



Box B:

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US profit repatriations and Ireland's Balance of Payments statistics

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US profit repatriations and Ireland's Balance of Payments statistics discusses how the Tax Cuts and Jobs Act (TCJA) 2017 by the US Federal Government and the accompanying profit repatriation by US multinationals affected the external statistics of both economies. Although the volume of funds repatriated was substantial, the direct effect on the headline Balance of Payment Statistics was subdued due to two offsetting transactions. The direct economic effects of these transactions on underlying Irish economic activity are likely to be limited.

Over the past decade a small number of very large "superstar" US multinational enterprises (MNEs) have accumulated considerable savings (Chart 1).¹ Retained offshore earnings, in particular, amounted to over USD 2 trillion by the end of 2017 and reflect profits earned by US MNEs' foreign subsidiaries from previous years.² Up until recently, US MNEs had been reluctant to repatriate these foreign profits because of the relatively high corporate tax rate maintained by the US.³ In this box, we document how the process of profit repatriation affected the external statistics of the United States and Ireland. Although the magnitude of the financial flows was sizeable, the extent to which they affected real economic activity is likely to be very limited.

US MNEs reduced their foreign retained earnings in 2018. The legislation of the Tax Cuts and Jobs Act (TCJA) by the US Federal Government in December 2017 substantially reduced the headline corporate tax rate from 35 percent to 21 percent. Combined with a one-time charge on profits

¹ See: Avdjiev, Stefan and Everett, Mary and Lane, Philip R. and Shin, Hyun Song, (2018), "Tracking the International Footprints of Global Firms." BIS Quarterly Review, March 2018; Ayyagari, Meghana, Demirguc-Kunt, Asli, and Maksimovic, Vojislav (2018), "Who are America's star firms?" World Bank Policy Research Working Paper WPS8534.

² See: Zoltan Pozsar (2018), "Repatriation, the Echo-Taper and the €/ \$ Basis," Credit Suisse, Global Money Notes No. 11.

³ See: Smolyansky, Michael, Gustavo Suarez, and Alexandra Tabova (2018) "U.S. Corporations' Repatriation of Offshore Profits," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, September 4, 2018.



currently held offshore of 15.5 per cent for cash and 8 per cent for investments in illiquid assets, this reduced the tax rate that US MNEs are required to pay when repatriating their foreign retained earnings (IMF 2018). As a consequence, many US MNEs repatriated some of their foreign retained earnings and then undertook substantial share buybacks, primarily in the first half of 2018 (Chart 2).⁴

These transactions had a substantial effect on the US balance of payments, namely the components of direct investment earnings and receipts (Charts 3). In the international transactions accounts, income on equity (or earnings) of foreign affiliates consists of two components: 1) Dividends that are repatriated to the parent company; and 2) Reinvested earnings that remain with foreign affiliates. According to the US Bureau of Economic Analysis (BEA), following the US corporate tax reform, reinvested earnings turned negative in the first quarter of 2018 reflecting the withdrawal of foreign retained earnings by U.S. parent companies from their foreign affiliates.⁵ The decline in reinvested earnings also translated into a partially offsetting decline in net acquisition of direct investment assets in the financial account (by USD 139 billion in Q1 2018) which only started to recover during Q3 2018.

The transactions of US MNEs were so sizeable that they had a material impact on global foreign direct investment (FDI) flows in 2018. According to UN (2018), global FDI fell by 19% in 2018, to an estimated USD 1.2 trillion from USD 1.47 trillion in 2017 (Chart 4).⁶ The decline was concentrated in developed countries where FDI inflows fell by an estimated USD 451 billion with flows to Europe declining by USD 272 billion. Furthermore, the OECD (2018) assert that the primary factor behind the decline in FDI was the repatriation of accumulated foreign earnings by US MNEs following the US tax reforms.⁷

Some of the profits repatriated by US MNEs involved their Irish subsidiaries. While the list of “Superstar” firms is very limited, many of them (including some of the technology firms included in Charts 1 and 2) maintain a presence in Ireland.⁸ This partly explains why on a country basis, Ireland,

⁴ Data on the volume of funds repatriated on an institution-by-institution basis is not directly available. However, JP Morgan estimate that USD 225 billion was repatriated during Q1 2018 and this slowed to USD 115 billion in Q2 2018 and USD 44 billion in Q3 and Q4. The research also suggests that, in addition to share buyback schemes, firms used the repatriated funds to retire corporate debt and, to a lesser extent, increase capital expenditure. See: JP Morgan (2019). Flows and Liquidity, Global Markets Strategy 08 March 2019.

⁵ See: Bureau of Economic Analysis (2018) “U.S. International Transactions, Third Quarter 2018,” 19 December 2018.

⁶ See: United Nations (2018) “Global Investment Trends Monitor”, October 2019.

