

BOX A: CONTRACT MANUFACTURING IN 2014

At the time of the November *Fiscal Assessment Report*, outturns for the first two quarters of 2014 were the most recent official National Accounts estimates of real GDP growth in 2014. As noted in the November *FAR*, these outturns were being heavily influenced by an activity referred to as ‘contract manufacturing’. This Box reviews the role played by this activity over the course of last year.

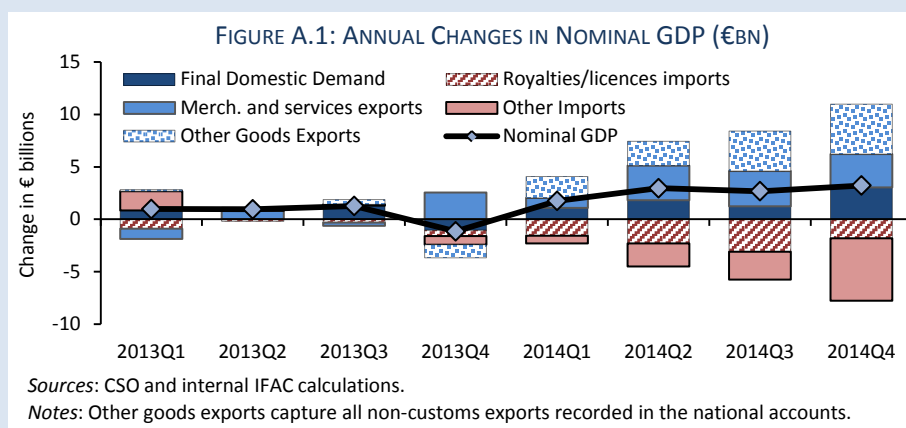
CONTRACT MANUFACTURING

Contract manufacturing activities occur when an Irish-resident firm (not necessarily Irish-owned) contracts a manufacturer overseas to produce a good for supply to an end-client abroad. The sale of the good is recorded as an Irish export of goods, while the contracted production is considered an import of services.¹ The value added that accrues to Ireland is the sale price of the good produced less some assortment of the following costs: manufacturing services used; the supply of material inputs used in production; imports of royalties for use of the patents; and imports of other services including transport.

In its previous *Fiscal Assessment Report*, the Council noted that the activity served to flatter early-year outturns, while also magnifying the degree of uncertainty around projections for net exports. It was also noted that it would be unlikely to boost domestic employment and that the contribution to the tax base was unclear. In terms of a full-year impact, it was believed at the time that the activities might represent a temporary, once off boost to real GDP growth for 2014 or that they might actually unwind in full before year-end.

IMPACT IN 2014

Data for 2014 suggest that the initial impact from Contract Manufacturing on GDP growth did unwind in the second half of the year. Fortunately, accelerated activity elsewhere offset the impact of this unwinding. The unwinding emerged as sharp increases in imports of royalties (including patents related to the use of intellectual property that covered finished products) offset the early-year boost from contract manufacturing-related exports. Total royalties/licenses imports were particularly strong in the third quarter of 2014 (Figure A.1).

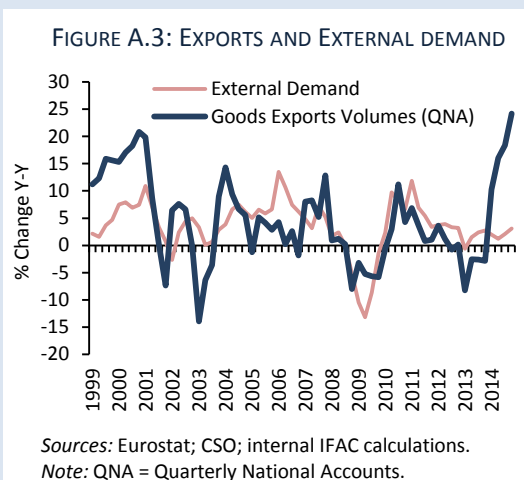
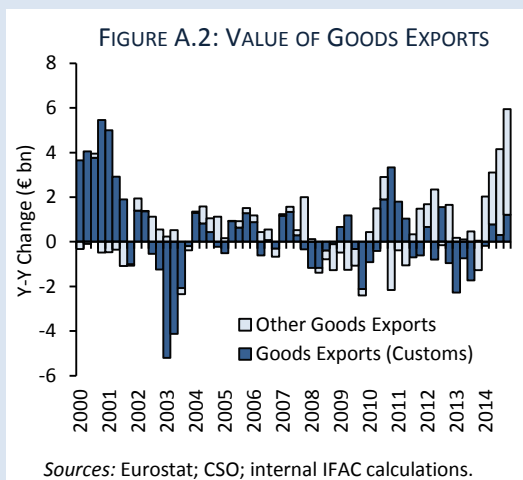


As a result of this unwinding, the CSO (2015) noted that contract manufacturing was “...not particularly significant” in explaining the provisional real GDP growth estimate for the full year at 4.8 per cent, though associated activities did have an impact on individual quarters. Although the net impact in 2014 is likely to be small, it is not possible to be precise as regards

¹ These activities, which reflect the complex global supply chains that multinational enterprises (MNEs) partake in, are expanded on in Box 1 of *Budget 2015* and Box 1 of the *IMF’s 2015 Article IV Consultation – Staff Report* (IMF, 2015a). The CSO have noted that as of March 2015 only 16 companies resident in Ireland were engaged in contract manufacturing, while the IMF (2015) note that the issue is most important in the pharmaceutical sector.

the exact scale of the impact on growth for two reasons in particular: (i) the activities in question relate to a very small number of companies and thus fall under the CSO's limits for discretion/uncertainty so that confidentiality issues are not breached; and (ii) data limitations mean it is not possible to net specific quantities of imports against corresponding exports relating to contract manufacturing activities.

Looking ahead, there may continue to be some impact from adjustments to goods exports like that of contract manufacturing. Such activities have caused goods exports – as measured in the National Accounts² – to deviate more than usual from customs data on exports (Figure A.2) as well as usually reliable indicators of external demand (Figure A.3). However, we anticipate that this will continue to be offset by related import growth so that the net effect should be relatively negligible even if gross imports and exports data continue to be impacted.



² The National Accounts measure of goods traded include adjustments to the primary data sourced from the monthly international trade series covering goods exports/imports (i.e., customs data). As well as contract manufacturing activities, the former also reflect merchandising and other conceptual adjustments.