



Upsetting the Apple Cart

Tax-based industrial policy in Ireland and Europe

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Indigenous Industrialization

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Abstract

Could Irish industry have been less dependent on MNCs? This question is addressed in a type of counterfactual examination of the turn of Irish economic development policy to Export Led Industrialization (ELI) from the Import Substituting Industrialization (ISI) of the 1930s to the 1950s. In a combination of critical examination of some of the policy failures and selection of cases of successful firm and sectoral growth, this paper argues that there have at the very least been missed opportunities.

Introduction

Irish industrial policies have been specific to particular periods in the economic history of the country's main trading partners. The policies were based primarily on free trade in the 1920s immediately after independence from Britain (when British policy was also relatively free trading), on protecting local manufacturers against imports from the 1930s (when protectionism was the mainstay in British, American and other countries' policies), and on export-encouraging from the late 1950s (when the Common Market and Britain's European Free Trade Area were being established).

It may be that the context reduced the degree of freedom facing Irish governments in relation to their choice of policy. When nearly all of a country's trading partners have raised tariffs and other impediments to its exports, for example, it is politically – if not economically – difficult for that country to adopt free trade. Perhaps the most important policy change in Ireland is that from protectionist ISI to more export-encouraging ELI in the late 1950s. There were also powerful contextual factors in this change and, as argued elsewhere (Jacobson, 1989), many countries on the European and American peripheries made similar changes to their policies at around the same time as Ireland. Even if the change to ELI rests to some extent on context, a number of questions remain. Given that the policies of ISI were failing already in the early 1950s, why was the change not introduced earlier? Why did the Irish policies favour foreign direct investment, so much so that industrial policy came to depend heavily on the corporate tax regime? Have policy makers underestimated the potential of indigenous industrialisation? This chapter addresses these and related issues.

Import Substitution

Policy evolution, especially in small, peripheral economies like Ireland, is strongly influenced by external trends. In the 1920s, the decade after Irish independence, the policy was highly open, free-trading with Britain, which continued to be the main source of industrial imports, and the main market for agricultural exports. The period was one in which Britain had relatively low tariffs on trade, and international trade in general was relatively high. The Irish government aimed at exporting primary products to Britain. The Irish firms and households benefitting from this trade

investment. There were two main problems with this policy. First, the size of the primary sector in Ireland was too small for its growth to impact on the rest of the economy to the extent necessary for indigenous industrialisation. Second, given that there was free trade between Britain and Ireland, that Britain's industry was relatively more advanced, and that Ireland had a comparative advantage in agriculture, the main impact of Irish agricultural growth on industrialisation would be in Britain rather than Ireland. In a sense, despite independence, in a free trade context the Irish economy's interaction with that of Britain was similar to that of other regions within the UK.

It is not a coincidence that as barriers to trade were raised all over the world during the Great Depression, Ireland too introduced protectionism. Explanations for the Irish shift to protectionism based on the policy choices of Fianna Fáil when it came to power in 1932 ignore the huge pressure that would have been on any government at that moment in history to adopt this policy. If the change to a protectionist policy in Ireland is the dependent variable, then the coming to power of Fianna Fáil, the party that promised protectionism, is at best an intermediate factor. It is a better explanation that the Great Depression led to the protectionism introduced by many other countries, including Britain, and that this in turn led to the success in the 1932 elections of Fianna Fáil, which then also implemented this policy. As argued by O'Rourke (2016, p.8), "it would be a mistake to view the switch to protection as having had causes that were fundamentally idiosyncratic and Irish. *Everybody* switched towards protection following the onset of the Great Depression in 1929".

There is a complex interplay of social, political and economic factors that lead to this type of internal response to shifts in the external environment. In 1932, for example, it can be assumed that the number of local business people interested in producing goods for the local market increased. The possibility of raising prices behind tariff and other barriers would increase the incentive to invest in production facilities. Hopes of jobs in such facilities would lead to support from workers. Some food producers, too – particularly those operating at a small, local scale – would also support a political shift towards protectionism in the hope that some processed foods would come from local producers rather than from abroad. More generally, the rise in nationalism which might otherwise have been expected in the immediate aftermath of independence was arguably suppressed by the openness of the trade environment, by the continuing economic dependence on Britain and by the conservative policy approach of the first governments of Ireland in the 1920s. If so, it was merely postponed to emerge in a groundswell of support for Fianna Fáil, and intensified by the "economic war" with Britain, in the 1930s.

This is not to say that ISI was inevitable but merely that there was a range of factors that made this the most likely set of trade and industrial development policies in the period during and immediately after the Great Depression. Within an ISI policy regime there is still space for choices about how intensively the state intervenes, either to impede imports and/or to encourage local development. O'Rourke (2016) has shown that Ireland was not unusually protectionist. Comparing Ireland's tariffs, quotas and restrictions on foreign ownership of production with those of other European countries, it comes out as near the average. This reflects the point that the extent to which the state, even under Fianna Fáil, was willing to intervene in the economy was limited.

This limit to intervention, based largely on a relatively conservative belief in the efficacy of markets, has run through virtually all governments of Ireland since independence. This constituted a factor ultimately of failure for ISI. For some of the protectionist period the policy generated a great deal of

investment and industrial employment. Industrial employment grew from 109,000 in 1929 to 167,000 in 1938 and to 227,000 by 1951, more than doubling over the period 1929-51 (O'Malley, 1989). However, productivity in the protected industries was generally weak and their substantial growth did not result in particularly strong growth of the economy. As O'Rourke observed, "between 1926 and 1938, Ireland grew at *exactly* the rate that it should have done, given its initial starting point" (2016, p.11). That is, its GDP per capita growth over this period was just on the average of a large group of European countries and the USA.

It was in the latter part of the protectionist period and subsequently that the failure of the way in which ISI was implemented in Ireland became apparent. Industrial employment stopped growing and then declined in the 1950s, dropping from 227,000 in 1951 to 210,000 by 1958 (O'Malley, 1989). The key failure was the failure to develop many industries that were capable of exporting. Indiscriminate protection alone, especially when applied to a very small domestic market, did not foster many substantial industries with the capacity to compete internationally. The Irish government should have adopted either a more interventionist policy, more active and selective in its choice of industries to support, or a less interventionist policy leaving to the market more of the determination of what industries should be set up.

The less interventionist but still protectionist version of ISI adopted in Ireland – indiscriminate protection – led to the raising of barriers to imports of almost anything that anyone in Ireland suggested could be produced in Ireland. Industries in which barriers to entry were relatively low were immediate candidates. Next, if the gap between average cost at low levels of output and average cost at the minimum efficient scale (minimum average cost) was not higher than the barrier to imports, then there were profits available for investors. In such circumstances, irrespective of the constraints of small local market, and the low likelihood of the industry being able to compete in international markets, capital was found and production initiated. In the short term – while protection remained – workers and investors shared the profits at the expense of the consumers.

There are many examples of industries that were set up during the 1930s and subsequently disappeared in the more open trading environment of later decades. An extremely clear example of what was logically a 'hopeless case' was the car assembly industry (Jacobson, 1981; 1989). High tariffs having failed to generate investment in local assembly, the industry was forced into existence in the mid-1930s by quantitative restrictions on imports. By the 1950s many different models were being assembled in Ireland. The minimum efficient scale of production for any one model exceeded 200,000. The total new car market was around 60,000. The arrangements with the car companies were such that sufficient components were provided to the assemblers for the local market only; exports were not permitted. The reason for this was that if the assembler exported the finished product it would add to the competition the car companies faced in their home and export markets. The result for the assemblers was that it prevented them from ever reaching minimum efficient scale. A more interventionist policy could at least have improved matters by restricting home assembly to one model and insisting on some local content. A less interventionist policy would have resulted in no car assembly in Ireland at all. Following a ten-year concession by the European Economic Community after Ireland joined in 1973, car assembly ceased to exist in Ireland.

It is clear that Ireland's ISI policy was not a complete failure; some sectors that grew during this period continued to grow subsequently, in particular food and drink¹. However, there were many other sectors where firms went out of business, for different reasons, in the period after ISI when outward looking policies were adopted. In sectors like textiles, and clothing and footwear, where there were relatively low barriers to entry, firms that did not succeed in breaking into export markets, that were out-competed by low-labour-cost competition from less developed countries, declined or closed down. In chemicals, indigenous firms closed down for different reasons; they faced significant barriers to entry in developed markets where large firms, with significant economies of scale in R&D, marketing and production, were already dominant. The argument of O'Malley (1989) is that the key problem facing Irish firms, in the process of attempting to compete in world markets under outward looking policies, is that Ireland was a "latecomer" in industrialisation. ISI could have played a role in ameliorating this problem but by itself in the way that it was implemented by Irish governments, it was inadequate.

Elements of a more interventionist policy, selecting sectors or sub-sectors that were more likely to have a competitive advantage in both local and international markets, could have been delineated. Such a set of criteria for support would have included, then and now: relatively low logistic costs; relatively high local content of material or human inputs, including skills, knowledge or enterprise; the existence of, or potential for, differentiation from competing products or services; and some linkage with other local enterprise so that there is a degree of embeddedness of the production in the local economy (Jacobson, 2010). These and related criteria for support of local industries are closely related to "dynamic comparative advantage". There are many valid criticisms of the theory – called theory of comparative advantage – that "proves" that free trade is best, among them that the assumptions of the theory never hold in practice. Such assumptions as perfect mobility of labour within countries and no mobility between countries, zero costs in the shift from one industry to another, and no economies of scale in industrial production, are completely unrealistic. Dynamic comparative advantage takes into consideration that even though in the short run a country's relative costs of production may be greater than those of its trading partners, in the longer run a combination of education and training, some economies of scale within existing technologies of production, and innovation and improvement in the development of new products, services and technologies of production, will result in the ability to compete in export markets. In a sense the criteria for support of indigenous industries can be reduced to the accuracy of the prediction that support in the present will lead to ability to compete successfully in export markets in the future.

The greater the extent to which firms are rooted, or "embedded", in the local economy, through dependence on local skills, materials, suppliers, partner companies, research etc., the more "sticky" they are likely to be in that place. The less the extent to which they are embedded, the more "slippery" they are likely to be in a free-movement, globalised world (Markusen, 1996). Industrial policy could and should be influenced by analysis of these types of criteria.

We will return to these criteria below but in the context of the ISI period, 1932 through to the 1950s, the commitment to development was constrained by what came to be identified by Kennedy (1992) as endemic problems in all Irish policy. He described the three weaknesses evident in Irish

¹ This and the rest of this paragraph, draws on O'Malley (1989, Ch 6)

development policies over the years as: “failure to grasp the implications of small size of country, absence of long term perspective, and neglect of the human resource dimension” (Kennedy, 1992, p.21). An important addition to the first of these would render it as follows: “failure to grasp the implications of the small size and peripheral location of the country”². The first weakness is reflected in the support for such inappropriate industries as car assembly, where the information on economies of scale was well known and should have provided an obvious message to policy makers that the Irish market was too small for this industry. The second weakness follows, in that even if ultimately the industry was doomed to failure, a short term perspective was adopted in which if the industry could provide immediate employment it was supported. And the third is reflected in the nature of that employment. It was at best semi-skilled and the need to generate competitiveness through the development of high skill, high knowledge, and what came to be called high-tech products and services was not considered.

A variety of factors explain these weaknesses. Policy decisions, in a still newly independent state, may have been driven to a much greater extent by politics than economics.³ The susceptibility of decision makers to the pressures of interest groups is well argued by Murphy (1996; 2010), and enhanced by both the relatively small population and the nature of the election system. This latter also helps explain the short-termism: if a politician wants to be re-elected, s/he must show results over the period between elections (maximum, five years).

Export Led Industrialisation

Given the failures of ISI, reflected in particular in the increase in unemployment and emigration in the 1950s, why were the industrial development policies not changed more significantly earlier? Just as external factors were important in the introduction of ISI, so too were they a key factor in the change towards ELI.

The policy of ELI consisted of three main elements: a new emphasis on promotion of export development; encouragement of FDI as a means of developing exports; and removal of protection against imports. This policy evolved over the period from the 1950s to the 1970s. Some of the main policy measures to promote exports and to encourage FDI for that purpose were introduced during the 1950s, including the establishment of the Industrial Development Authority (IDA). Its main function was to encourage new industries and propose ways of attracting foreign firms to set up in Ireland to produce for export markets. The potential for attracting such foreign investment was a newly emerging opportunity at that time since export-oriented FDI in industry was only starting to become a significant phenomenon in the international economy in the 1950s.⁴ Other relevant changes during the 1950s were the setting up of an export board, tax breaks on profits arising from exports, and the provision of grants to assist firms to prepare to enter export markets. Thus the main elements of the policy package to promote exports and to encourage FDI for that purpose

² Kennedy (1992) discusses peripheral location, suggesting that it may be advantageous during booms when the forces of economic development are centrifugal and disadvantageous during recessions, when these forces are centripetal. However, whatever the state of the business cycle, peripheral location is always disadvantageous for products with low value-to-logistic-cost ratios.

³ See, for example, Girvin (1989).

⁴ FDI in primary sectors such as mining, oil or plantation agriculture, or in industrial production for local (often

were in place by the end of the 1950s although further additions and refinements to the same general approach were made over the next few decades.

Ireland's shift to free trade with the removal of protection came a little later, beginning in the 1960s. A similar shift had been taking place for some time in many parts of the world (the General Agreement on Tariffs and Trade – GATT – came into effect in 1948) and particularly in Europe. The timing of this change in Ireland was heavily influenced by the international context. As argued by Breen and Dorgan (2013): “The exact timing of the transition was dictated by events at the European level, namely the process of intra-European trade liberalisation and the internalisation of this in Irish policy-making. In the absence of these unfolding processes, Irish governments would not have come under such pressure to put an end to protectionist policies”.

According to Donnelly (2012), the elements of the outward looking policies of ELI that were introduced in the 1950s were mainly incremental adjustments to ISI, which continued in a path dependence reinforced by the mutual co-dependence of industrialists hoping for returns on their investments and politicians hoping for political gains from the policies they had introduced. He argues that the IDA for example continued to support protectionism as a factor in the support for indigenous firms to build up towards export competitiveness. However, he shows how in a combination of external context – with the world moving towards free trade – and internal pressures arising from the failures of ISI and the election of Fine Gael-led governments, there was a “dissolution” of the protectionist path and its replacement with outward looking policies. This included the emerging conviction among decision makers in the IDA that free trade and the encouraging of foreign direct investment (FDI) were essential for the future of Irish industrialisation.

Politically the most important adjustment was that for Fianna Fáil, which was most closely identified with protectionism. At the same time, the huge investment of political capital in the transformation of Fianna Fáil from ISI to ELI, along with the institutional apparatus underlying the change, laid the foundation for a new path, with similar or perhaps even more intense dependencies. The essential elements of the outward looking policies that emerged during the period 1950s-1970s have remained in place ever since. These include low taxes on corporate profits and other elements of a fiscal regime aimed at encouraging enterprise growth including FDI; other than that (and also considered as facilitating FDI) a relatively non-interventionist approach to the operations of enterprises; and free trade ultimately expressed – as emphasised by Breen and Dorgan (2013) – in Irish membership of the European Union in 1973.

In the early years of the ELI approach it seems to have been expected that the growth of exports would come primarily from a substantial reorientation of Irish-based firms from selling almost exclusively at home to selling increasingly in export markets⁵, while new export-oriented FDI would provide some additional impetus to export development. As the years passed, however, it emerged that new FDI, rather than Irish firms, was actually the major source of export growth.

In fact new investment by highly export-oriented foreign-owned companies was largely responsible for the improved growth of industrial employment and output as well as exports, while indigenous industry did not fare so well. Most of indigenous industry was apparently not able to take much

⁵ After all, the aims of the IDA, when first established, were to support indigenous firms and prepare them for

advantage of the new incentives and opportunities to export, while at the same time it was quite rapidly losing market share to competing imports in the home market as the protectionist measures were dismantled after the mid-1960s.⁶ Consequently, indigenous industry was a significant net loser of market share during the transition to free trade. Competing imports continued to take a rapidly rising share of the domestic market in 1980-88 (Department of Employment and Enterprise, 1993, Appendix 3), while there was little or no increase in the export-orientation of Irish indigenous industry until about 1986 (O'Malley, 1998).

Employment in indigenous industry also declined, particularly in the 1980s when domestic demand weakened considerably. By 1986 foreign-owned companies accounted for 41 per cent of manufacturing employment, 50 per cent of manufacturing gross output and 76 per cent of manufactured exports (Census of Industrial Production, 1986).

The weakness of indigenous industry and the degree of reliance on foreign MNEs were causing some concern by the 1980s. The Telesis (1982) report to the National Economic and Social Council (NESC) criticised the practice of relying so heavily on foreign investment, and this point was largely taken on board by the NESC (1982) in its own conclusions. Trends in industry in the 1980s tended to give weight to their view since heavy reliance on foreign industry was no longer producing adequate results.

Beginning in the mid-1980s, some significant changes were made in industrial policy. The White Paper on *Industrial Policy* (1984) and subsequent official policy statements put an increased emphasis on the aim of developing Irish indigenous industry. This did not by any means imply an end of encouragement of MNEs, but it did reflect some acceptance that there were limits to the benefits that could be expected from FDI and that the relatively poor long-term performance of indigenous industry called for a greater focus on addressing that problem.