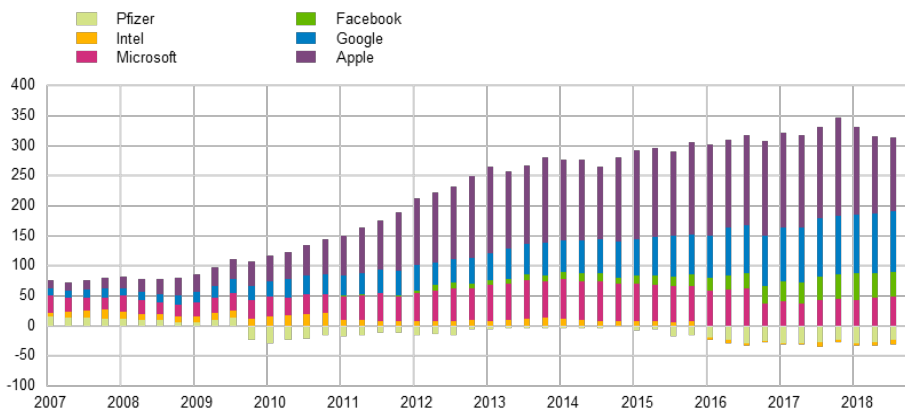
⁷ See: OECD (2018) “FDI in Figures,” October 2018.

⁸ Firm level data on the amount of funds repatriated is not available. However, the total amount of offshore earnings up to end 2017 was concentrated in a small number of entities particularly in the IT and healthcare sectors and many of these companies have operations in Ireland (Pozsar 2018).



despite its small size, remains the third largest foreign holder of US Treasury securities, as US MNEs and their subsidiaries have purchased these, and other safe assets, as a store of value for their retained earnings.⁹ Since the introduction of the US tax reform, Ireland's reported holdings of US treasuries have declined by approximately EUR 50 billion (Chart 5). This is consistent with the repatriation of retained earnings by US MNEs' subsidiaries, as the firms may have sold US treasuries in order to repatriate funds to the US before paying dividends or engaging in share buybacks.

Chart 1: Cash holdings of selected US MNEs



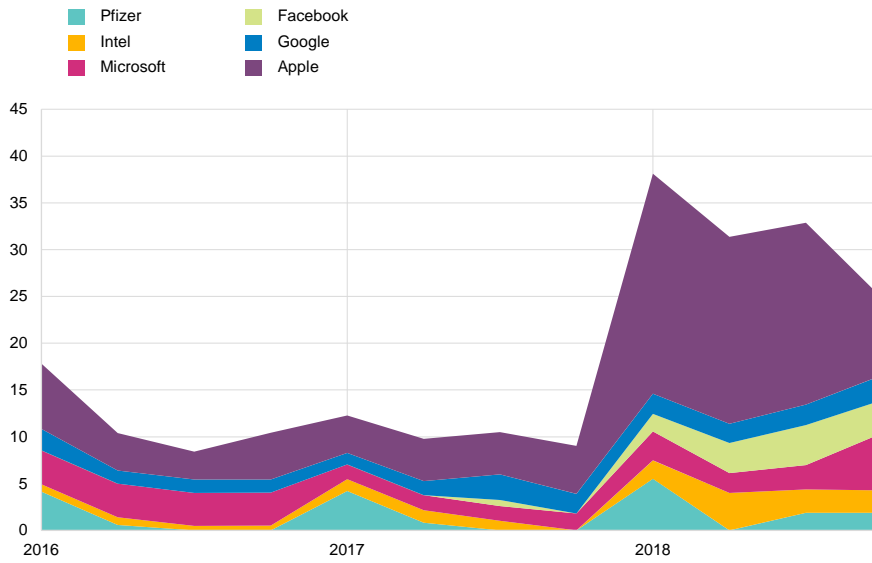
Source: Bloomberg

Unit: Billions of USD, cash and cash equivalents net of debt

⁹ The sizeable fund industry located in Ireland is another important factor contributing to the very large holdings US Treasuries by Irish residents. See: Daly, Pierce and Moloney, Kitty (2017) "Liquidity & Risk Management: Results of a Survey of Large Irish-Domiciled Funds," Central Bank of Ireland, Quarterly Bulletin 03/2017.

