be published? Similarly for the release that reports GVA for foreign-owned MNEs and other sectors – when might this be published?

Questions for CSO on revisions to NIE revisions

Department of Finance

1. Estimating the effect of contract manufacturing

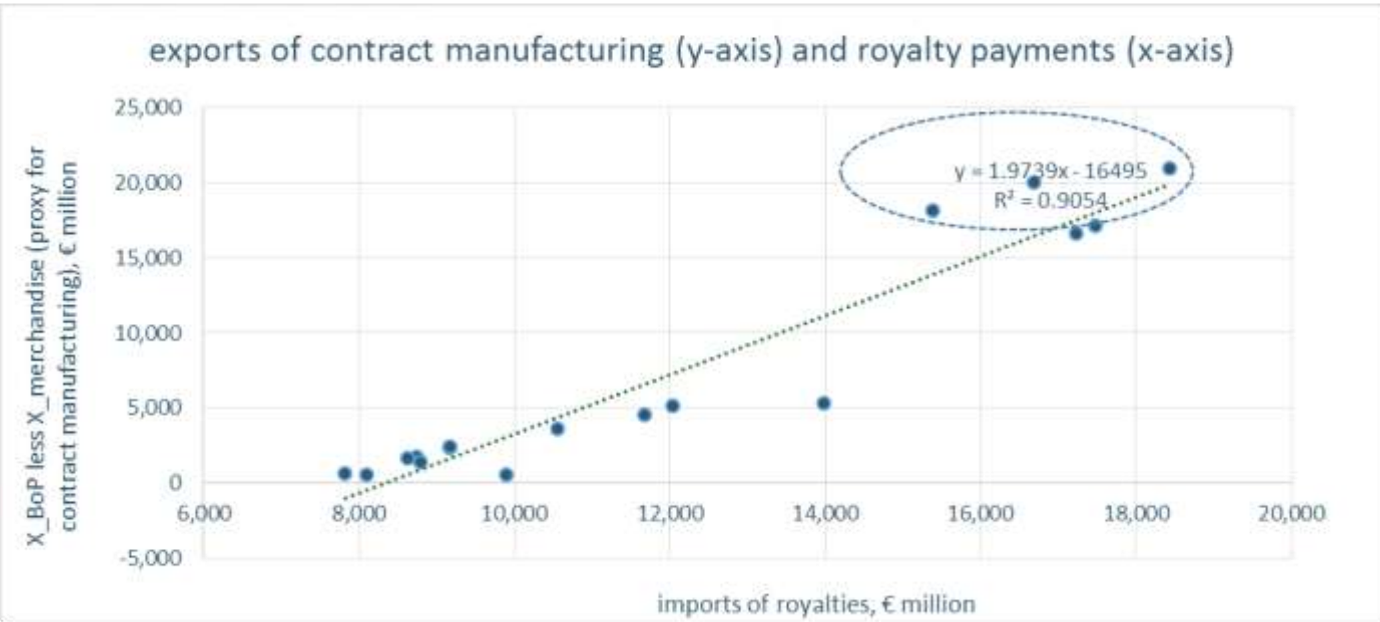
Proxying for the effect of contract manufacturing (CM) as the difference between BOP merchandise exports (net of merchanting) and trade values seen in the monthly stats, on the basis of revisions between the Q4 BOP release and this week's data this crudely suggests that the effect of contract manufacturing increased by some €47.3 billion in 2015.

Nominal GDP has been revised up €41 billion – we know upward revisions to operational leasing (mostly aircraft) contribute about €3.3 billion to this – leaving €37 billion unexplained/likely due to the CM channel?

Within this figure however about €6 billion of this is due to upward revisions in royalties imports. Other (non-CM related) factors boosting GDP (e.g. higher C/G) may have increased - but this still about €37 billion of an impact which seems likely due to CM effect.

