Box D: Macroeconomic Indicators for Ireland and Multinational Activities

The publication of the *2015 National Income and Expenditure* accounts and the accompanying balance of payments data revealed several distortions relating to multinational activities in Ireland. To deal with these distortions and to develop a greater insight into Irish economic activity, an expert group was assembled to advise the CSO on how to meet user needs.[1] The Economic Statistics Review Group (ESRG) compiled a report which was published by the CSO, along with responses from the CSO, on 3rd February 2017.[2] This Box examines the group's main recommendations and the indicators proposed for monitoring the Irish economy in the future.

To begin, it is worth considering what properties are needed to provide useful macroeconomic indicators for Ireland. A very useful measure for the public finances, and for understanding macroeconomic imbalances, would be a comprehensive aggregate that excludes obvious distortionary factors arising from the activities of multinational enterprises, which have little or no impact on domestic incomes and employment. Such an indicator would more closely capture the amount of economic activity that occurs in Ireland, and whose benefits flow to residents here. There are several uses for such a macroeconomic indicator, the most obvious of which include: (1) to examine the growth rate of the economy at any given moment in time; (2) to assess if the economy is above or below its potential level; and (3) to use as a denominator for ratios such as government debt and deficits. In addition to indicators of aggregate economic activity, indicators of potential imbalances, like the current account, have also been very difficult to interpret in recent times. This makes it challenging to discern the sustainability of ongoing economic developments.

The ESRG made recommendations under several headings, not all of which are discussed here. It was recommended that an adjusted indicator GNI* (read as 'GNI star') would be published. This indicator would correspond to:

GNI = Gross National Income, less retained earnings of re-domiciled PLCs and less depreciation of foreign-owned domestic capital*.

The first adjustment should ensure that retained earnings of redomiciled PLCs do not impact the recorded level of output in the Irish economy.[3] The second adjustment would ensure that balance sheet relocations and transactions would no longer impact on the level of activity recorded in Ireland, which was the case in 2015 (see IFAC (2016c)). These two adjustments would also be applied to the current account of the balance of payments to produce a consistent measure Current Account* (C/A*). It was proposed these adjusted measures would be published at both annual and quarterly frequency. In its response to the report, the CSO committed to producing these two series and publishing them alongside the National Income and Expenditure Accounts from June 2017 on an annual basis, with quarterly series to follow next year.

While no new data are yet published, the adjustments proposed should help move towards

[1] See IFAC (2016B) Box A: "Ireland's Revised National Accounts Statistics" for a review of the issues arising.

[2] Seamus Coffey (IFAC Chair) and Thomas Conefrey (then IFAC Chief Economist) were both members of the group.

[3] FitzGerald (2013) notes that the benefits of the retained earnings of re-domiciled plcs are attributed to their foreign owners, with no benefit to the Irish economy.

a more useful indicator of the level of national income in Ireland. Depreciation of relocated capital assets was associated with the increase in the capital stock, which led the jump in measured output in 2015. Therefore, the adjustment for this item should help to get a more realistic measure of national income in Ireland. The effect of redomiciled PLCs has been an issue for some time, particularly for the current account of the balance of payments and GNP. One would hope that the new C/A* might be able to provide appropriate guidance as to the external position of the Irish economy, and act as an input into assessing the position of the Irish economy relative to its potential.[4]

To get a better sense of the split between activities of foreign-owned multinationals and the domestic economy, the ESRG recommended that both the National Income and Expenditure accounts and the Non-Financial Corporate Sector of the Institutional sector accounts would be presented in a foreign and domestic ownership split. It was proposed that firms in the CSO's large cases unit (all of which are foreign-owned) and remaining firms (which would mainly, but not exclusively, be domestically-owned) be identified separately. The CSO has committed to implementing this presentation to elements of both the national accounts and sector accounts, and will examine other presentations of data that will be potentially useful to users. This would be a welcome step towards providing better assessments of developments in Ireland, and would help to address long-standing issues.

As has been pointed out in previous publications (IFAC, 2016b; 2016c) using GDP or GNP as denominators for fiscal ratios is now highly inappropriate for Ireland, as these indicators do not accurately reflect the potential revenue-raising capacity of the Irish economy. It is worth considering what a denominator for such ratios should represent. Two aspects would seem desirable. Firstly, the denominator would indicate the revenue-raising potential of the economy. This was one motivation for the Council using government revenue as an alternative denominator for fiscal ratios in recent *Fiscal Assessment Reports,* as it is an observed value of the revenue that can be raised from activity in the Irish economy. One weakness of this measure is that the amount of revenue raised is influenced by policy. The tax rates and bands set by government can change the level of government revenue raised. However, this does not mean that the economy's revenue-raising potential has changed. A second aspect that would be desirable for a denominator for fiscal ratios would be that international/historical comparisons could be made. This requires that the denominator is comparable to more traditional measures of output (GDP or GNP) as they were before the recent distortions became apparent.

With these considerations in mind, the proposed GNI* metric might serve as a more informative denominator for fiscal ratios. However, there are trade-offs when considering denominators to use for fiscal ratios. For example, the Council previously used a hybrid measure, which reflected the likelihood that the revenue potential of GNP is different from the excess of GDP over GNP. While GNP was assigned a weighting of one, the excess of GDP over GNP was estimated to have a weight of around 0.4. A similar hybrid measure could be constructed when the data on GNI* are released. The corresponding approach would see GNI* assigned a weighting of one, with the excess of GDP or GNP over GNI* getting a lower weight.

While alternative denominators may be desirable for ratios such as government debt and deficits, GDP is likely to remain as the denominator for ratios relating to the fiscal rules. If GNI* serves as an informative denominator for fiscal ratios, then the Department may consider presenting fiscal ratios using this denominator in future.

[4] The Council and the Department of Finance have in the past used the current account as a signal of macroeconomic imbalances in the context of estimating potential output for the Irish economy.