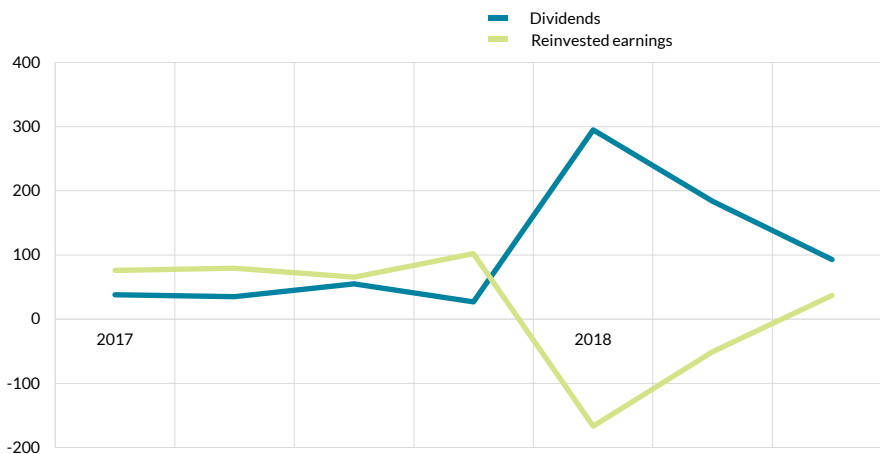


Chart 2: Share buybacks by selected US MNEs



Unit: Billions of USD
Source: Bloomberg

Chart 3: US Direct Investment Earnings and Receipts



Unit: Billions of USD, seasonally adjusted
Source: US Bureau of Economic Analysis



Chart 4: FDI Inflows by Region, 2017-2018

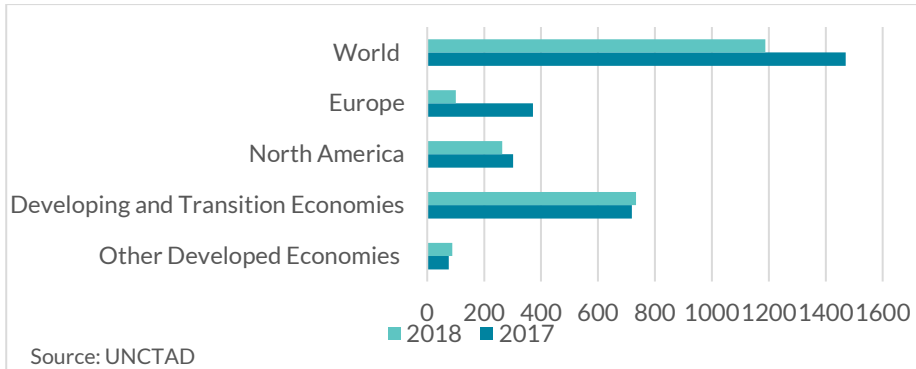
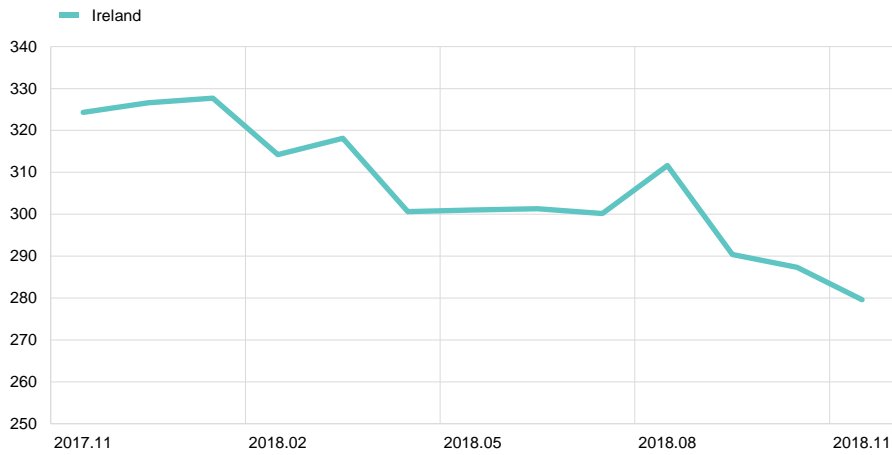