More specifically, policy towards indigenous industry became somewhat more selective, aiming to develop larger and stronger firms by building on those with a reasonable track record, rather than assisting a great many start-ups and very small firms indiscriminately. Policy also became more selective in the sense of concentrating state supports and incentives more on correcting specific areas of disadvantage or weakness which were common in indigenous firms such as technological capability, export marketing, and management skills. Expenditures on industrial policy were shifted to some extent from supporting capital investment towards improving technology, export marketing and management. Also, a shift began towards the use of repayable forms of financial support such as equity financing rather than capital grants.

In addition, administrative responsibility for promoting indigenous industry was separated from the task of encouraging FDI. The aim was to ensure that there would be a body of state agency staff giving their full attention to the indigenous sector.⁷

The introduction of policy changes along these lines was in some respects rather hesitant and gradual, and indeed there was some questioning about the real strength of commitment to the

⁶ See O'Malley (1989, Ch.6) for more detail on these developments.

⁷ This was done first in 1988 by means of an internal reorganisation within the Industrial Development Authority (IDA) which involved the establishment of separate divisions for the promotion of indigenous and

objectives. However, quite a number of relevant policy changes – of an incremental rather than a radical nature - were introduced over a period of some years.⁸

Some of these changes were significant moves in the right direction. Irish indigenous industry often faced barriers or obstacles to its development, arising from the established advantages of competitors in advanced countries, such as superior scale, technological capabilities, marketing, etc. Consequently, there was justification for measures to build larger and stronger firms and to focus assistance more on improving specific capabilities such as technological and marketing capabilities rather than just providing general support for investment.

However, the overall scale of this effort was clearly more limited than the Telesis (1982) report had envisaged. Telesis recommended that “the level of funds devoted to Irish industrial development should be as high as the Irish people can bear”, and they recommended that the proportion of total industrial policy expenditure going to indigenous exporting and skilled sub-supply companies should be raised to 75 per cent by 1990. In practice the total level of industrial policy expenditure declined a little in current values in 1985-1991, and the proportion going to indigenous firms was only just over 50 per cent by 1990.

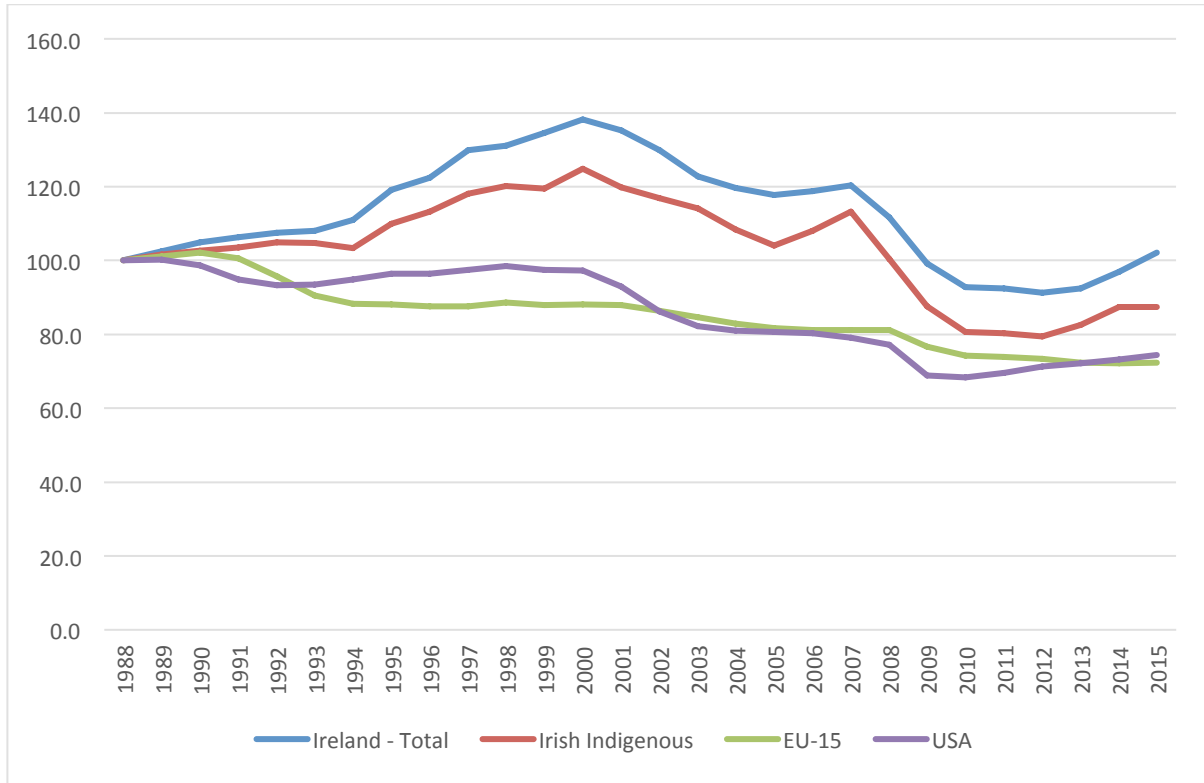
After the late 1980s there was very strong growth in Ireland for about two decades, and the growth in foreign-owned industry was mostly much stronger than in Irish indigenous industry. However, the growth of indigenous industry was significantly improved compared to earlier years and its record looked quite respectable by international standards although its performance was obviously overshadowed by the foreign-owned MNEs in Ireland.

Figure 1 shows the trends in manufacturing employment after 1988. It can be seen that the growth of indigenous manufacturing employment in 1988-2000 was in contrast to the declining trend in the EU and USA although it was clearly growing more slowly than employment in foreign-owned industry in Ireland. After 2000 there was often a declining trend in indigenous manufacturing employment, especially during the major recession of 2007-2010 which hit Ireland particularly hard. However, Figure 1 shows that over the whole period 1988-2015 the record of indigenous manufacturing employment was actually quite good compared to international experience.

By 2007 foreign-owned companies accounted for 52 per cent of manufacturing employment, 77 per cent of manufacturing sales and 89 per cent of manufactured exports.⁹ Ireland’s ELI policy – supported by the initiatives of the IDA – has obviously been very successful in attracting MNEs to Ireland. The pinnacle of this success was the Celtic Tiger, with record levels of FDI, of employment and of exports (Sweeney, 1999).

⁸ Further details on relevant policy changes can be found in official documents such as *Industrial Policy* (1984) and *Department of Industry and Commerce (1987 and 1990)* and in O’Malley et al (1992)

Figure 1: Manufacturing Employment Index (1988 = 100), Ireland Total, Irish Indigenous, EU-15 and USA, 1988-2015.



Source: *Census of Industrial Production* for Irish data, with a few minor adjustments to take account of changes in data definitions during the period. EU-15 data from EUKLEMS database (euklems.net). USA data from OECD’s STAN database.

The annual reports of the IDA are among the best places to find evidence of these successes. Many of the top companies in the world, in pharmaceuticals, in ICT and in medical devices, have their European centres in Ireland. The foreign controlled enterprises in Ireland account for 15.5 per cent of total employment. However, they also account for only 2 per cent of the total number of enterprises in Ireland; most of the large employers in Ireland are MNEs. In manufacturing, total employment in “agency assisted enterprises” (AAEs) is around 186,000, of which around half is in foreign-owned enterprises. Table 1 shows the size difference between foreign-owned and Irish enterprises.

Table 1: Total and Average Employment in Manufacturing Plants in Ireland, by Ownership, 2012

		Foreign-owned	Irish-owned
Total employment in manufacturing: AAEs, 2012	186,000	91,140	94,860
Average employment per manufacturing plant	46	173	27

Source: Forfás (2013)

The relative concentration of MNEs, both in particular sectors and from a particular country, the USA, is also important¹⁰. The dominance of the USA is evident in the fact that American companies (531) account for over half of all MNEs in Ireland (1,033); more importantly, employment in American companies accounts for 73 per cent of all employment in foreign companies in Ireland. Foreign concentration in particular sectors is shown in Table 2.

Table 2: All Employment in Foreign-Owned Enterprises in Ireland, Selected Sectors, 2016

Sector	2016	
	Number	% of Total Empl. in the Sector
Manufacturing		
Chemicals and Pharmaceuticals	20,099	88
Computer, Electronic and Optical Equipment	13,485	80
Medical/Dental Instruments & Supplies	25,070	96
Services		
Computer Consultancy	15,149	58
Computer Facilities Management	9,206	99
Computer Programming	27,191	96
Financial Services	11,171	77

Sources: Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact*.

What Table 2 indicates is that the most advanced technology sectors, like pharmaceuticals, ICT and electronics, are dominated by subsidiaries of MNEs. In some sectors, like chemicals and pharmaceuticals, this may be because companies generally need to be large to be competitive so that large established MNEs can thrive while relatively small and/or new indigenous enterprises would often face great difficulties. Other possibilities include that the technology is not available to local enterprise, that the entrepreneurship is not available, and that the IDA is more successful at encouraging inward investment than Enterprise Ireland is at encouraging indigenous investment. Whatever the causes, the result, the table shows, is that in chemicals and pharmaceuticals, for example, 86 per cent of employment is in MNE subsidiaries.

The fact that foreign-owned MNEs account for a very large share of exports makes them particularly influential in the Irish economy because sectors that export and have positive foreign earnings make an essential contribution that helps to sustain the rest of the economy. The importance of exports in a small and very open economy derives from the fact that a large part of the economy's expenditure is used to purchase imports. Whenever the economy grows there usually tends to be increasing demand for imports, including imports of materials, equipment and fuel required as inputs for growing production sectors and also imports of consumer goods to meet growing demand from consumers. When Ireland had its own national currency before 1999 it was quite clear that export growth was needed to pay for the increasing imports. If exports did not grow sufficiently, a balance of payments deficit tended to open up and hence the value of the Irish currency tended to decline. A declining currency tended to result in inflation as prices of imports rose and at the same time it reduced the country's purchasing power when it came to paying for the imports of inputs required for production, which became an obstacle to economic growth.

From 1999 onwards Ireland had the euro as its currency. It was sometimes argued that Ireland's international trade performance and balance of international payments no longer mattered much. However, although the mechanism became somewhat different, a good performance in international trade continued to be essential for the health of the economy.

At any given time, a certain proportion of expenditure in Ireland is used to purchase products and services that can be traded internationally and the rest is used to purchase "non-traded" products and services that generally have to be produced locally to meet domestic demand. If Ireland has a competitive and successful performance in international trade its internationally traded sectors can grow, employment in those sectors can grow, and this increases demand for the products of the non-traded sectors which allows them to grow too and to increase their employment. Thus in these circumstances total employment can grow. On the other hand if Ireland imports a growing proportion of the internationally traded products and services that it requires, and if it fails to increase exports to the same extent, production and employment in the internationally traded sectors are reduced. As the internationally traded sectors decline, that in turn reduces demand for the output of the non-traded sectors which forces them into decline too, with adverse consequences for total employment.

Consequently, the fact that foreign MNEs account for close to 90 per cent of exports from Ireland makes them very important. At the same time, however, it should be recognised they are not really quite as important as that figure suggests. This is because they import an unusually high proportion of the inputs that go into their products, and they also make very large profits which are mostly withdrawn from the country. Consequently, their contribution to the country's net foreign earnings is actually much less than the value of their exports. If we take account of their high import-content and large profit withdrawals, as well as the lower import-content in exports from indigenous companies, it can be estimated that foreign MNEs account for about 70 per cent of net foreign earnings while indigenous companies account for about 30 per cent. Whereas foreign MNEs outweigh indigenous companies by about 9:1 in terms of exports, it is not much more than 2:1 in terms of net foreign earnings.

It is clear that in the past serious consideration has been given to the view that it was unsatisfactory and unwise to be relying so heavily on foreign-owned MNEs for growth while indigenous companies

lagged behind. Significant – though inadequate – efforts were made to do more to develop indigenous industries. More recently, however, it seems that Irish governments and the mainstream of political opinion in general have been happy to depend heavily on foreign MNEs and have been highly committed to maintaining and defending the tax measures that are seen as essential for attracting FDI.

Even the strains of the financial collapse in 2008, leading to the ignominy of bailout by the Troika in 2010, only seemed to reinforce the Irish commitment to the policy of encouraging FDI through fiscal measures. According to Donnelly (2012), the outward looking policies *per se* were not to blame for Ireland's dependence on the bailout. However, the light regulatory hand that has always been part of the Irish commitment to FDI, particularly as applied in banking and finance, was clearly an element in the collapse of the Irish banks that were the trigger for the bailout. This light regulation had and continues to have a negative impact on Ireland's reputation (Griffin *et al*, 2017)¹¹.

Among the demands placed on Ireland in the context of the bailout, were those (mostly successfully resisted so far) related to the corporate profits tax regime. Before¹², during¹³ and since¹⁴ the bailout, there has been significant European and American¹⁵ pressure on Ireland to increase its rate of tax on corporate profits, and to adjust its fiscal regime in other ways to reduce the extent to which the regime facilitates profit switching by MNEs.

The resistance to change reveals a combination of the path dependency of the ELI range of policies, and a related extraordinary commitment on the part of most political strands in Ireland, to the view that a low corporate tax regime, with certainty in its continuation, is essential for the continued attraction of FDI into Ireland.

As argued above, a light regulatory hand was part of the Irish commitment to FDI and regulation was shown to be inadequate in relation to banking and finance. This resulted in over-lending and over-investment in construction, reflected in construction's share of total employment, which reached over 13 per cent in 2006, the highest share in the OECD (Whelan, 2011). The banking collapse was therefore a property development collapse and a construction employment collapse all in one.

All this supports the argument that an underlying weakness of the Irish version of outward looking policies has been the regulatory deficit that has consistently been part of this approach. Inadequate regulation contributed to Ireland's crisis being among the worst in the context of the Great

¹¹ Griffin *et al* (2017), in their Bloomberg article, describe the case of an Azerbaijan bank that set up a Special Purpose Vehicle (SPV) under Irish regulations to raise funds. The authors quote Shaen Corbet, Assistant Professor in Finance at DCU: "The lack of oversight within this [Irish] system is generating an environment where questionable, immoral, unethical and downright illegal funding channels can flow undetected."

¹² "German MEPs stepped up the pressure on Ireland over its corporation tax rate insisting that it would have to double if the country needed a bailout" (Cahill, 2010).

¹³ "Ireland should not be allowed to access the EU/IMF bailout fund while maintaining a low corporation tax, French President Nicolas Sarkozy warned yesterday" (O'Hora and Collins, 2011).

¹⁴ "Just when good news was starting to flow again out of Ireland, along comes the European Commission to spoil the celebrations... [Ireland's] cherished corporate tax regime, which has attracted billions of dollars of foreign direct investment over four decades, is now under intense international scrutiny" (Beland, 2014).

Recession after 2008¹⁶. The institutional structure of Ireland's "liberal political economy" was the context for the "economic failures that led to Ireland's crisis" (O'Riain, 2014: 215 and 287).

The crisis has not brought about the end of ELI; nor should it. After all, the remarkable Irish recovery has been to a large extent export-driven. The fault is in the Irish version of this policy. The argument here is not that Ireland should not have introduced the policies of ELI but rather that – in a sense similar to the ways in which the governments of the time implemented ISI – they should have been more interventionist. Instead industrial policy has relied too heavily on one tool, that of tax measures aimed particularly at attracting FDI.

Success and Failure in Industrial Development

The importance of foreign-owned MNEs in the Irish economy could be seen as leading to either of two very different conclusions. First, it could be taken as an indication of the necessity for the Irish government to do whatever it can to ensure that the economy remains attractive to foreign companies. Or second, it could be seen as a danger signal; slight changes in regulation, particularly fiscal and corporate regulation and enforcement in the USA or the EU (and Apple is a case in point), could result in a mass exit of MNEs from Ireland, and the more real this possibility, the more intensely should the Irish government be seeking alternative, indigenous means of generating employment.

Of the two possibilities, the Irish government's policy preference tends towards the former. The continuing emphasis on a low corporate tax regime – even in the face of the intense pressure outlined above – is evidence of this preference. The support for, and importance of IDA Ireland, is further evidence. The IDA clearly reflects policy, including policy to develop particular sectors. The sectors targeted by the IDA have included: Business Services; Consumer Products; Clean Technology; Entertainment and Media; Industrial Products and Services; Information and Communications Technologies; ICT Cloud Computing; International Financial Services; Medical Technologies; Pharmaceuticals; Emerging Business¹⁷. There is no doubt that, with the attractions of the low corporate profit tax regime, the liberal regulatory regime, the English language, education and skills of the workforce, among other factors, this relatively broad targeting policy has been successful. However, it remains to be seen whether, if and when regulations outside Ireland change, this success can be maintained.

What if the Irish government were to favour the alternative approach, committing to intensive efforts to develop the indigenous sector as a major means of generating employment? What sort of measures would be required? In fact, many of the necessary types of measures are already in place but they have never been given sufficient resources to make a decisive breakthrough and they have often been subject to restrictions or limitations which curtail their effectiveness.