<u>Getting at the type of activity behind this CM effect:</u>

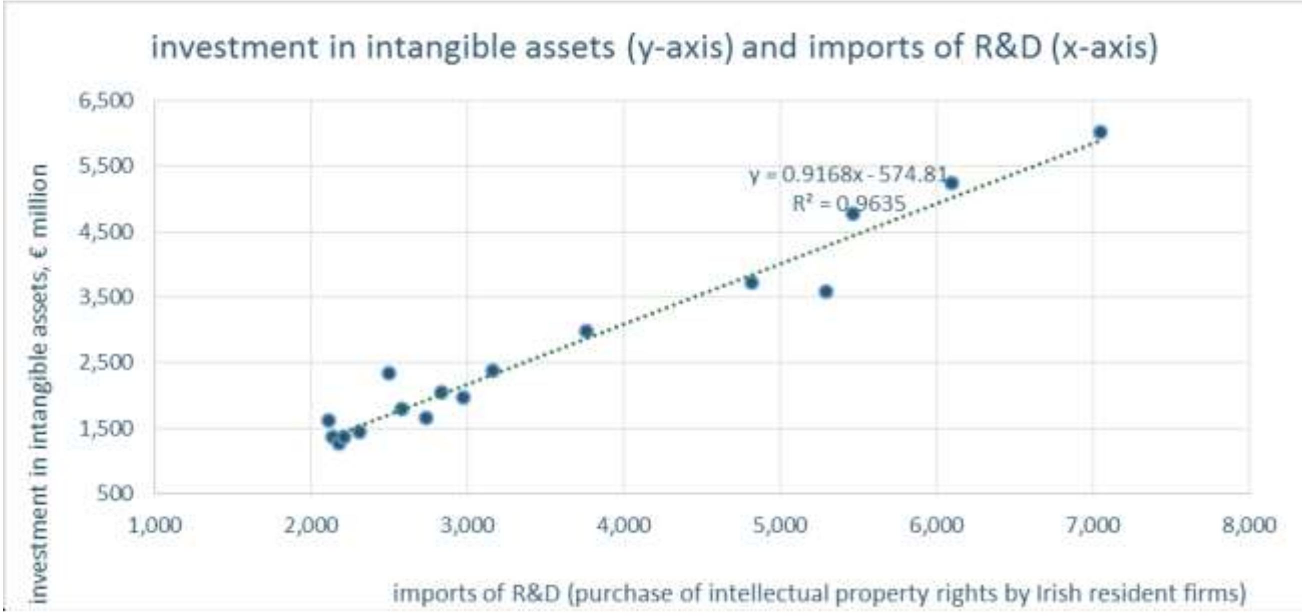
- Is the CM effect driven by newly re-domiciled Plcs re-locating in Q1 or is this impact arising from the restructuring of already existent MNC firms in Ireland?
- If CM effect were largely due to non- re-domiciled companies, this would surely be reflected by substantial profit outflows.
- It would seem then that CM is concentrated amongst re-domiciled companies (either newly located or pre-existing) explaining the sharp increase in GNP in the NIE figures. In other words this would explain the absence of correspondingly strong profit outflows.
- It seems puzzling that contract manufacturing related exports are not fully offset by services imports of royalties (see chart below). Can you give some further detail on what explains this?



- Has the limited increase in royalties got to do with some interaction with the IP on-shoring?
- Can the CSO give some detail on how contract manufacturing effects are measured in terms of data collation – is it on the basis of survey based direct reporting as opposed to accounts?

2. **The effect of intellectual property related factors**

   - On the issue of intellectual property–related imports, comparing vintages of BOP data on the import of R&D indicates that for 2015 as whole this element has gone up some €7 billion relative to the position as of Q4.
   - This seems far higher than the increase in intangible investment (+€3 billion) – what's driving this?
   - All else equal this would seem to suggest that changes in IP have negatively impacted the revision in GDP??



- We are puzzled as to the Q1 fall in imports of R&D and the corresponding decline in the level of intangible investment. Both appear now to be back at levels seen at the end of 2014 – does this imply that IP on-shoring is associated with a level shift in 2015 which is washing out of the figures now? Pipeline indications from the IDA seemed to suggest that this was in prospect for some time longer.

3. **Capital stock related impacts from NIE revisions**

- Related to the capital stock figures shown in Figure 6 of the CSO press conference slides – when do the CSO expect to be in a position to break capital stock down by sector?
- Revisions to capital stock in line with this release will form a key input to Budget 2017 calculations. We have already requested from S. Donnelly that the accompanying aggregate capital stock series by provided in line with the published Figure 6.
- It would be helpful in the meantime if the CSO could provide and indication of the breakdown of depreciation by asset type.
- NIE depreciation levels have not been published by sector in the way they were previously. Would it be possible to provide these?
- This creates difficulties in terms of estimating the capital stock for purposes of estimating potential output (and the output gap)