Chart 5: Irish holdings of US Treasuries

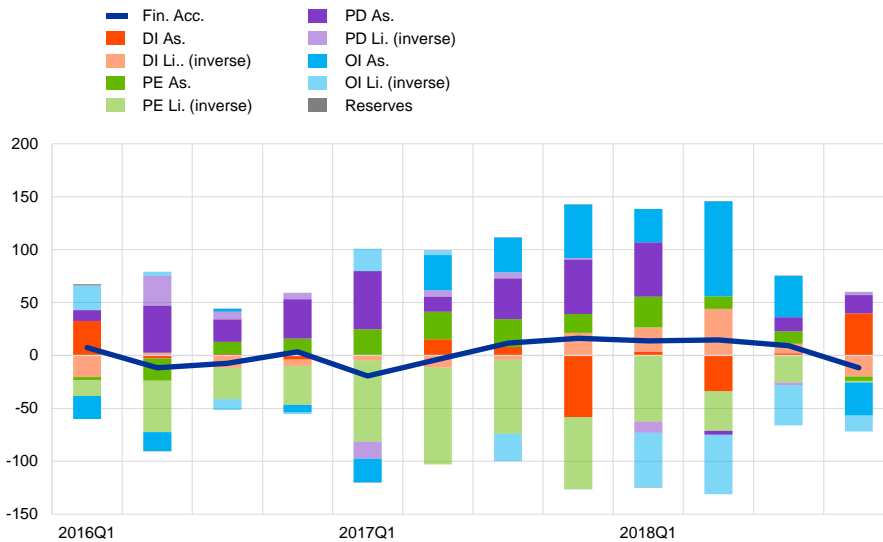


Note: Billions of USD

Source: US Department of Treasury, Treasury International Capital (TIC) system.



Chart 6: Irish Financial Account - Standard Components



Note: Euro Billions. Positive values denote outflows, negative values denote inflows. Inverse indicates that signs on liabilities have been reversed.

Source CSO, Balance of Payments Tables BPQ16 and BPQ17

The repatriation of profits by US MNEs also affected portfolio and direct investment in the Irish BoP.¹⁰ Prior to the second quarter of 2018, Irish resident investors (including Irish resident subsidiaries of US MNEs) consistently purchased substantial portfolio debt securities, which likely include perceived safe assets such as US Treasuries (Chart 6). Up to Q1 2018, these flows frequently reached EUR 50 billion per quarter, but turned negative in the second quarter of 2018 and remained low in the third and fourth quarters of 2018. At the same time, between Q4 2017 and Q3 2018, direct investment into Ireland declined by EUR 97 billion, while direct investment out of Ireland declined by EUR 86 billion.¹¹ These transactions primarily took place vis-a-vis euro area countries, rather than the US (Chart 7). This reflects the fact that US MNEs are often organised in a very complex way involving European and other financial centres whereby the location of profits and sales

¹⁰ According to the UN (2018), repatriations by US MNEs had a major effect on a few important host countries, particularly Ireland, which registered outflows of USD 121 billion.

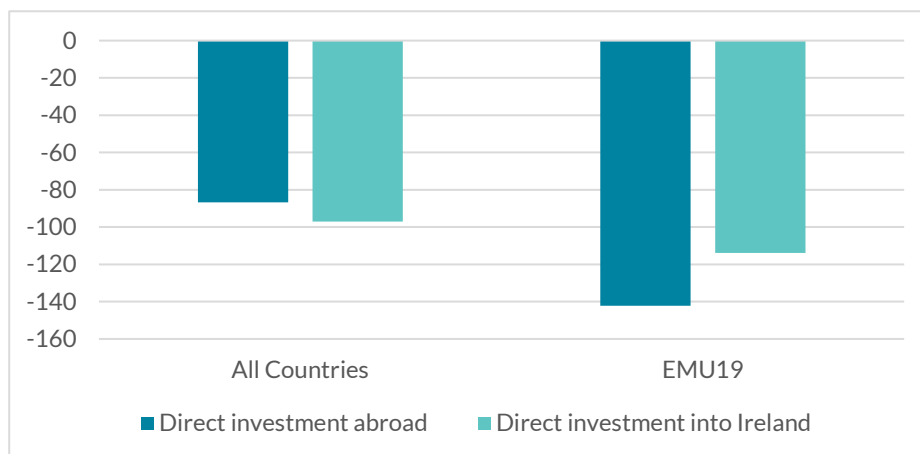
¹¹ It should be noted in Q4 2018 increases in direct investment both into and out of Ireland were recorded for the first time since Q3 2017.



do not always fully overlap. Consequently, Ireland might have served as one intermediary in the process of profit repatriation back to the US.¹²

Finally, it is important to emphasise that, while the accounting values involved are very large, adverse real economic effects on domestic Irish economic activity are likely to be very limited. In fact, Clancy (2019) finds that past US tax cuts have typically had a small, positive, effect on Irish economic activity.¹³ Moreover, the effects of the TCJA legislation might be even more limited insofar as they are primarily linked to US MNEs' tax optimisation activities, much of which focus on the movement of intellectual property assets rather than physical capital and underlying economic activities.

Chart 7: Direct Investment into and out of Ireland by Region (2017Q4 - 2018Q4)



Source: CSO

¹² A similar decline in FDI assets and liabilities is also observable in the balance of payments statistics of Luxembourg. It should also be noted that the effects on the balance of payments of the US and Ireland are unlikely to be entirely symmetric. See: Flaherty and Sibley (2016) "Explaining Ireland's FDI Asymmetry with the United States," Central Statistics Office.

¹³ Clancy, Daragh (2019) "US corporate tax rate cuts: Spillovers to the Irish economy," Journal of Statistical & Social Inquiry Society of Ireland, forthcoming.