It is already well recognised by government that the relatively small scale of Irish enterprises creates an inter-related set of problems that have to be overcome by policy measures. Consequently, Enterprise Ireland has a considerable range of schemes to facilitate the growth of indigenous enterprises including funding. These are described in some detail in Forfás's 2013 report, *Making it*

¹⁶ O'Riain (2014: 240) references Laeven and Valencia's (2012) research showing that "Ireland's banking crisis was among the most severe in world economic history"

in Ireland: Manufacturing 2020. However, there are three problems. The first is that in identifying firms that should be supported, EI focuses on those with significant exports. Arguably those that sell to MNEs in Ireland are competing in a global market and should therefore at least be considered for support. Second, EI does not take more than a 10 per cent share in any of the companies it assists. A greater share could provide more of the capital needed to develop the scale or skills required to compete abroad. The third and related problem is that EI, with such a low equity share, has no way of preventing foreign takeovers of successful indigenous firms. Takeovers can and often do mean a closing down or restriction of the Irish operation and/or the shift of the skill base to the headquarters of the new owner, thereby undermining the potential of some of the most promising Irish companies to contribute to the Irish economy. Therefore EI should be provided with far greater resources and should be given the power to deal effectively with these three problems.

Even if the most appropriate policy measures were applied, successful, sustainable development of indigenous industry would still not be easy. This task would call for a consistent long-term policy commitment but there is no reason to believe that it would be impossible. In fact there have already been some notable successes in indigenous development. These provide indications that significant strengths do exist and they give grounds for believing that more far-reaching success is possible.

For one thing, the employment trend in indigenous manufacturing may often have been relatively weak when compared with foreign-owned industry in Ireland, but that is actually a very demanding standard of comparison since foreign-owned industry in Ireland can be continually boosted by further inflows of new investment and new companies coming in from outside the country. If we make a more appropriate comparison between Irish indigenous industry and industry in the EU or USA, the Irish indigenous employment trend looks relatively strong, as outlined above.

Is there evidence of potential for export success on the part of indigenous industry? The trend in export growth has looked considerably weaker in indigenous than in foreign-owned industry for much of the time since the 1950s, but there have been significant periods when that was not the case. For much of the 1980s Ireland experienced a prolonged recession, until two decades of a sustained export-led boom began in the late 1980s. A feature of the early years of that boom was that the value of indigenous manufacturing exports grew by 12.2 per cent per year in 1986-90 while the value of exports from foreign-owned manufacturing grew a little more slowly at 11.9 per cent per year.¹⁸ More recently, the value of indigenous exports has generally grown about as fast as, or faster than, the value of exports from foreign-owned companies in the years after 2000. In 2000-2016, the value of indigenous exports increased by 5.2 per cent per year compared with 5.7 per cent per year for foreign-owned exports. Starting from the low point of the great recession, the value of indigenous exports increased by 10.8 per cent per year in 2009-2016 compared with 7.8 per cent per year for foreign-owned exports.¹⁹

Compared to many European countries, Irish indigenous industry was relatively highly concentrated in the more mature traditional sectors; it lagged behind in development of the more high-tech or

¹⁸ Measured in current Irish pounds, *Census of Industrial Production* (various years).

¹⁹ Data from Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact*. These data refer to exports from manufacturing plus the internationally traded services which are covered by

medium-high-tech sectors until the 1980s. However, it then made considerable progress in developing higher tech activities during the 1990s. Perhaps the clearest example of this was the software industry. During the 1990s, when major US software MNEs were expanding rapidly in Ireland and the software industry in Ireland was growing much faster than in most advanced economies, indigenous software companies increased their employment at a slightly faster pace than the foreign-owned MNEs so that they consistently accounted for about half of the sector's employment in 1991-97. The indigenous companies also had faster growth of sales and exports than the foreign MNEs and they had a rapidly growing market share in international markets.²⁰

There are no comparable data for recent years on the software industry as such, partly because the range of software businesses cuts across the major categories "manufacturing" and "services" in standard official statistics. However, most of the indigenous software companies that engage in exporting would be included among the "internationally traded services" which are covered by the enterprise development agencies, along with other activities such as certain business services, financial services, etc. In that group of internationally traded services, employment in indigenous companies grew by 4.7 per cent per year in 2000-2016, which was faster than the rate of 3.4 per cent per year in foreign-owned companies. In the same group of services the value of indigenous exports grew by 8.8 per cent per year in 2000-2016 compared with 8.9 per cent per year for foreign-owned exports.²¹

Apart from the case of the software sector, among the indigenous manufacturing sectors there was also clear evidence in the 1990s of particularly rapid growth of the higher technology sectors as opposed to the more mature traditional sectors. In 1991-2000, total indigenous manufacturing employment growth was quite rapid at 2.1 per cent per year. At the sectoral level, nearly all of the sectors that are classified by Eurostat as "high technology" sectors grew exceptionally fast – communication equipment & technical instruments (14.2 per cent per annum), pharmaceutical products (8.3 per cent p.a.) and office machinery & computers (7.6 per cent p.a.). Similarly nearly all of the sectors that are classified as "medium-high-technology" grew at well above average rates – electrical machinery & apparatus (9.8 per cent p.a.), machinery & equipment (4.5 per cent p.a.) and other chemicals (4.4 per cent p.a.).²² Thus the composition of indigenous manufacturing employment was shifting substantially towards the higher technology sectors.

A similar shift was occurring in the EU as a whole but the shift in Irish indigenous industry was considerably stronger. Thus, in all of the high-technology and medium-high-technology sectors combined, indigenous industry more than doubled its share of EU employment from 0.14 per cent in 1991 to 0.33 per cent by 2000. The Irish indigenous share of EU employment in the low-technology and medium-low-technology sectors also increased in the same period but the rate of increase was slower, from 0.39 per cent in 1991 to 0.49 per cent in 2000.²³

In the years after 2000, however, we can see how these trends were undermined by the impact of takeovers of promising Irish companies by foreign companies. In 2000-2006, according to *Census of Industrial Production (CIP)* data, indigenous manufacturing employment declined and there was a

²⁰ National Software Directorate data, quoted in O'Malley and O'Gorman (2001).

²¹ Data from Department of Business, Enterprise and Innovation, *Annual Business Survey of Economic Impact*.

²² Data from the *Census of Industrial Production* (various years).

reversal of the earlier sectoral trends since the decline tended to be particularly severe among the high-technology and medium-high-technology sectors. However, it is important to note here that in the *Census of Industrial Production*, companies' nationality of ownership is defined according to their nationality in each individual year. Consequently, if some companies are Irish-owned at the start of a period and then are acquired by new foreign owners during that period, their employment would be included in the indigenous category in the initial year but not in the final year. This could cause indigenous employment to decline even if there were no real weakness in the sense of job losses or declining companies.

There is evidence that this type of effect was very influential among the indigenous high-technology and medium-high-technology sectors in 2000-2006. In the Forfás *Annual Employment Survey* companies' nationality of ownership was defined according to their latest nationality when responding to the survey and then the presentation of data on past trends in the survey report applied the latest nationality of each company to all past years, so that changes of nationality of ownership did not affect the trends over time. Using this approach, the data from the *Forfás Annual Employment Survey 2008* (Appendix Table 5) indicated that employment in the indigenous high-technology and medium-high-technology sectors declined by just 0.5 per cent p.a. in 2000-2006, which was far less than the decline by 5.8 per cent p.a. in the CIP data. Meanwhile, in the low-technology and medium-low-technology sectors the rate of decline was similar in both data sets, at 1.6 per cent p.a. in the CIP and 1.3 per cent p.a. in the Forfás survey.²⁴

The combination of the two data sets tells us that there were significant net transfers of ownership from Irish to foreign during 2000-2006, with these transfers being very largely concentrated among the high-technology and medium-high-technology sectors. In the absence of such net transfers of ownership, the employment trend in the indigenous high-technology and medium-high-technology sectors would have looked much stronger, so that the overall trend in indigenous manufacturing employment would also have looked stronger.

As regards the years after 2006, there was a discontinuity in the CIP data series in 2006-2008 because of expanded coverage in 2007 followed a change in the classification system used. In 2008-2014 the comparison between the CIP and the *Annual Employment Survey* shows no very significant net transfers of ownership from Irish to foreign-owned. Since that period was dominated by the "great recession" in Ireland and elsewhere perhaps many companies had to focus primarily on surviving in very difficult conditions rather than expanding by means of acquisitions.²⁵ In the absence of significant net transfers of ownership, the trend of particularly rapid growth among the higher technology sectors resumed within Irish indigenous manufacturing. According to the CIP, employment grew by 1.6 per cent p.a. in the indigenous high-technology and medium-high-technology sectors in 2008-2014 despite the recession, while it declined by 2.9 per cent p.a. in the low-technology and medium-low-technology sectors.²⁶

²⁴ Note that the international context in that period was a general decline in manufacturing employment in developed economies. In the EU, manufacturing employment declined by 1.3 per cent per year in 2000-2006.

²⁵ If so, then a pattern of takeovers of Irish firms by foreign-owned firms might be expected to recur under more benign conditions.

²⁶ CIP data for 2015 do not have sufficient sectoral detail to include 2015 here while 2016 results are not yet

A different type of success story in Irish indigenous development concerns the growth of Irish MNEs. Relative to the size of the Irish home base a large number of indigenous companies have developed into MNEs operating successfully in overseas markets.²⁷ The obvious ones include CRH, Smurfit Kappa, Primark, Ryanair, Kerry Group, but there are also hundreds of other Irish MNEs. The CSO reports that 774,000 people were employed in Irish-owned foreign affiliates in 2015, meaning in the overseas subsidiaries of Irish-owned MNEs.²⁸ The CSO also notes that foreign enterprises which had redomiciled their controlling operations to Ireland would have a bearing on this figure as they would then be defined as Irish enterprises. Unfortunately, it is not clear how great is the effect of this redomiciling on the employment number mentioned above. However, even if we look at just 11 of the largest and best-known Irish MNEs for which employment numbers are readily available, their total employment amounts to about 294,000.²⁹ Probably more than 90 per cent of these jobs are outside Ireland. Clearly the number employed abroad in all of the hundreds of Irish MNEs must be a great deal larger than this.

The development of Irish MNEs may have made a relatively limited contribution to employment and the economy in Ireland, relative to the size of these companies, but the main point here is that it does show that the entrepreneurship and skills required to build large and internationally successful companies have not been lacking in Ireland.

Less well known examples of indigenous success would include Oceanpath, a fish processing company that was only set up at the beginning of the 1980s and is now one of the most significant players in its sub-sector, having grown through a monopoly-monopsony relationship with Superquinn in the 1980s and 1990s (McGrath and Jacobson, 2010; Li *et al*, 2018). This type of tight relationship, sometimes vertical as in Oceanpath and Superquinn, and sometimes horizontal as in industrial districts and clusters, is often evident in indigenous success.

Two cases of indigenous industries will now be described where initial success arising from such cooperation ultimately faded and the promise of continuing growth was not realised, at least partly as a result of policy failures. The first is the case of the software supply sector and the second is the case of the furniture industry in Co. Monaghan.

In the software supply sector the story began with IDA success in attracting to Ireland the main software companies in the world in the 1980s. Irish printing firms became first, software manual printers (SMP) and ultimately disk duplicators and suppliers. Many were, like Oceanpath, very closely related to – even dependent on – the software producers like Microsoft. So, when technology changed and first CD-ROM came out, then Windows, then online downloading of software, the SMP industry, with most of the Irish firms, went out of business (Andreosso and Jacobson, 2005, pp.431-439). Two interventions might have made a huge difference. The first is in the relationship among the SMP firms. They were required, for “preferred supplier” status with their software company customers, to use optical character reading (OCR) machines to ensure zero

²⁷ The rate of growth of outward direct investment (ODI) from Ireland in the Celtic Tiger years was substantially greater even than foreign direct investment into Ireland. “ODI stock grew 416 per cent between 2000 and 2007, compared to a growth of only 47 per cent in FDI stock during the same period” (King and Jacobson, 2010, p.51).

²⁸ Central Statistics Office, “Outward Foreign Affiliates Statistics - 2015”.

²⁹ The 11 MNEs concerned are CRH, Primark, Smurfit Kappa, Kerry Group, Greengore, Ryanair, Kingspan

defects. These were expensive pieces of equipment and the capacity of the OCRs was beyond what any one of the firms needed. It was clearly in their interest to set up some kind of joint venture to own the OCRs and provide the quality control services that the machines provided to all of them. Asked in interview why they had not done this, they replied that the main reason was that there was a strong tendency for them to 'keep their cards close to their chests'. In other words the norms of Irish business behaviour seemed to preclude trust and cooperation, even where this was in the firms' collective interest. We can call these 'institutional barriers to local development', but clearly they were barriers that could have been overcome by appropriate EI intervention.

The second intervention could have come at a later stage in the evolution of this sub-sector. CD-ROMs were being produced by a number of subsidiaries of MNCs from Japan, America and Canada attracted to Ireland by the IDA. This essentially kept employment in the software supply sector in Ireland. However, software by the end of the 1990s was beginning to be supplied through downloading from servers. At this point the Irish government privatised the national telecom supplier, Telecom Eireann. The net result of this from the point of view of the internet access technology for public and private users in Ireland was disastrous. It removed the potential for a public provision of fibre-based infrastructure and both household and enterprise access to the internet, the web and wifi were delayed by many years. The possibility of Ireland continuing to be the main location from which people and firms in Europe – and elsewhere – would obtain their software was not pursued. It could not be pursued because the technology was not good enough. As soon as the internet replaced CD-ROM as the means of distributing software, the CD-ROM producers left and a potential for technology development and employment in Ireland – arising from the location here of the global software supply sub-sector – was not realised.

A key part of the furniture industry in Ireland in the 1990s was the industrial district in Co. Monaghan. Although the roots of the industry in Monaghan went back centuries, the main impetus for its growth in this period was the rapid growth of the economy in general and in particular of construction. There were many firms, all both cooperating in various ways and competing in the production and sale of furniture of all kinds, mainly (but not exclusively) for the Irish market. The origins and development of the furniture industrial district are described in some detail in Jacobson and Mottiar (1999) and Heanue and Jacobson (2001-2). Two interventions by the state both failed to develop the sub-sector. First, the furniture design and technology centre was set up as part of the Galway-Mayo Institute of Technology, in Letterfrack. It would have made much more sense for this to have been located in the middle of the industrial district in Monaghan, rather than in Letterfrack where there was no furniture production at all. Second, at a crucial juncture, when the construction boom had peaked and the Monaghan furniture district needed a significant fillip, Enterprise Ireland provided a €3 million grant to one company, John E. Coyle, for redevelopment. What this was aimed at by the company was to change its own production system so that it could produce and supply furniture by itself, using modern modular techniques. The consequences for the development and improvement of the collaborative interactions of the past were extremely negative and in any case the investment failed to save furniture production in Monaghan. Even John E. Coyle itself, employing 140 production workers at its peak, soon after ceased production and became a furniture importer and retailer.

As with FDI into Ireland, so with indigenous firms, there are examples both of success and failure.

far more successful than the indigenous sector. The cases discussed above suggest that at least part of the explanation lies in failures of policy. Either interventions – that is policies that were actually implemented – were defective, or interventions that could have had positive impacts were not available because of an absence of policy or lack of ability to identify the necessary intervention.

Conclusion

There can be little doubt, therefore, that better policies, better implemented could, over the decades since the introduction of ELI in Ireland, have led to more indigenous start-ups, growing firms, skill development, employment and exports. The underlying principles of tax based industrial policy and the relatively light or liberal regulation favoured by the IDA and its MNE clients have in general been successfully proffered among the means of attracting FDI into Ireland by an agency aggressively pursuing new projects. They have been less effective in the indigenous sector. Better training for those involved in the development and implementation of policy towards indigenous firms is essential. More resources would also help. More cohesion in the many inter-related policies – in education, training, R&D, taxation, etc. – would also facilitate a more focused industrial policy. One way of pursuing this objective would be to ask, about all policies that have an impact on indigenous enterprises, whether they contribute to those firms being or becoming “sticky places in slippery space” (Markusen, 1996). These are firms or groups of firms in a location where for a variety of reasons – natural resources, unusual skill base, other supplier or buyer firms – they are embedded with activities that are sustainable. “Slippery space” refers to globalization and the ease with which economic activities can be relocated. And we have now returned full circle to the criteria for support of firms, the accuracy of the prediction that support in the present will lead to ability to compete successfully in export markets in the future. Continually considering whether a particular intervention will improve the stickiness of the target activity in the slippery space of globalization will increase the accuracy of the prediction of future success in international competition.

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Taxing Multinationals: An International Perspective

Esmé Berkhout

1) Introduction, competition as an out-dated ideology

If we believe many of our governments' Finance Ministers, we should soon expect to see an end to corporate tax avoidance. While it is true that significant steps have been taken to stop corporations from shifting their profits to tax havens, the problem is not solved. Not only do many corporate tax loopholes remain open, but governments are also replacing policies that facilitate tax avoidance with overall lower corporate tax rates. Generally, the reason behind this lowering of corporate tax rates is to maintain a 'competitive tax system' and to attract FDI (Holder, 2017). An increasing concern of international bodies is that this might lead to a 'race to the bottom', so that even with anti-profit shifting measures, the result might be "corporations reporting the correct amount of profits in each country, but paying very little taxes over those profits anyway" (Weyzig, 2015). The possible decline in corporate taxes contributes to concerns about the impact of corporate tax competition on rising levels of extreme inequality worldwide and within countries.

While our governments have been willing to tackle tax avoidance through adjustments of technical tax policies (e.g. through the OECD-Base Erosion and Profit Switching/BEPS process, further discussed below), they have been much less keen on discussing the more global and more politically sensitive problem of tax rate competition between countries. This topic hits the core of what is wrong with dominant economic thinking. Tax competition between countries is a logical consequence of the neoliberal economic system that positively values competition. As clearly explained by Shaxson and O'Hagan (2013), while competition between companies in a market is broadly a good thing, competition between countries on tax is not. In effect, not only is competition valued positively under neoliberalism, but also inequality (Murphy, 2014). Driven by the perceived need for countries to compete on tax for FDI, corporate tax rates have fallen globally from an average of 26.95 in 2007 to 24.95 in 2017. In 1990, the average statutory corporate tax rate for OECD countries was around 40 per cent; in 2000 it was 32 per cent; and in 2017, it was 24.7 per cent (KPMG, 2018). "Overall, the number of countries with a statutory rate above 30 per cent decreased from 21 in 2000, to 7 in 2008 and 5 in 2016" (OECD, 2017). A recent study by the *Financial Times* shows that big multinationals' effective tax rates have fallen from around 35 per cent in the 1990s to 20 per cent or less in 2016 (Toplensky, 2018).

While there is increasing consensus that inequality is bad for economic growth, stability, poverty reduction and society overall, the insistence that tax 'competition' is (nearly always) a good thing does not seem to have changed in any significant way, especially at the national level. At the level of global institutions, concerns have been raised for decades about the likely negative impact of tax competition. The 1998 OECD report on Harmful Tax Practices concluded that governments must take measures against the proliferation of harmful tax practices resulting from tax competition. The OECD recommended intensifying international co-operation to protect tax bases and avoid a

riders”, who benefit from public goods while not contributing fairly to their financing (OECD, 1998). The negative effects of tax competition have also been a recurrent topic at the regional level. For example, France and Germany have pushed for many years to put harmonisation of the tax base in the EU on the agenda, as well as a possible minimum corporate tax rate. In the global South, the topic of tax incentives has received increasing attention, with growing acknowledgement of the contribution of many of these tax incentives to regional races to the bottom (instead of serving the purpose of increased investment and economic growth) (UN Office on Drugs and Crime, 2015).

Despite the increased international attention for the need to end harmful tax competition and to address tax incentives, national policy debates around tax incentives and the corporate tax rate often remain introverted and selfish in nature. These debates often focus on consideration of the competitiveness of the fiscal climate vis-à-vis other countries and how to outcompete them for foreign investments. These debates are heavily influenced by corporate interests and high levels of political capture and revolving-door practices.

Despite the denial of the harm of tax competition at the national level, increasingly governments are forced to acknowledge that measures are needed to prevent a corporate tax ‘race to the bottom’ (Rumney, 2018). It is not yet known exactly where the bottom is but this will be discussed further below.

Many countries argue that regional or global cooperation on corporate tax rates would violate national sovereignty. However, in a globalized world where powerful and large firms are key actors, it is questionable whether countries, especially poor countries, really can exert full sovereignty in this area. Tax Justice Network argues that the only way to reassert democratic national sovereignty on taxing MNEs is international cooperation towards systemic solutions at the global level (TJN, 2010). Without this international cooperation, countries will feel they have no choice but to give in to the demands of multinational enterprises and will continue to offer (often harmful) tax incentives or lower tax rates, out of fear of losing FDI.

2) Why time has come for a minimum effective corporate tax rate

a. Sustainable and fair finance to achieve the global development goals

In September 2015, countries across the globe adopted the Global Development Goals, a set of goals ‘to end poverty, protect the planet and ensure prosperity for all’. Governments have until 2030 to achieve the targets set out under these goals (UN, 2015), which include commitments towards ensuring access to quality healthcare and education and to reduce inequality within and between countries. The finance needed for these aims is huge. It is estimated that it will take from US\$5 to US\$7 trillion to achieve them (Niculescu, 2017). Considering the decreasing role of already insufficient international aid to poor countries, efforts have intensified to support countries with domestic resource mobilization, including improvements to tax systems.

These improvements are necessary because fair tax systems are crucial for establishing a healthy and strong relationship between the government and its citizens. “Well-functioning tax systems allow countries to chart their own futures, pay for essential services such as education and healthcare, and build trust with their citizens. Indeed, tax capacity is a fundamental development issue” (Brumby, 2016). Especially in many developing countries, tax systems are weak and there is significant potential for increasing tax revenues by improving tax administrations.

It is therefore significant that world leaders agreed, through the Addis action agenda, to ‘work to

opportunities for tax avoidance’, ‘to address excessive tax incentives’, ‘to scale up international tax cooperation’ and to ‘make sure that companies pay taxes to the governments of countries where economic activity occurs and value is created, in accordance with national and international laws and policies’ (UN, 2015). Through the Addis Tax Initiative, more than 40 countries signed the commitment to double technical cooperation in the area of domestic revenue mobilization and for partner countries to step up domestic revenue mobilization. All countries restated their commitment to ensure policy coherence for development (Addis Tax Initiative, n.d.).

Our governments have turned some of the commitments into action, including by adopting the OECD actions against BEPS (Base Erosion and Profit Shifting) (see below). Some countries have acknowledged the impact of their tax systems on developing countries. In 2017, Ireland published a review of Ireland’s tax code including consideration of the benefits for developing countries from higher levels of global tax transparency (Coffey, 2017). Ireland and the Netherlands are also reviewing their tax treaties with developing countries in response to the critique that these treaties reduce the taxing rights of developing countries and facilitate tax avoidance. In June 2017, as part of the OECD-BEPS measures, 78 countries signed a convention to incorporate anti-tax avoidance measures into tax treaties in a coordinated and consistent way (OECD, 2018). This is progress, even though many countries unfortunately opted out of critical elements of the convention or do not plan to apply it to all tax treaties with developing countries.

The ability to raise corporate tax revenues and to address tax avoidance is crucial for developing countries. “Many developing countries have relatively high nominal corporate tax rates and they rely on corporate taxes for a high share of all tax revenues. In 2017, the median nominal corporate tax rate for a sample of 36 poor countries in sub-Saharan Africa was 30%” (Henry, 2017). The corporate tax income share of overall government revenues is also relatively high in developing countries. The IMF reported that “corporate income taxes account for about 16 per cent of government revenues in low and middle-income countries, compared to just over eight per cent in high-income countries” (ActionAid, 2015: 7).

The relative importance of corporate tax revenues for developing countries makes it all the more urgent to address the current shortcomings, or major errors, in the global (and national) tax systems. UNCTAD has estimated that developing countries miss out on at least US\$100 billion as a result of corporate tax avoidance (UNCTAD, 2015). With regard to tax losses due to competition on tax incentives, ActionAid estimated that just four East African countries could lose around US\$1.5 billion and possibly up to US\$2 billion a year by providing tax incentives (TJNA and ActionAid, 2016). Based on work by the IMF, Johannesen *et al* (2016) state that poor countries are up to three times more vulnerable to the negative effects of other countries’ tax rules than rich countries, and the poorer a country, the more vulnerable.

It could be argued that there is no ‘race to the bottom’ because income from corporate tax relative to GDP has remained relatively stable despite the lowering of the corporate tax rate. This is called the ‘corporate tax paradox’. However, as several studies have pointed out, the corporate tax income relative to GDP has remained relatively stable in many OECD countries because a base broadening compensated for the rate-reduction. It can also be a result of increases in corporate profits as a share of national income, but this topic needs further research (OECD, 2017). It has also not been true for all countries. The base broadening (e.g. increase in number of taxable corporations) could arguably have led to higher (relative) corporate tax income if the rates had not been reduced.

The OECD concludes that corporate income tax (CIT) “rate reductions are all associated with significant negative revenue effects” (OECD, 2017: 59). In addition, it is clear that the income from corporate tax as a share of overall tax income has decreased significantly in many countries.

Governments have partially offset the cuts in corporate tax by raising other taxes, including VAT and personal income taxes (PIT).

In recent years, tax revenues in OECD countries have shifted towards greater shares of labour taxes and VAT. The share of CIT revenues in total taxation remained below 9% of total tax revenues in 2014, compared to 11.2% in 2007, shifting more of the income tax burden towards households... [T]he share of revenues from VAT has been increasing since 2007 and reached just over 20% in 2014. Revenues from income taxes reached 33.7% of total tax revenues in 2014. Within this category, the share of PIT in total tax revenues continued to increase following the crisis, reaching 24% of total tax revenues in 2014 (OECD, 2017: 31).

Similar declines in CIT revenues have occurred in developing countries. In Senegal, for example,

corporate tax revenues accounted for about 10% of tax revenues in 2005 but declined to between 7.2 and 8.9 over the period 2006-2012, after a CIT rate decrease from 33% to 25% in 2006. When a new government in 2012 increased the CIT rate to 30%, the CIT contribution increased to 9.3% (Oxfam and Le Forum Civil, 2015).

While corporate tax competition is leading to a corporate tax race to the bottom, it is important to understand it in the wider context of competition between countries. For example, competition for private wealth between countries seems to be intensifying. As described in the latest OECD report on tax policy reforms:

Some countries focus on high-wealth individuals as an attempt to broaden their tax base and to stimulate entrepreneurship. Italy, for instance, allows individuals who become Italian residents after having resided for at least nine of the last 10 years outside of Italy to pay a yearly lump-sum substitute of tax of EUR 100,000 (for a maximum of 15 years) on all foreign-sourced income instead of having to pay the regular PIT on this foreign-source income, in addition to the incentives for highly skilled workers; Portugal introduced a non-habitual residents (NHR) regime, which grants a special tax residency status if certain conditions are fulfilled (OECD, 2017: 47).

In his analysis of this NHR scheme, Weyzig (2017a) pointed out that the tax breaks are only for people who were not Portuguese residents during the previous five years, and the scheme requires foreigners to physically move to Portugal for at least 183 days in a year. Thereafter, however, they become entitled to pay tax in Portugal for ten years without having to live there. Lest it be thought that this discriminates against Portuguese millionaires, he points out that they in turn can opt to become residents of other tax havens like a Caribbean island, Jersey or Malta. This shows that each such scheme to compete for high net-wealth individuals generates further means to reduce their tax burden.

The tax competition between countries on income and wealth is relevant to the discussion on the corporate tax race to the bottom. *The Economist* concluded: “Many rich individuals can choose to shift the way they report their income to take advantage of lower corporate-tax rates. So it is difficult to push up the tax rate on individual incomes while simultaneously lowering the corporate rate” (*The Economist*, 2017). There is little evidence that reductions in corporate taxation are good for investments and economic growth (see more below); there is similarly no good economic rationale behind this type of competition between countries for private wealth. The IMF’s *Fiscal Monitor* in October 2017 found little support for the argument that fiscal policies aimed at progressive redistribution could harm economic growth (IMF, 2017). As summarised by a headline in *The Economist*, “Higher taxes can lower inequality without denting economic growth” (*The Economist*, 2017).

Many articles and contributions (including those of the IMF), raise the issue of lack of political support for more intensive international cooperation. While this is currently the political reality, unless governments are able to accept higher levels of coordination on corporate and private tax, tax havens will not end and the efforts against BEPS will be futile. As concluded in the 2016 report of the UN Independent Expert on the promotion of a democratic and equitable international order, “an international tax convention is necessary to stop competition among tax jurisdictions and abolish secrecy.” He also recommended that governments “agree on a minimum corporate tax rate and curb tax competition among countries, acknowledging that this policy facilitates corruption, bribery and money laundering” (UN, 2016: 25).

b. The failure of BEPS

In 2014, the IMF published a report on the international effects of domestic tax rules. The report concluded that these effects are significant and that the ‘institutional framework’ for addressing these ‘tax spillovers’ is weak. The authors argued that this weakness increases the need for “an inclusive and less piecemeal approach to international tax cooperation” And: “Current initiatives, which operate within the present international tax architecture, will not eliminate spillovers” (IMF, 2014: 35). This seems explicit critique of the BEPS action plan that the OECD agreed in 2013.

While many countries have committed to valuable actions against corporate tax avoidance through the BEPS action plan, there are many noteworthy shortcomings especially for developing countries. It was clear from the beginning that the OECD-BEPS project took a developed-country perspective and was less suited to the needs of developing countries. The proposal from developing countries to place global decision making on tax clearly under a UN structure has been rejected by OECD members for many years now. Instead, the OECD has made the OECD-BEPS project more inclusive. However, the project’s focus is mainly on implementation of those actions that OECD-countries had already agreed on, with little attention given to the fundamental changes that are needed to ensure that developing countries can raise a fair level of corporate tax.

Many of the BEPS actions require considerable tax administrative capacity, which presents significant challenges to developing countries that lack the necessary institutions. The OECD-BEPS action plan also does little to address the rising concern of developing countries that the reduction in source-based taxation; the provisions of the BEPS plan does not take their needs into account. For instance, BEPS ‘Action 7’ focuses on changes to the definition of Permanent Establishment (PE) to “prevent the artificial avoidance of PE status.” Developing countries, however, are also concerned “with the appropriateness of the PE definition generally and the extent to which it unduly restricts

source-based taxation of activities that involve substantial economic activity in the domestic jurisdiction” (Ault and Arnold, 2017: 17).

The Permanent Establishment (PE) concept concerns the level of business presence required in a source country for that country to be permitted to tax profits that are attributable to this establishment within its territory (Article 7 UN and OECD Model Tax Conventions). According to Martín Jiménez (2017: 408), the PE concept was not designed for the benefit of source countries: “Full alignment of the source-country economic presence and taxation rights can be achieved only through relevant and substantial changes in the concept of PE or by using other tools, not by reinterpreting it or by forcing the acceptance of anti-avoidance rules in a context where they do not fit very easily”. This issue is also particularly important in the context of digitalization of the economy (see below).

Another problem is that the OECD has deliberately avoided more fundamental discussions on how to address tax competition between countries in the long run. As already predicted by civil society organizations, measures against base erosion actually intensify competition between countries on corporate tax rates (Weyzig, 2015). The same risk of increasing tax rate competition applies to the EU plans for a Common Consolidated Corporate Tax Base. If the EU countries can no longer compete through differences in domestic tax rules, it is likely that competition among European countries via tax rates will intensify.

BEPS-actions have not only intensified rate-competition, but also competition through tax incentives that do not violate the OECD-BEPS agreements. “In 2016, many countries introduced enhanced or new tax incentives for businesses, driven by growth stimulus and tax competition objectives” (OECD, 2017: 59). Patent boxes and other R&D tax incentives are a clear example of such business oriented measures.. While in principle there is nothing wrong with stimulating R&D, rather than increasing investment or employment in R&D and innovation, these tax incentives significantly reduce tax revenues and encourage profit shifting. For example, the tax loss for the Netherlands as a result of the Dutch Innovation Box was more than €1 billion in 2016, or 7.6 per cent of total corporate income tax revenues (Berkhout, 2016a). In the OECD-BEPS action plan, patent boxes are not considered harmful, but countries would need to ensure sufficient economic substance (or ‘nexus’). The BEPS monitoring group warned that through this approach the OECD would legitimize ‘innovation box’ regimes and hence supply legal mechanisms for profit shifting (BEPS Monitoring Group, 2015).

Some of the OECD-BEPS actions, including Controlled Foreign Company (CFC) rules (if countries adopt the strong version) and the reporting requirement that large corporations disclose where they make their profits and where they pay their taxes, help discourage profit shifting. However, unless the OECD and other international and regional institutions address the issue of ever-increasing tax-rate competition, there is a risk of corporations “reporting the correct amount of profits in each country, but paying very little taxes over those profits anyway” (Weyzig, 2015: 10).

c. Blacklists are not the solution

While the low corporate tax rate may have helped Ireland attract FDI in the past, it has earned the reputation of creating a corporate tax haven. However, Ireland has been far from alone in capitalizing on low corporate tax. It is important to acknowledge that among the biggest global corporate tax havens are countries with far higher corporate tax rates than Ireland, that have enabled multinationals to avoid paying their fair share of tax through other policies, including patent boxes, tax rulings, notional interest deduction and the absence of effective Controlled Foreign Company (CFC) rules. Countries belonging to this category are the Netherlands, Switzerland and

Hong Kong (Berkhout, 2016b). In its push for a more systematic identification of corporate tax havens, Oxfam developed a test that assessed a country's nominal corporate tax rate, its harmful tax practices and the extent to which it participates in intergovernmental efforts against tax avoidance (Berkhout, 2016b; Chardonnet and Langerock, 2017). The national responses to this list from countries rejecting their identification as 'corporate tax havens' shows they do care about their tax reputation:

- According to the Irish Ministry of Finance spokesman, the 12.5 per cent is fully in line with the OECD and international best practice in having a low rate and applying it to a very wide tax base. It "violates no international rules" he said (Kirwin, 2016).
- "The Netherlands have a corporate tax rate of 25 per cent", the Dutch finance ministry official said. "The Netherlands also actively cooperates with international initiatives to tackle base erosion and profit shifting within the OECD, as well as within the EU" (Kirwin, 2016).
- "The Cayman Islands is not a 'tax haven.' The Cayman Islands is an efficient and effective tax neutral jurisdiction that does not add additional taxes and has been recognised for decades as a strong partner in combatting global financial crime including money-laundering, terrorism financing, corruption and tax evasion" (Scott, 2016).
- "The great progress made by Switzerland over the past years is absolutely not reflected in this rating. Its value is therefore not very meaningful" (Allen, 2016).

While lists such as Oxfam's have been successful in putting pressure on governments and raising attention among the wider public about the problem of tax havens, only regional and global institutions can ensure coordinated action and policy change. For example, the OECD's attempts to use blacklists have pushed countries towards higher levels of transparency. Likewise, the EU exhibited real courage in 2017 by publishing a grey and blacklist that was not only based on countries' lack of transparency, but also on an assessment of 'preferential regimes' and zero tax rates. As of March 2018, there is an EU list of nine non-cooperative jurisdictions: American Samoa, the Bahamas, Guam, Namibia, Palau, Samoa, Saint Kitts and Nevis, Trinidad and Tobago, and US Virgin Islands. Another 62 countries have committed to address deficiencies found, and have been put on a grey list. Out of those 62, six jurisdictions have committed to 'introduce substance requirements' (Bermuda; Cayman Islands; Guernsey; Isle of Man; Jersey; Vanuatu) and 27 have committed to improve in the area of 'fair taxation' (including Switzerland, Hong Kong, Mauritius and Curaçao) (European Commission, 2017a).

In 2018, countries on the grey and blacklist will need to change some of their policies to avoid EU sanctions, including restrictions to channel EU funds through non-cooperative tax jurisdictions.. Since the publication of the lists, several countries have agreed to implement the OECD minimum BEPS standards. While the EU list is a step in the right direction, the lack of public transparency on what preferential regimes and zero-tax countries must do to be de-listed is problematic because it suggests the EU is taking a political, rather than an objective, approach to the de-listing of tax havens. As one article on Guernsey, Jersey and Isle of Man put it: "What the islands will have to do is clear as mud to the public" (Mann, 2017). According to the EU, these islands have committed to 'introduce substance requirements', although it is yet unclear as to what those requirements are. It may also be the case that these jurisdictions will need to increase their corporate tax rates to avoid being blacklisted in the future, but as the EU regards the setting of tax rates a sovereign right, this demand has not been made explicit (Mann, 2017).

The purpose of the EU blacklist has been described as an effort "to deal more robustly with external threats to Member States' tax bases and to tackle third countries that consistently refuse to play fair on tax matters, (European Commission, 2017a)" and also as a way to "improve tax good governance

Member States do” (European Commission, 2017b). Considering that among the world’s most significant corporate tax havens are EU member states such as the Netherlands, Luxembourg and Ireland, trying to force non-members to abide by the same standards might be considered consistent. However, it is of course inadequate. Although it has not been made public exactly what the ‘fair taxation’ criteria are, it can be assumed that the criteria will not go (much) beyond the general OECD and EU agreements, with regard to identifying harmful tax practices, anti-profit shifting rules (e.g. CFC) and transparency requirements. Extremely low corporate tax rates alone are not enough to cause a country to be blacklisted and it is unclear which preferential fiscal measures have been identified as unacceptable.

Any blacklist based on a narrow tax haven definition of a country that fails to meet the current flawed international tax standards is destined for eventual failure. While the short-term improvements in tax transparency and abolition of harmful tax regimes is welcome, these initial changes will most likely be replaced by an overall lowering of the corporate income tax rate, or lead to a legitimization of other harmful tax practices. In this case, the end result will be the same, with a loss of corporate tax revenues and a shift of tax burden on to citizens. Oxfam (2017) argued that a corporate tax haven should be defined as a country or territory that plays a significant role in the corporate tax race to the bottom, in part through an absence of transparency. The international community needs to initiate a transparent and public dialogue on the definition of ‘harmful tax practice’, on the risks of the downward trend of the corporate income tax rate and on how countries can work together to prevent a race to the bottom.

Assessing tax havens in light of their contributions to the global corporate tax race to the bottom would also force EU and other countries to consider their own tax policies more critically. This reflection should provide more opportunity to consider how to support countries that currently seem dependent on their zero-corporate tax rate (instead of mainly focusing on sanctions, or other countermeasures). The reality is that for many countries, being a tax haven has not brought the level of prosperity expected (Harrington, 2016).

d. US tax reform

In December 2017, the US adopted its most far-reaching tax reforms in decades, changes that will affect poverty and inequality in the US and around the globe. The US tax reforms could provide a window of opportunity for more fundamental reforms to corporate taxation. However, the cut in the corporate tax rate from 35 per cent to 21 per cent is a major negative contribution to the global race to the bottom on corporate taxation. Also, the move towards a territorial system could intensify tax competition. As noted by the IMF for the UK and Japan, but just as relevant for the recent US changes: “Shifting profits to, or investing in, low tax countries becomes more attractive if the income generated there becomes less heavily taxed in the parent’s residence country” (IMF, 2014: 38). With foreign business profits exempted the effective tax rate in source countries becomes more relevant and this in turn can lead to more intense competition in source countries. “Tax holidays and other tax breaks become more attractive to investors if the tax saved in source countries is no longer offset by increased taxation in their residence country. The point is especially important for developing countries, with CIT bases often substantially weakened already by incentives” (IMF, 2014: 38).

The move to a territorial system has increased the risk of profit shifting from the US to tax havens, since profits generated outside of the US will no longer be taxed in the US.

Particularly relevant to the global discussions on taxing rights is the new US introduction of a 'Base Erosion and Anti-Abuse tax' (BEAT). The BEAT is designed to impose a minimum tax on profits of companies with more than US\$500m in annual revenue in the US and with significant payments for services, interest and royalties to foreign parties. The minimum rate will be 10 per cent in 2019 and 12.5 per cent in 2026. This tax is meant to discourage profit shifting, especially in today's digital economy where profit shifting has become easier. Several EU countries have raised strong concerns about this tax, as it is likely to lead to double taxation for European companies, especially in the technology, banking and pharmaceutical sectors

BEAT can be considered a vote of 'no confidence' against the current global transfer pricing guidelines. The US is not alone in deviating from international principles out of reaction to increasing concern over the inadequacy of the outdated global tax rules. The European Union is now considering a tax on turnover rather than profit so as to be able to tax the digital economy (see below). The UK's 'diverted profits tax' of 25 per cent on profits, which is considered artificially shifted to tax havens, is another example.

Countries and regions now have the choice between looking the other way as an increasing number of countries take unilateral approaches against profit shifting and base erosion, which will likely have more negative consequences such as those that accompany BEAT, or joining regional and global efforts towards a more fair and coordinated global tax system. BEAT and the discussions around taxing the digitalized economy provide an opening towards discussing the allocation of taxing rights more fundamentally. The question now is whether we can get our political leaders convinced of the need to quickly go back to the drawing board on international taxation.

The UK leaving the EU might increase the chance of finding political agreement at the EU level on harmonized corporate tax rules (the common, consolidated corporate tax base - CCCTB). "The idea of imposing a common consolidated corporate tax has been circulating in European capitals over the years, with the most fervent opponents being Ireland and the UK. Now that the latter has opted for Brexit, the opportunity now exists to push on with these necessary changes and finally take full advantage of the common market" (Kratunkova, 2017). With Brexit, Ireland will lose a strong and vocal opponent to the CCCTB within the EU (Doyle *et al*, 2017). There are valid reasons for Ireland to support the EU's efforts to collectively tackle corporate tax competition at the EU and global level. Ireland has been able to attract disproportionate amounts of MNE investments in the past, but it is losing its competitive advantage as other countries lower their own corporate tax rates. Ireland has little or no scope to further reduce its already very low corporate tax rate, as any reduction would have serious budgetary implications and reduce the Irish government's ability to invest in education, housing, and infrastructure. These public funding areas are all important for maintaining an attractive investment climate, which is why tackling a race to the bottom through further international cooperation is in the interest of all countries, even countries like Ireland.

The EU's recent decision to investigate whether the UK Group Financing Exemption complies with EU state aid rules is an indication that the EU is concerned about the consequences of the UK leaving the EU. The UK will no longer be subject to EU state aid regulations and the EU Code of Conduct for business taxation and could intensify tax competition with EU countries. Consolidating the tax base in Europe, in combination with a minimum (effective) tax rate, could stop this competition.

e. Discussion around taxing of digital economy

The challenge of taxing 'the digital economy' has intensified the discussions on harmonization of tax rules and rates. As concluded by O'Donovan (2018), "Ireland's right to set its own tax rate, and more

companies, whose profits are huge and hard to pin down, are being targeted in particular by EU tax reformers. But there is little reason to think the push for harmonisation will take in profits made by Facebook and not extend to Pfizer.”

It is increasingly recognized that new rules should apply to all businesses, irrespective of their degree of digitalization, as there is really a ‘digitalization of the economy’ as a whole rather than a separate ‘digital economy’. Action 1 of the OECD-BEPS action plan was to ‘address the tax challenges of the digital economy’. The growing importance of profits generated through digital sales, services and data have made the need to address the out-dated global corporate tax system more acute. The current international tax rules “can no longer distribute taxing rights fairly among countries and adequately define a country’s tax base” (Li, 2017: 479) As further noted by Li (2017: 480), “The digital economy threatens the tax base of the corporate income tax and the value added tax by facilitating BEPS and potentially causing the tax base to disappear (base cyberization)”. The digitalization of the economy has particularly big consequences for developing countries, which already struggle with limited taxing rights. The tax base of these countries is more at risk as these nations are net importers of digital goods and services. By June 2016, “the internet population in Africa, Asia, Latin America and the Caribbean, and the Middle East accounted for 73 per cent of the world’s internet users. Whereas 65 per cent of Chinese shoppers make purchases online via their mobile devices, the same is true of only 22 per cent of American shoppers” (Li, 2017: 481)

The importance of the digitalized economy is expected to increase. It is also combined with an increasing ‘dematerialization’, referring “to the transformation of any material object into something of virtual or digital quality” (Li, 2017: 495). The increase in digitalization of the economy makes it more difficult to define where a company is located. For example, many business functions and sales or services are in various locations, with varying degrees of digitalization and dematerialization across the globe. In addition, people are no longer merely ‘consumers’ but are increasingly contributing to value-creation as a source of big data (Li, 2017). This makes the current profit attribution rules, which are largely based on physical presence, outdated.

Several proposals are being discussed at EU and OECD level now to address the challenges of digitalization. The OECD published its interim report in March 2018, mainly highlighting a lack of international consensus on the way forward (Martin, 2018). The EC, clearly not satisfied with the lack of progress at the OECD level, put forward a short-term and long-term proposal to be discussed at the EU level (European Commission, 2018).

The short-term options considered by countries includes the proposal by the European Commission for a 3 per cent tax on gross revenues from certain digital activities (a turnover tax) based on where users are located rather than where the physical presence of the corporations is (European Commission, 2018). Yet another short-term fix for tax in the digitalized economy is to introduce a withholding tax on digital transactions. “This could apply to payments by residents of a country for online purchases of goods and services from non-resident enterprises” (Li, 2017: 518). The advantage of a withholding tax is that it will be relatively easy to implement, but it is likely that such a tax will be passed on to consumers, resulting in double taxation (BEPS Monitoring Group, 2017).

With regard to more long-term proposals, one proposal that the EU and OECD will further discuss is to adjust the permanent establishment (PE) rules to take into account significant digital presence. According to Li (2017), having a PE is either not needed or more easily circumvented in a digital economy. “Under the existing rules, attribution of profit is based on assets, ownership or intangibles and risks. Little or no profit is attributed to the role of the market, connectivity infrastructure

success of the digital business” (Li, 2017: 504). As 2014 IMF study notes, “To the extent this results in sales themselves creating a presence that could trigger a CIT liability, the change in the current international tax architecture would be profound” (IMF, 2014: 50). A new PE definition should also enable allocation of profits to a ‘virtual PE’, one that does not necessarily have a physical presence but a clear digital presence in a jurisdiction (Li, 2017).

The European Commission sees scope within the proposal for the CCCTB to revise the PE rules and to ensure an apportionment approach based on a formula that effectively captures digital activities and attributes profits in a way that better captures how and where value is created (European Commission, 2017d).

The BEPS monitoring group has also suggested adopting a residence-based, worldwide taxation system through which MNEs would be taxed on worldwide profits in the country of residence of the ultimate parent, but then eligible for a credit for foreign taxes. This option was not considered during the OECD discussions on base erosion and profit shifting, and with the move of an increasing number of countries (like the US) towards territorial systems, this approach does not seem to have much traction. Also according to the BEPS monitoring group, another possibility could be a combination of the long-term options, for example “regional formulary apportionment with full-inclusion for CFCs outside the region” (BEPS Monitoring Group, 2017: 22).

The fact that different short-term proposals are on the table reflects a political lack of confidence that a regional or global-level consensus can be achieved on fundamental changes. Moreover, the options also reflect a lack of clarity, or perhaps lack of agreement, on the exact problems that need addressing. Central questions that need to be answered include how to address the digital economy problem of corporations shifting their profits to tax havens in which they have little real economic activity; how to determine what level of tax constitutes a country’s ‘fair share’; how to address the fact that profit shifting activities of large multinationals contribute to unfair competition between small and medium enterprises and large multinationals; what to do about the likelihood that this unfair competition will put further pressure on governments to lower the CIT rate for all corporations, exacerbating the race to the bottom and the immediate revenue-raising challenges for governments around the globe. To solve this last problem, governments will not be able to rely on temporary solutions, but will need to support more fundamental, lasting reforms.

f. Need to end business pressure to eliminate CIT

Business representatives often insist that lowering the CIT attracts FDI and increases economic growth. These arguments were used in The Netherlands when large corporations successfully lobbied for abolition of tax on dividends (Thompson, 2017). Large companies in the US and other countries that successfully lobbied for decreases in CIT also used these same arguments. There is research that can be used to support business’s arguments. OECD research, for example, (used by Ireland to support its low CIT), suggests that a 1 per cent rise in corporation tax results in a fall in FDI of 3.7 per cent (Department of Finance, 2014; Hodge, 2016). However, even OECD tax experts are starting to explain that while lower corporate tax rates may boost GDP, they are likely to lead to undesirable tax competition and to contribute to higher levels of income and wealth inequality (Bowers, 2016). With regard to the US corporate tax rate reduction, IMF’s chief economist has said that the lower rate might just give a “one-off boost”, but that the US economy will “ultimately face an economic bill” of lower growth later, reduced revenue and increased federal debt (see Ryan, 2018).

Other studies strongly challenge the business (and OECD) claims that lower corporate tax rates are positive for economic growth (Shaxson and O'Hagan, 2013). A study for the Australia Institute on Australia and OECD countries found no correlation between corporate tax rates and economic growth (Richardson, 2016). In Australia, increased levels of investment can be most accurately explained by the impact of a mining boom and of privatisations. The study concludes: "If the aim really is increased economic growth, then Australians would be better advised to ignore the business lobby's call for lower company tax rates and look seriously at other policies" (Richardson, 2016: 16). A study by the Canadian Centre for Policy Alternatives on the interplay between the Canadian CIT regime and growth found no significant relationship between CIT and growth. This paper even suggested that CIT rate reductions might contribute to slower growth. The conclusion was that "If the findings contained in this paper are true, then corporate income tax cuts will go down as one of the great Canadian public policy blunders of recent times" (Brennan, 2015: 6). In a 60-nation panel study that tested the assumptions that lower corporate tax rates increase FDI and lead to GDP growth, it was found that while reduced corporate tax rates may attract FDI inflows, "that influx does not lead to the expected economic growth". The study found, rather, that countries that lowered their marginal CIT rates most, "significantly decreased their economic growth rates". The apparent inflow of FDI "may be in financial instruments for debt-reducing, tax-deductible write offs, as opposed to operational FDI that generates economic activity" (Anguelov, 2015: 28-29).

For business investment decisions, tax rates and policies matter but may not be the main determinants (OECD, 2008). To analyse the relationship between tax rates and competitiveness, Weyzig analysed the top 50 countries in the Global Competitiveness Index and found that tax rates on profits are irrelevant for a country's competitiveness (with a few exceptions). He found that "highly competitive discounters," including Switzerland, Singapore, Hong Kong and Ireland are just as competitive as "notorious high-tax countries," a group that includes the US, Germany, Japan, Belgium and France (Weyzig, 2017b).

Despite the aforementioned research, it seems that business representatives are not just asking for lower corporate tax rates, but for completely replacing corporate tax with other forms of taxation (such as VAT or sales tax). While the evidence is thin on the need to lower corporate tax rates, the justification for replacing corporate tax seems to be missing altogether. This topic needs more attention from policymakers, researchers and civil society, as with the lack of international consensus on how to tax corporations fairly, and with the move from some governments and regions towards turnover tax (e.g. EC proposal for taxing large digital corporations), the corporate income tax may be heading towards an existential crisis.

According to Richard Murphy, Professor of International Political Economy at City University London, replacing the corporate income tax with a sales tax, "would create massive complications in the tax system; would shift the burden of tax onto lowest paid and small business, would increase income and wealth inequality. It would also give big business a real boost in their competitive advantage as a result of that tax boost... I can see every reason why a lot of lobbying will be thrown in the direction of such a tax now" (Murphy, 2016). Grahame Steven, of Edinburgh Napier University, explains in a brief summary on the topic that this would be bad for companies as they would be taxed on their sales even when making small profits or even losses; it could, as a result, be a disincentive to investment. A sales tax would have to be introduced on a global scale, as companies cannot pay taxes on profits in some jurisdictions but on sales in others. Alternatively, sales could become focused on countries with lower tax rates, which would intensify a race to the bottom. It would also be complicated to define which tax rate to apply to different business sectors and different business models (Steven, 2016). Justin Doss, who teaches public finance and economics at Indiana University,

examined theory and case studies on turnover taxes and concluded that developed countries have had good reasons to abandon them. In countries with very weak tax administrations, such as in some developing countries, this type of tax could enable them to raise more corporate tax (Ross, 2016). However, as a study on Pakistan concluded, in a situation with relatively strong tax administrative and enforcement capacity this should not be the preferred option. In such circumstances taxing profits is preferable (Best *et al*, 2014).

In the Netherlands, civil society organizations investigated the influence of big corporations and their tax advisors on the Dutch government policies. They looked first at the relationships between tax advisors and universities, as universities are important contributors to Dutch policy making. Out of 289 tax partners, 40 were connected to one or more universities, many of them as professors. In 2011, 26 per cent of professors at the accountancy departments of Dutch universities were also tax partners at one of the big four accountancy firms. Tax advisors were also found to take central positions in advisory bodies, committees and working groups that inform the policy and positions of Dutch political parties and of the government (Berkhout, 2016a). Through an access to information request, documents were made public that showed that the Dutch government consulted intensively with business representatives before taking new tax policies to parliament and found their approval very important (Oxfam Novib, 2016). The lobbying of business representatives has been focused on protecting the ‘fiscal crown jewels’, including the Dutch tax rulings system, the innovation box, and the lowering of corporation income tax to compete with other countries. While consultation with corporations and their tax advisors is important, what remains to be seen is whether governments remain able to keep the public interest in mind when they make their policies.

Instead of governments serving business interest by reducing the corporate income tax, what the general public needs is a government that is able to defend (a fair level of) corporate income tax and to reject risky alternatives.

3) What a global minimum tax rate might look like

If the objective of governments truly is in line with the sustainable development goals, the objective of any industrial policy should not be focused on competition with other countries, as competition naturally includes ‘winners’ and ‘losers’. Creating losers is not in the spirit of the sustainable development goals, including ensuring quality access to health and education and reducing inequality within and between nations. While the current competition-focused strategies of many countries may be compatible with the political reality of global competition, in the medium to long-term, these strategies are extremely harmful to all countries.

The ability of governments to collect tax is harmed by regional and global corporate tax competition. This competition undermines the efforts by governments to achieve the sustainable development goals and to fight poverty and inequality. Corporate tax incentives, including lowering of overall corporate income tax rates, have led to a shift in tax burden from large corporations to citizens while decreasing much-needed funding available to governments. In response to the developments described in this chapter, governments should seriously consider working towards setting a minimum effective tax rate for corporate profits at the national, regional and global level. Such an initiative would help to prevent a further race to the corporate taxation bottom.

A few proposals have been put forward so far for a minimum (effective) tax rate, including by the rapporteur of the European Parliament Committee on Economic and Monetary affairs, Paul Tang, to introduce a minimum corporate tax rate of 15% in each EU member state. Oxfam is currently

preparing a position paper on a global minimum effective tax rate, including how it could be implemented and the rate it should be set at. This will hopefully advance thinking on this area.

Importantly, one minimum effective tax approach published so far would even enable countries or regions to take the initiative without having to wait until a worldwide agreement. Azam (2017) suggested for the US to adopt a minimum global effective corporate tax rate, to serve as a general anti-avoidance rule against international corporate tax avoidance. Building on his work, governments could consider the following to end the corporate tax race to the bottom: they can decide that when the *global effective corporate tax rate* of any multinational and its Controlled Foreign Companies (CFCs) falls below 20 per cent, the corporation should be required to close the gap and pay up to the minimum of 20 per cent or the CIT rate in the home country (if above 20 per cent). Countries with a statutory rate of less than 20 per cent could commit to ensuring that within two years they would impose a minimum effective corporate tax rate of at least 10 per cent. Countries and regions can advance alone on this. As Azam (2017) remarked on his proposal for a minimum global effective corporate tax rate: “This might produce a race to the top, since residence countries will be increasingly interested in adopting the regime and setting a minimum rate in order to get the right of taxation as the resident country”.

A minimum effective tax rate of 20 per cent should be acceptable, considering the current effective tax rate that corporations report is often higher. In the EU, it is not just the statutory rates that have declined, but also the effective tax rates, which have decreased significantly over the past decade but are still above 20 per cent on average (European Commission, 2017e).

While a rate of 20 per cent could be set as a minimum to discourage further profit shifting to tax havens, countries should adopt regional and global objectives to ensure that revenue from the corporate income tax is sufficient to meet the sustainable development goals. At regional and global level it should be considered to adopt targets on increasing the regional and global average CIT (e.g. 30% in 2030). In agreeing such a proposal consideration may have to be given to adopting a bandwidth of (effective) tax rates to be adopted differentiating between smaller/bigger economies based on GDP.

In addition, jurisdictions that claim to be dependent on extremely low corporate tax rates need to be supported to move towards a more sustainable economy.

This proposal would not necessarily rule out all tax incentives. Some exceptions could be made for sectors with clear and explicit social benefits (e.g. for the purpose of greening the economy), but in these cases governments should place caps on private shareholder and executive pay.

Beyond working towards a minimum effective tax rate, countries should consider moving towards a complete overhaul of the current global tax system, or a system of unitary taxation. The discussions on the CCCTB, BEAT and the taxing of the digitalized economy open windows of possibility for such a scheme. A complete tax overhaul of this magnitude, however, will present a whole new set of challenges, especially for developing countries. The success of a unitary taxation model will depend on the influence that poor countries have in the negotiation process at the regional and global level on how to apportion profits across jurisdictions. This will determine whether the taxing rights of developing countries will improve.

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Apple Tax Case and the Implications for Ireland

Jim Stewart

Abstract

The focus of this chapter is on tax strategies that stem from aspects of Ireland's corporate tax regime. The chapter deals in particular with Apple tax strategies, and the European Commission ruling on Apple. The chapter critically examines the Irish Government's and Apple's case against the European Commission ruling. Finally the chapter considers more broadly the case against the European Commission State aid cases from the United States Government perspective that the decision creates additional uncertainty in tax with considerable adverse implications for economic growth.

Apple Tax Case and the Implications for Ireland.

Introduction

Taxation of large corporations has moved centre stage. In part, this shift relates to concern about taxation of the digital economy. This is important because, as noted by the EU (European Commission, 2017a, p. 5), “Digitalisation affects all businesses, but to varying degrees”. That is to say, it is a continuum and not a dichotomy. For example aircraft travel and tourism has a very large digital element – payment, marketing and provision of some services, but would not generally be recognized as being part of the digital economy.

In association with taxation, regulation of large firms in the ‘digital age’ has also become a central issue. Particular problems have received extensive publicity, for example, using digital platforms to interfere in the U.S. and other elections. These problems stem from a concentration of power. This concentration of power “creates a new set of gatekeepers, allowing a handful of platforms to control which ideas and opinions are seen and shared” (Berners-Lee, 2018).

Dominance of key sectors by MNEs has been a recurring theme. For example, the dominance of what were known as ‘the seven sisters’ in oil production for three decades preceding the 1973 oil crisis (Sampson, 1975). Likewise, the dominance of U.S.-owned companies has long attracted interest (Servan Schreiber, 1967).

Ireland is central to the tax strategies of several major U.S. corporations such as Apple and Google. This chapter deals in particular with Apple tax strategies, including recent disclosures from the ‘Paradise Papers’, and the EU ruling on Apple. The chapter critically examines the Irish Government and Apple case opposing the EU ruling. The chapter then considers the U.S. Government case against the European Commission state aid ruling, a decision that creates additional uncertainty in tax with considerable adverse implications for economic growth. Issues relating to a possible windfall gain of more than two times tax revenues for Ireland and possible revenue losses for the U.S. are not discussed.

Maintaining a low corporate tax and attracting foreign direct investment are key aspects of Irish economic policy. Irish industrial policy can be summarised as continuing to focus “on attracting and retaining foreign direct investment and a competitive corporate tax strategy is a key tenet of that policy” (Department of Finance, 2013; Grant Thornton, 2014). In particular, tax policy and foreign direct investment (FDI) have been seen as key to Ireland’s economic recovery. In this regard, the Apple case is significant because it calls into question the use of favorable corporate tax regimes to attract FDI.

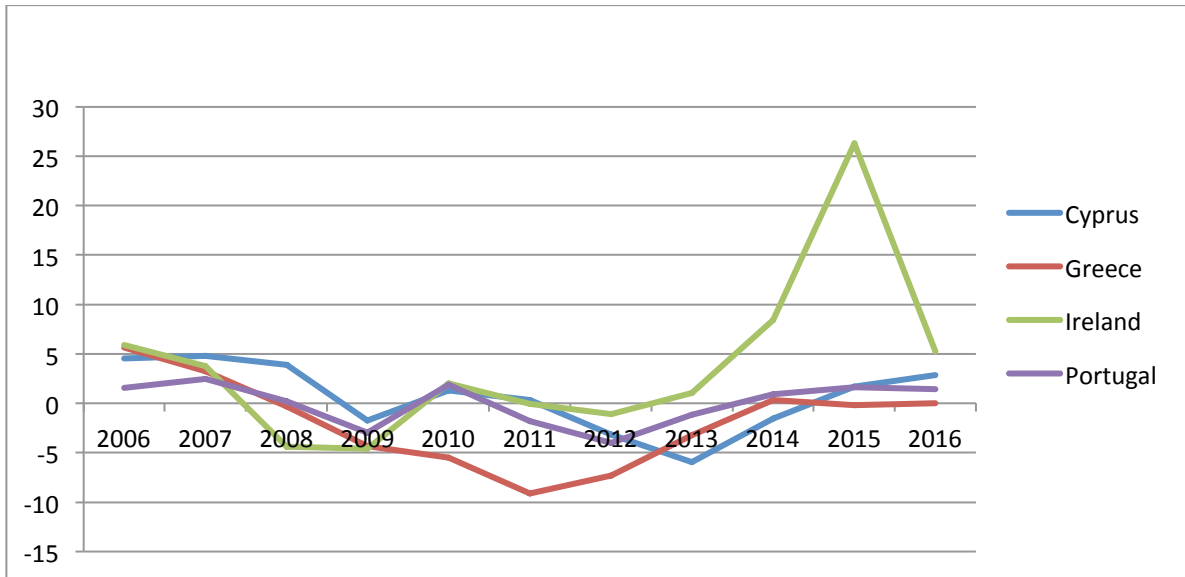
The chapter is structured as follows: the first section discusses the role of FDI in Irish economic growth and recovery; the next section discuss the European state aid cases and their implications; this is followed by a discussion of Apple and its tax strategies and

effective tax rates; then the Commission Apple Decision and appeals are then considered; then a consideration of the arguments of the U.S. Government that State aid cases have created uncertainty in tax positions. Finally, the chapter considers some policy recommendations for industrial strategy.

(1) FDI and Irish economic growth and recovery¹

Figure (1) shows the recent fall in Irish GDP followed by recovery. The figure shows GDP change for three other bailout countries. It also shows that all four bailout countries have experienced growth in recent years. Irish economic growth was a spectacular 26.5% in 2015. Some reasons for this improvement will be discussed later.

Figure (1): GDP Change 2006-2016

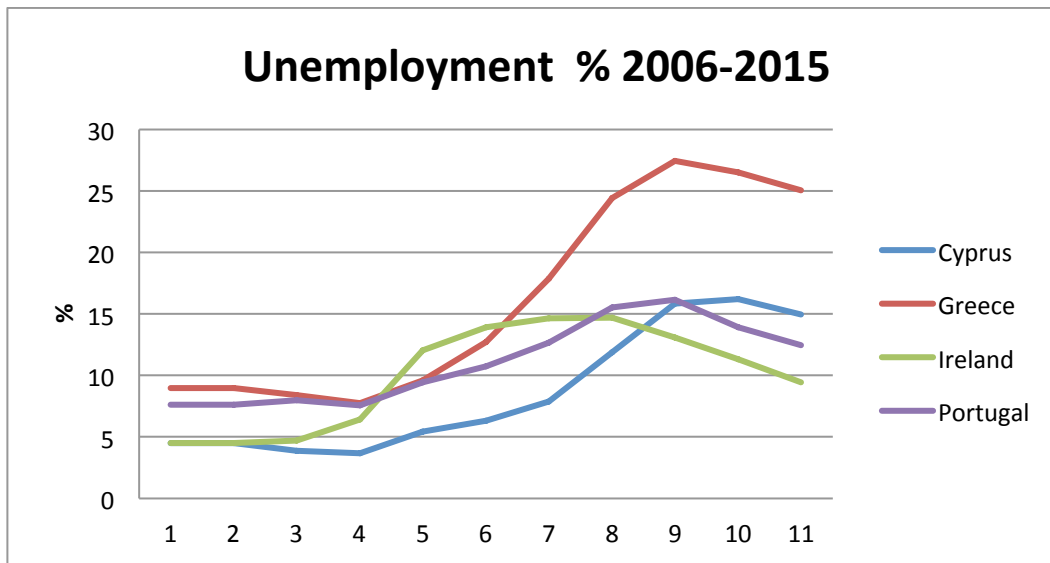


Source: IMF World Economic Outlook database

Figure (2) shows rising rates of unemployment followed by a fall in all countries. Again, Ireland experienced the steepest decline in unemployment rates. Similar to other 'bailout countries', there has been net migration from 2009 to April 2015, but also growth in employment. An important question: was the fall in unemployment due to Ireland's industrial policy to attract FDI?

¹ All charts are from The IMF World Economic Outlook database available at

Figure (2)



Source: IMF World Economic Outlook database

What explains Ireland's recent economic success?

(a) Reasons for the recovery

Ireland's very favorable corporate tax regime and the role of FDI are often cited as the main reasons for the economic recovery in Ireland. However, GDP growth is an unreliable indicator of economic health, as interpreting Irish national account figures has become increasingly difficult due to the effects of MNE tax strategies such as switching profits to Ireland via transfer pricing. The recent growth in GDP (and growth in corporate tax payments) may be largely explained by MNE tax strategies. The level of direct investment, excluding the Irish Financial Services Centre, rose from €168 billion in 2013 to €560 billion in 2016.² This increase is mostly explained by inflows of intellectual Property (IP). The increased value of IP has in turn led to an increase in profits and corporate tax payments. Trading profits increased from €95.3 billion in 2014 to €141.7 billion in 2015. At the same time the value of capital allowances increased from €2.6 billion in 2014 to €26.8 billion in 2015 (Tancred, 2016, p. 8), reflecting the large increase in IP tax credits. So that while trading profits increased by €46 billion corporate tax payments increased by €2.2 billion to €6.87 billion between 2014 and 2015. Capital allowances on the value of IP, plus interest deductions on the financing of IP, are an integral part of the recent tax strategy of Apple as discussed later.³

² CSO, Dublin, Quarterly International Investment Position and External Debt, Table (4).

³ The European Commission Working Paper no. 71 states (p. 12):- "Ireland stands out as the Member State with the highest net royalty payments (as a percentage of GDP), which is consistent with a potential ATP

The U.S. Bureau of Economic Analysis (BEA) has consistently reported larger net income of U.S.-owned investment in Ireland than is compatible with published Irish economic data (see Table 1). One reason for this was because a small number of firms were 'stateless', such as Apple. These firms were not regarded as resident in Ireland for tax purposes and their profits were not recorded in Irish economic data. In fact, Apple famously declared to the U.S. Senate subcommittee on investigations that they were not resident anywhere for tax purposes.⁴

Similarly, profits of MNE subsidiaries that use a 'double Irish' tax strategy (Google is an example), were allocated in Irish economic data to where they were deemed to be 'managed and controlled', or rather where they were resident for corporate tax purposes (often locations such as Bermuda or the Cayman Islands).

The recent increase in measured GDP reflects the incorporation of previously earned profits in Irish resident but not tax-resident subsidiaries, in Irish economic data. It is no longer possible for Apple to remain stateless for tax purposes, and around 60 per cent of the value of Apples Group profits are declared in Ireland, so that Apple is now one of the largest payers of corporate tax in the country.⁵

Table (1) shows that profits of U.S. MNEs increased between 2014 and 2015, although the increase was not as great as that shown in Irish statistics. Table (1) also shows that nearly 68% of total profits earned by U.S. firms within the EU are earned within three countries: the Netherlands, Ireland and Luxembourg, where tax rates are low (under 3 % for 2015) and have fallen in recent years in the case of Ireland and the Netherlands.

⁴ Apple famously stated to the Senate subcommittee (2013) that "Apple has not made a determination regarding the location of AOI's central management and control. Rather, Apple has determined that AOI is not managed and controlled in Ireland"

⁵ Tim Cook wrote in 2016 "we have become the largest taxpayer in Ireland" see

Table (1)
Net Income of U.S. MNEs in Various Countries (\$ billions)

	2013	2013	2013	2014	2014	2014	2015	2015	2015
Low tax Countries	Net Income	Tax Paid	Tax Rate %	Net Income	Tax Paid	Tax Rate %	Net Income	Tax Paid	Tax Rate %
Netherlands	134.1	3.7	2.7	152.6	5.6	3.5	186.5	3.8	2.0
Luxembourg	112.7	0.4	0.4	124.4	0.8	0.6	81.6	0.8	1.0
Ireland ¹	106.8	3.6	3.3	115.3	4.0	3.3	131.6	4.0	2.9
Bermuda	76.5	0.2	0.2	84.2	n.a.	n.a.	70.4	0.7	1.0
Switzerland	64.5	2.9	4.3	70.6	2.8	3.8	69.9	3.1	4.2
UK Islands Caribbean	49.6	0.9	1.7	74.2	0.7	0.9	63.0	0.6	0.9
Others									
France	6.8	3.5	33.9	2.4	4.1	63.0	7.9	3.5	30.1
Germany	16.9	3.9	18.7	23.0	6.7	22.6	21.1	4.9	18.8
UK	72.3	8.6	10.6	9.7	9.1	48.4	11.8	7.1	37.6
E.U.	483.2	32.0	6.2	544.3	40.3	6.9	585.8	32.6	5.3
Total World	1044.6	138.9	11.7	1166.2	160.6	12.1	1065.8	91.2	7.9

Source: U.S. Bureau of Economic Analysis various issues

(b). What about employment?

Discussions of the impact of FDI sometimes refer to the total number employed in foreign-owned firms. For example, the Department of Jobs, Enterprise and Employment (2014, p. 1) states:

“Foreign Direct Investment (FDI) has been a key contributor to Ireland’s economic development and growth through providing rewarding employment for over 250,000 people directly, knowledge transfer, and transformation of the enterprise base.”

The CSO estimated the total number of those employed in foreign-owned firms to be 297.7 thousand in 2012 and 305.9 thousand in 2015, an increase of 7,200 thousand. Table (2) shows that total employment increased between these two dates by 18,500. This growth seems to indicate that employment in foreign owned firms, while important, is not the most significant contributor to recovery.

Rather than total employment in foreign-owned firms, which includes Tesco (14,500 employees)⁶ and Lidl (4500 employees)⁷ Marks and Spencer (2300 employees)⁸, etc. Most analysis focuses on what are described as ‘agency-supported’ foreign-owned firms, in particular U.S.-owned firms. Thus total employment in foreign-owned firms likely

⁶ See <http://www.top1000.ie/tesco>.

⁷ See <http://lids.lidl.ie>

overstates the extent to which FDI, as conventionally understood, has driven employment growth during the recovery.

Indeed, according to the Industrial Development Authority (IDA) there were 111,600 employees in U.S. companies in Ireland in 2012 and 137,700 in 2015, an increase in employment of 26,100. However CSO data for employment amongst U.S. companies shows a much smaller increase of 6,100 during the same period.

Table (2)
Employment by U.S. firms in Ireland

Year	US BEA Data ¹	IDA Data ²	CSO ³	CSO ⁴
2016		144.06		
2015	124.8	137.7	115.9	122.0
2014	123.6	125.6	111.6	117.9
2013	106.8	118.4	110.04	116.6
2012	106.6	111.7	109.7	116.3
2011	98.3	106.8		

(1). Majority-owned foreign affiliates. (2) IDA Annual Report and accounts

(2) IDA Annual Report and Accounts

(3) CSO (2015) defined as 'location of owner and referred to as "United States".

The data refers to ". Foreign affiliates with voting rights resident in the U.S. CSO (2015) Table 3.3. Location refers to the location of the *Ultimate Controlling Parent*,

Definitions:- Although 10 % ownership of the voting power is recommended as the lower threshold for FDI, the Benchmark Definition (BMD4) follows the OECD Handbook on Economic Globalisation Indicators in recommending that the Activities of Multinational Enterprises (AMNE) should be compiled for the controlled subset of foreign affiliates. The controlled subset is defined as part of the Foreign Direct Investment Relationship, as the subsidiaries of the parent. Subsidiaries are entities in which a direct investor owns more than 50% of the voting power Source <http://www.cso.ie/en/releasesandpublications/ep/p-fdi/fdi2015/ae/> Table 3.3.

(4) Defined as "regional location of owner" referred to as "America". Source <http://www.cso.ie/en/releasesandpublications/ep/p-fdi/fdi2015/ae/> Fig. 3.1

This publication presents employment data based on administrative data sources, namely the Revenue Commissioners' P35L dataset of employment. Employment, for the purposes of this section, is defined as the number of permanent employees in an enterprise in a given year. This includes both full-time and part-time employees. In order to include temporary employees and employees who commence/finish work during the year, a number of temporary employees whose cumulative insured weeks amount to a full year, are counted as one employee.

Source:- CSO:- Foreign Direct Investment in Ireland 2015.

Table (3) thus shows most employment growth in the period between Q3 2011 and Q4 2015 came from sectors other than those dominated by U.S. MNEs.⁹ The table also shows that

⁹ Reported employment by firms such as Apple often varies for the same period for different sources. For

employment in these sectors continued to grow between Q4 2015 and Q4 2016, but that employment has yet to reach a pre-recession peak of 2.146 million.

Table (3)
Employment by Sector ('000)

Year	Jun/Aug 2007	Q3 2011	Q4 2012	Q4 2015	Q4 2016	Change Q3 2011 to Q4 2015
Agriculture and Food process.	104.7	81.1	90.0	106.4	109.7	+25.3
Accommodation and Tourism	138.4	111.1	118.3	143.1	148.0	+32.0
Construction	283.2	107.5	103.2	126.6	138.2	+19.1
Total employment	2146	1796.5	1849.9	1983	2048.1	+ 186.5

Source:- CSO, Quarterly National Household Survey, Q3 2016, Table 2, and Q 4 2008, Table 2b.

(2). State aid cases

On a global basis, the widespread use of tax havens and tax avoidance strategies has resulted in considerable adverse comment due to the growth and size of assets held offshore (Henry 2012, p. 36), and as a result of increased tax avoidance. Losses due to corporate tax avoidance alone are estimated at \$100-\$240 billion per annum by the OECD (2015a, Table 3.3), while other estimates are much higher (Oxfam, 2016, pp. 12-13).

Low tax policies have been subject to criticism from the OECD BEPS program, from EU initiatives and also from State aid cases. State aid cases have played an important part in reforming corporate tax within the EU, as have OECD and European Commission proposals for increased information exchange and an anti tax avoidance directive.¹⁰

The state aid cases are important because for many countries such as Ireland, the corporate tax regime is more important than the nominal tax rate. For example, tax rulings that permitted stateless income, or the 'double Irish' and legislation that enables financial firms availing of special tax reliefs ('section' 110 firms) to have an effective tax rate close to zero, are far more important than the nominal tax rate.¹¹ State aid cases have resulted in a number of these tax rulings becoming illegal, and furthermore have signaled that the Competition Directorate could potentially challenge tax rulings that favor a single sector.

Similar to the aims of the OECD, a key motivation of EU policy is to prevent 'unfair tax competition'. A second key objective is to ensure that "income is attributed to where value is created" as in proposals for a common tax base (European Commission, 2016b, p. 2). The

before the Permanent Subcommittee on Investigations US Senate, May 31, 2013 states (p. 2), that there Apple "employs nearly 4000 people" whereas the Senate Subcommittee report (2013, footnote, 103) states there were 2452 employees.

¹⁰ See European Commission "Anti Tax Avoidance" https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package

Directive on Tax rulings is also designed to “deter tax authorities from offering selective tax treatments to companies” (European Commission press release on Tax Transparency 6 October, 2015). The EU Competition Directorate has been investigating tax rulings of member states since 2013 on the basis that tax rulings have resulted in granting “selective tax advantages” that constitute state aid (Almunia, 2014).¹²

Decisions that tax rulings constituted illegal State aid have been made against the Belgian Government, Luxemburg in relation to Fiat, and the Netherlands in relation to Starbucks (European Commission Press Release, January 11, 2016). In these latter cases, tax repayments will amount to €20-30 million. The Commission has required Ireland to reclaim a far larger sum of €13 billion in illegal State aid plus €6 billion in interest from Apple. This constitutes a total of almost three times its annual corporate tax receipts (European Commission Press Release, August 30, 2016a). Preliminary findings of illegal State aid have also been made in relation to Amazon and McDonalds in Luxembourg, IKEA in the Netherlands (EU Commission, State aid: Commission opens in-depth investigation into the Netherlands' tax treatment of Inter IKEA, 18 December 2017) and further investigations of other companies are possible.¹³

Prior to publication of the Commission rulings, the Governments of four countries issued similar statements that suggested they expected to be exonerated. In relation to Apple, the Irish Minister for Finance stated that “Ireland is confident that there is no state aid rule breach in this case”. Even though Ireland would benefit from any tax payments the Minister also stated that “we will defend all aspects vigorously”.¹⁴ After publication of the Commission findings, all four countries appealed the Commission decisions to the European courts, as did Starbucks, Fiat and Apple.

The Minister for Finance stated after publication of the Commission findings :

“The Government has decided unanimously to bring an appeal before the European Courts to challenge the European Commission’s decision on the Apple State aid case. I believe that there are some very important principles at stake in this case and that a robust legal challenge before the Courts is essential to defend Ireland’s interests” (Department of Finance press release 2/9/2016).

There are a number of reasons given why the Irish Government is appealing the Apple decision. To begin with, Ireland seeks to “challenge the encroachment of EU state aid rules

¹² See EU “State aid: Commission investigates transfer pricing arrangements on corporate taxation of Apple (Ireland) Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg), Brussels, 11th June 2014.

¹³ See Gaspard Sebag and Aoife White, “Microsoft Taxes Said to Face Scrutiny as EU Quizzes Luxembourg”, Bloomberg, July 4, 2014; Jim Brunnsden and Josh Noble, “European Commission to examine Google’s UK tax deal”. Financial Times. January 28 2016.

into the sovereign Member state competence of taxation”.¹⁵ Other motivations will be discussed later. The next section discusses some key features of Apple and its tax strategy.

It is also of interest that the Irish Government finally agreed terms to collect sums due and announced the fund manager in March 2018, after the Commission initiated a case against Ireland.¹⁶

3. Key features of Apple

Table (4) below shows values for Apple using different criteria. The table shows that market values are approximately twice the Balance Sheet values, and that the largest valued item in the Balance sheet is not fixed assets but rather cash and near cash. In this case, all non-cash assets (buildings, machinery, inventories) are under 15 per cent of market values for each year 2012-2016.

(4)
Apple values (\$ billion)

	Market value	Balance Sheet values	Balance Sheet/market values %	Non-cash assets/total B/S assets %	Non-cash assets/Market values	Cash and near cash/Balance Sheet values
2016	617.588	321.686	52.1	26	13.5	74
2015	598.344	290.345	48.5	29	14.0	71
2014	647.361	231.839	35.8	33	11.8	67
2013	504.770	207.000	41.0	29	11.9	71
2012	500.610	176.064	35.1	31	10.9	69

This asset structure is similar to new economy and internet-based firms such as Google and Facebook and has key implications for tax strategies. A central aspect of Apple tax strategy is in the location of its intangible capital, which includes intellectual property. In tax planning, this designation can be extremely important, as location can be ambiguous (Bryan et al, 2017). Bryan et al. argue that “it is increasingly possible to unbundle assets in terms of their legal protection, their tax jurisdiction and the location for registering revenue streams that they generate “ (Bryan et al 2017, p. 67). This means that Apple IP assets may be owned in the U.S. with strong patent protection, but income from this IP may be transferred to Ireland with low effective tax rates.

The Apple Group has seven (identified) subsidiaries incorporated in Ireland; three (AOI, ASI and AOE) are not resident for tax purposes, and all are organized as unlimited companies.

There are a number of reasons for the success and high profitability of Apple and other U.S. companies. U.S. MNEs often establish a dominant market position for a variety of reasons.

¹⁵ The U.S. Treasury (2016) has also published a detailed critique of Commission state aid cases

Their organisational structure and competencies are particularly well-suited to take advantage of the single market. For example :

a. **Organisation specific competencies:** the ability to outsource production and to produce with no reduction in quality, as in the case of Apple; the development and use of ‘enabling technology’, in the case of Facebook and Google.

b. **Organisational structure:** in particular the use of value chains and ‘shell companies’ (for example unlimited companies in Ireland, Dutch Partnerships); the location of key subsidiaries in tax havens/low tax jurisdictions such as Jersey enables widespread use of tax avoidance strategies and further distorts competition. ‘Shell’ companies may have billions in assets, revenues and profits, and yet have no employees.

c. **First mover advantages:** the use of marketing and extensive litigation to protect market position, for example in the case of the ‘smart phone wars’, and to develop market dominance.

d. **Regulatory arbitrage.** U.S. firms have particular advantages in exploiting differences in regulation across countries. An example is in data collection and transmission, and also within countries where absence of regulation enables firms to behave as companies without being regulated as one, such as in the provision of accommodation without regulatory requirements faced by hotels.¹⁷

The success and high profitability of Apple is driven by the development of ‘organizational competencies’, market power, and intellectual property.

Organizational competencies include ‘factory-less production’ (contract manufacturing). For example, Apple’s subsidiary in Cork, ASI, contracts with a firm in China to produce finished products. These products are then shipped from China to the final market. While en route ASI pays for the goods. The U.S. Senate Report states (2013, p. 27): “Once ASI took initial title of the finished goods, it resold the goods to the appropriate distribution entity, in most cases without taking physical possession of the goods in Ireland.” Through this scheme, ASI has earned substantial income.

Apple has built considerable market power through bundled technologies and products that are not compatible with rival producers (i.e. marketing, obsolescence in products through continuous software updates, enhanced features, and far greater memory and computing capacity.¹⁸

Mazzacuto (2015, p. 210) states:

¹⁷ There are other examples of regulatory arbitrage as an organisational competence by non-U.S. companies, for example Ryanair and the rather elastic concept of ‘self-employed’

“Apple’s success did not hinge on its ability to create novel technologies; it hinged on its designing, operational and organizational capabilities in integrating, marketing and selling those low-hanging technologies.”

Once Apple gained control of these technologies, it has been involved in lawsuits over several years where Apple has been sued by rivals such as Nokia (Waters and Dye, 2016), and has in turn sued other firms such as Samsung (Gibbs, 2015). These lawsuits have been widely reported and are referred to as the “patent wars” (Waters and Dye, 2016)¹⁹.

4. Effective tax rates and Apple

As noted, Apple’s operations in Ireland are very important for the company’s profitability and tax structure. Since 2013, the Apple Form 10K has stated:

“Substantially all of the Company’s undistributed international earnings...were generated by subsidiaries organized in Ireland”.

It should be noted that Form 10K income’ is in general shown by broad geographic area. For example, Europe is shown as a whole, and pre-tax profits are not broken down by country or even by region.

Prior to 2013, Apple had no reference to Ireland and its tax position in Form 10K. Although Apple had numerous subsidiaries throughout the world, its 2012 Annual Report refers to only four, three of which are in Ireland. In 2010-2011, its annual report referenced three subsidiaries (two were in Ireland), and prior to 2009, it referenced only two subsidiaries (one was Ireland). In fact, Apple currently has seven longstanding subsidiaries in Ireland.

The U.S. Senate (PSI, 2013) found that one subsidiary located in Ireland (Apple Sales International) had no employees, an income of \$22 billion in 2011 (64 per cent of group income) and paid \$10 million in tax (Table 7). This compares with income before tax for the Apple group of \$34 billion for 2011 and cash tax payments of \$3.3 billion. The U.S. Senate Report also groups Ireland as a tax haven along with Bermuda and the Cayman Islands (p. 3) stating that “Ireland has essentially functioned as a tax haven for Apple, providing it with minimal income tax rates approaching zero” (p. 21). For 2014 the effective tax rate for ASI fell further to 0.005 per cent (European Commission, 2016).

The low tax rate for ASI is explained by:

¹⁹ Because of the need to protect IP and perhaps more important expensive litigation Apple also has strict secrecy rules and rarely gives interviews to journalist. Stone and Vance writing in the New York Times (June 22, 2009) state “Few companies, indeed, are more secretive than Apple, or as punitive to those who dare

- (1) Switching profits to Ireland via transfer pricing in particular relating to IP (PSI, p. 5, p. 8);
- (2) Key subsidiaries of Apple had “no declared tax residency anywhere in the world” and consequently paid no corporate tax (PSI, 2013, p. 4). This is an example of what has been described as ‘double non-taxation’ (OECD, 2015, par.7).

Table (5) shows profits and the tax charge for ASI for the years 2004-2011, and 2014.

Table (5)
Profits and Taxes Paid (\$ billions) for Apple Sales International (ASI) 2004-2014

	2004	2005	2006	2007	2008	2009	2010	2011	2014
Pre-Tax profits	\$0.268	\$0.725	\$1.18	\$1.844	\$3.127	\$4.794	\$12.0	\$22.0	n.a.
Tax charge in	\$2.1	\$3.9	\$6.5	\$8.9	\$14.9	\$3.653	\$7.0	\$10.0	n.a.
Effective Tax Rate	0.78 %	0.54 %	0.55%	0.48 %	0.48 %	0.08 %	0.06%	0.045%	0.005%

Source: - PSI, (2013), p. 21, Apple Sales International Accounts filed with the Australian Securities and Investment Commission, European Commission (2016a),

Table (6) shows various measures of ETR for Apple for the period 2006-2015. One measure of ETR based on cash flows (cash tax payments/pre-tax profits, ETR 2, column 8), is considerably lower at 17.0% than the ETR reported in company accounts of 25.6% (calculated as the tax charge/pre-tax profits, ETR1 column 7).

The table shows that while the Apple group pays corporation tax, little corporation tax is paid outside the U.S. (columns 2 and 5). The foreign tax charge on overseas earnings (non-U.S. tax charge/non-U.S. earnings) amounted to 5.2% for 2016 (ETR4, Table 4). A similar pattern exists for other U.S. MNE’s in the study.

An alternative measure shows an even lower ETR of 3.4% for 2016, although up from 1.2% in 2011 (ETR 5 Table 6).²⁰ This measure estimates tax paid on unremitted earnings as the difference between the U.S. statutory rate of 35% and tax shown as due if remitted as disclosed in Form 10K (Donohoe, et al, 2012). In contrast to Apple, most U.S. firms do not disclose tax due on unrepatriated earnings, because as stated in accounts ‘it is not practicable’ to do so.

Because Apple’s overseas tax rate is so low, a tax credit for overseas tax is also low, so that on repatriation of those profits, Apple would be subject to a much higher tax rate.

Table (6)

Tax Payments and Effective Tax Rates for Apple (\$ million) 2006-2016

²⁰ This increase in overseas tax payments means that Apple is now ‘the largest tax payer in Ireland’ Letter

Year	Group Pre-tax profits (1)	Tax shown in income statement (2)	Cash Tax Paid (3)	Foreign earnings (4)	Tax on Foreign Earnings (5)	Foreign Tax Savings (6)	ETR1 % (7)	ETR2 % (8)	ETR3 % (9)	ETR4 % (10)	ETR5 % (11)
2016	61372	15685	10444	41100	2138	5582	25.6	17.0	14.5	5.2	3.4
2015	72515	19121	13252	47600	2938	6470	26.4	18.3	15.8	6.2	3.3
2014	50483	13973	10026	33600	1489	4944	26.1	18.7	16.3	4.4	2.4
2013	50155	13118	9128	30500	1133	4614	26.2	18.2	16.0	3.7	1.8
2012	55763	14030	7682	36800	713	5895	25.2	13.8	13.0	1.9	1.3
2011	34205	8283	3338	24000	602	3898	24.2	9.8	9.3	2.5	1.2
2010	18540	4527	2697	13000	-93	2125	24.4	14.5	13.8	-0.7	n.a.
2009	12066	3831	2997	6600	310	647	31.8	24.8	15.4	4.7	n.a.
2008	8947	2828	1267	4600	200	500	32	14.2	13.4	4.3	n.a.
2007	5008	1512	863	2200	87	297	32	17.2	16.2	4.0	n.a.
2006	2818	829	194	1500	84	224	29	6.9	6.4	5.6	n.a.

Source: Form SEC 10K . The year end for each year is September.

Notes to Table (6)

ETR 1, 2 and 3 are defined as for Table (2)

ETR 4 = is defined as in Table (4)

ETR 5 = Tax rate on unremitted profits (column 11).

Apart from Apple, the number of Irish incorporated entities that are not resident in any country for corporate tax purposes is unknown.²¹ The ability to remain incorporated in Ireland but not resident for tax purposes in any country was ended by the Finance Act 2014.

(5) The commission Apple decision

The role of the branch structure and profit split

In the Commission Apple decision, the Commission (European Commission 2016b) states:

Specifically, Revenue endorsed a split of the profits for tax purposes in Ireland: Under the agreed method, most profits were internally allocated away from Ireland to a "head office" within Apple Sales International. This "head office" was not based in any country and did not have any employees or own premises. Its activities consisted solely of occasional board meetings. Only a fraction of the profits of Apple Sales International were allocated to its Irish branch and subject to tax in Ireland. The remaining vast majority of profits were allocated to the "head office", where they remained untaxed.

Apple replied to this point (third plea in law) by stating:

The Commission made fundamental errors by failing to recognise that the applicants' profit-driving activities, in particular the development and commercialisation of intellectual property (Apple IP), were controlled and managed in the United States. The profits from those activities were attributable to the United States, not Ireland.

²¹ Reasons given for non-disclosure are "confidentiality" and the "small number of companies involved"

The Commission wrongly considered only the minutes of the applicants' board meetings and ignored all other evidence of activities.

The Commission comment on this organisational structure (par. 271) is as follows:

Since ASI's and AOE's Irish branches do not have a separate legal personality from the companies to which they belong, neither those branches nor any other part of those companies, in particular their respective head offices, could be said to separately own the assets or owe the liabilities of those companies.

Why should ASI and AOI be regarded "as non-resident companies" ?

Apple and Ireland claim (Commission Decision, par. 113):

That critical business activities conducted by or for ASI and AOE are conducted outside of Ireland, for example through Apple Inc. employees or the board of directors of ASI and AOE.

In contrast the Commission could find no evidence that AOI or ASI were managed and controlled outside Ireland. For example (par. 282) states :

The only evidence provided of activities performed by ASI's and AOE's board of directors during the period when the contested tax rulings were in force is the decisions taken in the meetings of the boards...Those minutes do not demonstrate that ASI's and AOE's board of directors performed active and critical roles with regard to the management and effective control of the Apple IP licenses.

ASI and AOI were regarded by Revenue as not tax-resident in Ireland (European Commission, 2016a, par. 50) because:

ASI and AOE had a trading activity in Ireland through their respective branches and were managed and controlled outside Ireland (Commission Apple decision, p. 50).

Furthermore both companies were not resident in any other jurisdiction The Commission Decision, (par. 52) states:

During the time that the contested tax rulings were in force, ASI and AOE could therefore be best described as "stateless" for tax residency purposes.

The 'central management and control test' is applied on "the basis of fact and precedent" (Revenue, 2013, p. 1). Importantly, these "facts" cannot include the location of fixed assets

U.S. (Senate subcommittee Report (2013, p. 22, 24), but that those meeting minutes did not indicate that the Board of Directors performed ‘active and critical roles’.

One difference between Apple’s tax approach and that of companies that used a ‘double Irish tax strategy’ is that the latter group had identifiable addresses, often in Bermuda, for example. As noted, the Apple decision is important for corporate tax change within the EU and especially for Ireland. The Department of Finance summary of the basis of Ireland’s Appeal 22 does not refer to the fact that ASI and AOI are registered companies in Ireland, but rather refers to the ‘Irish branches’ of ASI and AOI.

There are several important legal requirements for Irish incorporated companies that are different from branches. The country of incorporation has assumed greater significance as a result of European Court of Justice Rulings that established the registered office (the place of incorporation) as the ‘centre of main interests’ (CoMI), as well as the place where the firm should be liquidated even though the subsidiary may have no employees and no fixed assets (Judgement of the Court of Justice in Case C-34/04 Eurofood IFSC 2 May 2006).

In relation to the tax jurisdiction of dual residents, the proposed multilateral convention to implement tax treaty changes to implement BEPS proposals states:

...its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors.²³

The postal address of ASI and AOE

The addresses of ASI and AOE on cost sharing agreements are consistently Irish (Commission Decision, footnote 254). For example, a 2008 marketing services agreement between Apple Inc. and ASI lists ASI’s address as Cork (par. 133 of Commission decision). The address is important because Apple advisors and Revenue agree that ASI has two component branches and that the larger of these branches is not tax-resident in Ireland.

The Commission (par. 281) argues that:

Based on the facts presented to the Commission, it appears that during the period the contested tax rulings were in force the head offices of ASI and AOE existed on paper only, since ASI and AOE had no physical presence or employees outside of Ireland during that period.

²² ‘Explanation of the main lines of argument in Ireland’s annulment application lodged with the General Court of the European Union on 9 November 2016’, published on 19th December, 2016.

²³ See OECD, 2016, Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, article

It is important here to note that if the overseas branches of ASI and AOE have no fixed assets, employees, nor addresses abroad, it is difficult to envisage what the “facts” were that led to Revenue’s decision.

In contrast, Double Irish or Bi-Location Tax strategy is a tax strategy in which a subsidiary is deemed to be located in another jurisdiction, such as at an address abroad. In a number of cases, the foreign address used was that of the law firm Conyers Dill and Pearman (Stewart, 2014).

Ireland as a tax collector for the rest of the world?

One of the often-heard criticisms of the Commission Decision on Apple was that Ireland would become a “tax collector for the rest of the world”.

The Commission press release of 30th August 2016 states:

The amount of unpaid taxes to be recovered by the Irish authorities would be reduced if other countries were to require Apple to pay more taxes on the profits recorded by Apple Sales International and Apple Operations Europe for this period.

The Commission Decision refers to two cases, one in Italy and another in an unnamed country, where this scheme has happened (par. 99). The transfers were not direct transfers from the Irish state. Such reallocation of profit from Ireland to other countries (mostly EU countries) has become common. In fact, around 100 such adjustments have taken place since 2005 (Stewart, 2018). These adjustments resulted in a reduction in profits declared in Ireland, a consequent repayment of Irish corporate tax of around €900 million, and an associated increase in reported profits and corporate tax payments in other countries. It is also likely that the increase in reallocated profits will make up for the fall in Irish corporate tax receipts because of the already high rates of corporate tax.

There are likely to be far more cases involving Irish subsidiaries in future years as a result of increased data provisions to other countries, in particular country by country reporting. Such adjustments could be seen as a form of introduction of CCTB (Consolidated Corporate Tax Base), but on a bilateral basis.

Revenue in commenting on the decision to appeal the Apple decision stated:

MNE’s should pay tax on profits and it is not the function of revenue to defend the use of international tax law by multinationals.

By appealing this case, the Irish Government appears to be doing just that. For example, the

further expenditures in the future. Without these expenditures Apple expenditures are likely to be much higher. It is telling that the words “Apple” and “Ireland” are consistently conjoined in the Commission Decision, giving the impression both cases are identical. For example, (par. 53) states:

Ireland and Apple provided descriptions of the functions performed by the Irish branches of ASI and AOE, which were used as a basis to present and support Apple’s estimates of the taxable profit of those companies for Irish corporation tax purposes.

(6) Tax certainty and the arguments against Commission state aid rulings

The U.S. Treasury (24th August 2016) published a white chapter that was highly critical of EU Competition Directorate decisions on illegal state Aid (See: <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/White-Chapter-State-Aid.pdf>).

The U.S. Government (and Apple) have argued that the Apple decision (the 11th Plea in Law) violates “the principles of legal certainty and non-retroactivity” and in (Plea 14) that the commission violated legal certainty by ordering recovery under an unforeseeable interpretation of State aid law.”

However, critics of the EU decision (Hufbauer and Lu, 2016, p. 5) say:

Retroactive changes in tax law are not forbidden [in the US] but they are regarded as bad public policy, because retroactivity creates doubt about legal stability, upsets financial plans, and prompts firms to seek higher “hurdle rates” before undertaking an investment.

In most jurisdictions, not only is retroactive collection of taxes not illegal, it is often normalized in cases of ‘aggressive tax avoidance’ that are found to be illegal.²⁴

This chapter is highly critical of EU policies in relation to state aid and maintains that the the U.S. Government is acting as an advocate on behalf of affected US companies. For example, by devoting considerable resources to building the case against the Commission’s three recent decisions on illegal State aid.

The White Chapter states:

(1).“...recovery of past allegedly unpaid tax would constitute retroactive enforcement of a newly adopted approach to State aid”, and “As a general matter, retroactive enforcement runs counter to one of the fundamental principles of EU jurisprudence: the principle of legal certainty” (p. 14).

²⁴ See for example, the case of *Huitson and HMRC* involving retrocession. Source: BBC news. Will retrospective

It should be noted that, historically, retrospective recovery is a long-established principle in relation to cartel cases (and sometimes for very large amounts) that have taken up by the Directorate General for Competition. Retrospective recovery is also a long-established principle of tax law in which a particular tax or elements of a tax strategy has been found by the courts to be illegal.

(2). The White Chapter states (footnote 74 p. 19) "...the Commission has suggested that it may also become an arbiter of tax settlements agreed to by Member States with taxpayers. The case referred to is the agreed settlement between the UK Government and Google. The Commission became involved only after a complaint from the First Minister and Leader of the SNP in Scotland."

The competition directorate may often initiate investigations following complaints. Indeed U.S. firms are sometimes the initiator of these complaints as seen in the case by Microsoft vs. Google in relation to the dominance of the Google search engine.

(7) Apple tax strategy: From stateless income to Jersey.

As noted earlier in this chapter, a number of firms moved IP assets to Ireland in 2014 and 2015 in response to the announced ending of the 'Double Irish', as well as new, valuable tax concessions. The new tax scheme enabled the cost of IP and financing purchased abroad to be offset by Irish corporate tax. The EU Apple decision refers to new structures put in place in 2015 (Apple decision pp. 128-129), structures that were revealed in the 'Paradise Chapters'.²⁵

Apple operations in Ireland consisted of five companies, three of which were stateless: ASI, AOI and AOE. AOE obtained a domicile in Ireland, while ASI and AOI moved theirs to Jersey. It is worth noting that ASI and AOI hold the bulk of Apple's cash (\$250 billion) and that ASI owns Apple IP, which it sells to AOE in Ireland. AOE then licenses the IP and earns large profits in addition to getting substantial tax write offs from the newly acquired IP. AOE also borrowed money from recently re-domiciled Apple subsidiaries in Jersey companies to finance the purchase of IP assets. The interest on this borrowed money was used as deductible against ASI profits in Ireland. Thus, the Jersey-based companies now hold large cash assets, which they earn interest on, mostly from ASI operations.

(8). Conclusion: Irish corporate tax policies are not a model for sustainable growth

²⁵ See 'Paradise Chapters: Apple's secret tax bolthole revealed' BBC Panorama, 6 November 2017; Hopkins and Bowers, 'Apple secretly moved parts of empire to Jersey after row over tax affairs', Guardian Newschapter, 7th November, 2017. The only clue available in documents lodged with Companies Registration Office in Ireland to these organizational changes is the appointment of a company secretary to AOE whose address is given as Cork. Previously the address of the company secretary had been the U.S.

Industrial policy in Ireland emphasises keeping tax rates low to attract FDI (specifically U.S. FDI). This policy is frequently described as the “cornerstone of industrial policy”.²⁶ However, as this chapter illustrates, this policy model is a risky one. The most attractive aspect of tax incentives offered by Ireland is not the tax rate itself, but an Irish tax regime that regularly criticised by Governments of other countries, NGO’s and increasingly by the public.²⁷ As a result, policies that discourage ‘aggressive tax strategies’ have been introduced through the OECD BEPS Programme and from the European Commission. This initiatives have increased disclosure (country by country reporting) and exchange of information on tax planning.

The value of tax incentives may also change because of proposals to introduce CCTB, CCCTB. A proposal to introduce a type of digital tax on companies could also pose a threat to the operations of MNE’s in Ireland.²⁸ The relative value of tax incentives could also change because of ‘tax competition’. For example, the Trump administration has introduced a corporate tax rate of 21 per cent and the U.K. prime minister has stated that Britain will have “the lowest corporate tax rate in the G20” (Financial Times, November 21, 2016). It is likely that such changes will trigger reductions in corporate tax rates in other countries.

Table (1) shows that 55% of U.S. MNEs’ profits earned outside the U.S. is earned in the EU. The EU is thus a very profitable location for U.S. firms and proposed increases in taxation are unlikely to affect their location within the EU. However, while these firms are highly likely to continue to operate within the EU, they may not necessarily continue to operate within low-tax jurisdictions such as Ireland.

An industrial policy for Ireland that is less dependent on tax incentives needs to be developed and implemented. Balanced growth requires a greater emphasis on indigenous firms. Here, Ireland has an advantage, as the devaluation of the Euro was of enormous value to the Irish indigenous sector. Likewise, there is no other country in the Eurozone as trade dependent on a non-Euro member, particularly in trade within the indigenous sector.²⁹ Hence, fluctuations in the Sterling/Euro exchange rate cannot impact other Eurozone countries to the same extent. This dependence also poses risks, however, because a devaluation of the Sterling post-Brexit could work to the extreme disadvantage of indigenous Irish.

²⁶ See Budget Statement 14th October 2014;

²⁷ Ireland has been ranked 6th in the world in terms of corporate tax havens, see Oxfam, (2016), Tax Battles, The dangerous global Race to the Bottom on Corporate Tax, p. 13, Available at <https://www.oxfam.org/en/research/tax-battles-dangerous-global-race-bottom-corporate-tax>

²⁸ See Mehreen Khan, Alex Barker and Rochelle Toplensky “Google, Facebook and Apple face ‘digital tax’ on EU turnover Proposed Brussels levy will target big-tech revenues rather than profits”. , Financial Times March 15 2018.

²⁹ See CSO (2016). Brexit: Ireland and the UK in numbers. Tables 14 a and 14b, available at -

This chapter holds that State support for indigenous firms is vital as is finance, particularly in the case of small and medium-sized enterprises. But as noted by Mazzucato (2013), it is not just the supply of finance that is missing, but also the demand “from private firms willing to engage with the difficult uncertain worlds of innovation”.³⁰ Mazzacutto argues that an emphasis on competitiveness in terms of unit labour costs is misplaced. For example, he posits Germany is competitive because of a strong innovation system, patient capital, for example from the KfW, strong science and industry links, for example through the Fraunhofer institutes, and high spending on research and development.

This tale, however, is a cautionary one. Further risks arise because, as a result of Brexit, Ireland is likely to seek important concessions from its EU partners, as well as emergency economic measures for certain sectors. It is unfortunate that in two major areas, the introduction of CCTB and CCCTB, and the Apple case, Ireland is in dispute with the Commission. The CCTB, CCCTB and digital tax proposals are supported by a majority of governments in the EU and by other groups, such as those advocating tax reform.

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