35

The Economic Research Institute

Revised: August 19th, 1965

Economic Planning in Ireland[1]

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The recently published Report on Economic Planning, prepared by the General Purposes Committe of the National Industrial Economic Council raises issues which are theoretically of fundamental importance. Despite the widely different experiences of economic planning in countries such as France, Norway, and the countries of Eastern Europe, they have never been satisfactorily resolved in practice.

There is first of all the question of the level of economic activity at which the Plan should operate. Planning at the product level might be ideal in theory but is evidently impossible at the present stage of development of data processing. As the Report observes, planning at the firm level is too inflexible, so the industry level is selected. Since this is a choice based on necessity, it may seem churlish to criticise it. The problem is the usefulness of planning at this level. In effect, quantitative estimates are made for the output of collections of goods five years hence. Possibly the relevant question for the businessman, however, is not how much to produce but what to produce. This question becomes increasingly relevant as the rate of change of product quality increases. To some extent it may be less important in Ireland than elsewhere because of the preponderance of agricultural products - which tend to be more homo-

(1) This paper has benefited from discussions with the Director and other members of the staff of the Economic Research Institute.

geneous - but it clearly will become more important with the development of manufacturing industry. The present planning framework gives the impression that it contains insufficient incentives towards diversification, especially on the part of firms facing declining demand for their products under freer trade conditions.

Since planning at the product level is out of the question, some other way must be found of making sure the right type of goods are produced in the future. This is the problem of incentives, which exists also in ensuring that firms will adhere to the plan, supposing output to be specified unambiguously.

Exhortation alone is unlikely to be successful in getting the right decisions made at the firm level. It is likely to be particularly unsuccessful where the price system tends to operate in the opposite direction to the Plan. In other words, it is unreasonable to expect a firm to try to increase its exports, if through protective import tariffs it enjoys effortless access to the home market. Equally, another firm which is compelled by tariffs to use as inputs high-cost domestic materials instead of the cheaper imports cannot be expected to compete successfully in foreign markets.

The point is that the price system including money wages, taxes, and investment and other allowances ought to be used as the incentive system which promotes adherence to the Plan. A hurried view of the present system of incentives is that there are too many carrots (adaptation grants, etc) but not enough sticks, (low-price competing imports) to get the donkey to move. There is a point beyond which the offers of inducements to foreign businesses becomes self-defeating. Hard-headed businessmen look with suspicion upon excessive allowances as a sign of lack of confidence. Price stability, co-operation, and the availability of the necessary factors may be more important than financial lures.

The Plan was conceived on the basis of membership of the E.E.C. by 1970. Even if this does not come about, one hopes that tariffs will be reduced sufficiently unilaterally - or bilaterally in agreement with the U.K. - to provide a really effective system of incentives. The classical argument against protection is that it directs resources which would otherwise be devoted to export production to production for the home market. In the last thirty years, it might have been argued that, in fact, the effect of abandoning protection in Ireland would be to create wholesale unemployment of these resources. Is this any longer true? The real costs of protection are almost always neglected, because they are hidden whereas the short-run employment gains are quite apparent. The removal of protection would lead to a reduction in the price of intermediate goods and in consumer goods, which should favour exports as well as increasing real wages. It would be interesting to calculate the likely effect on the consumer price index of the removal of import tariffs.

If the price system is the major instrument affecting the magnitude and direction of output - as it must be in any system of decentralised decision-making, be it capitalist or socialist, what role is left for planning?

Planning, it seems to me, can do several things which the price system does not do, or does less well.

First, it can analyse the consequences, in aggregate, of the many individual decisions. It can calculate the likely size of the market for a particular product or product group, and the availability of factors and materials in relation to their demand. In the case of Ireland, it seems that imports and skilled labour may be among the more important constraints to which the Plan can direct attention.

Secondly, the price system is less effective in determining the allocation of capital goods than in allocating resources for current production. This is so because the price system which is relevant for investment decisions is some future price system, as yet non-existent. However, the more important influences on the profitability of specific capital projects can be identified by careful analysis. Investment decisions lend themselves to planning in the way in which output decisions do not, because they are few and large in value and because the decision should involve some detailed analysis of the future. Investment decisions commit mobile resources (loanable funds) to specific form (real assets) thus determining the structure of production for some time to come.

In a recent article[2] on French planning Massé distinguishes detailed projections of the economy from the Plan itself. The projections are conditional forecasts of what will happen whereas the Plan is less detailed but more normative. According to Massé, the principal targets with which the current Plan is concerned are:

(1) The division of gross domestic product between investment and consumption.

(2) The desirable structure of final consumption.

(3) The direction to be given to social and regional policy.

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(2) Pierre Massé; "The French Plan and Economic Theory" <u>Econometrica</u> 33:2 April 1965.

Lange is quoted in the same article as suggesting that a National Plan must do two things:

(1) Divide national income between investment and consumption, thus determining the rate of growth of the economy.

(2) Fix the share of investment for each sector of the economy, thus determining the direction in which the economy develops.

For Ireland, perhaps one might suggest the following principal planning objectives:

(1) The division between investment and consumption.

(2) The desirable structure of exports.

(3) The share of investment for each sector of the economy.

Such targets might be established at first independently of the projections of the Second Programme. The Government could use its various powers to encourage desirable developments and discourage the undesirable while leaving scope for the unexpected.

Whatever ~~Whether~~ the formal procedure, planning in Ireland should shift its emphasis from conditional forecasting to a more normative position. Both public and private capital formation ought to be incorporated explicitly in such a planning scheme.[9] It should be possible to estimate at least the more important investments which firms are planning to undertake in the next five years. From these estimates, important conclusions may be drawn about the future demand for capital goods imports, and for the services of the domestic construction industry. This information should be required of new firms applying for industrial grants. In this way some important elements in the balance-of-payments may be anticipated - including the extent of the inflow of financial capital.

The critical investment decision is, of course, what to produce? Although the debate on generalised investment criteria, conducted in the journals in the late fifties, was, like all such debates, inconclusive, nevertheless economists can generally agree on some common principles which are usually not observed in practice. For instance, the politician may argue that there have been no choices in investment in Ireland in recent years, that any form of private investment has been gladly accepted, and that public investment was devoted to fulfilling social needs as funds permitted. While it may be true that there was no conscious machinery of choice, nevertheless the decisions to undertake a housebuilding programme in the early fifties and an industrialisation programme in the late fifties are examples of clear choices. Politicians have always made choices without knowing it: it is just that the process is becoming an increasingly conscious one.

The planning organisation cannot be expected to survey the entire range of possible products, involving changing techniques of production, marketing and sales organisations etc, in order to determine in which product or products capital should be invested. Such decisions obviously require the intimate knowledge of engineers and businessmen. However there is no doubt, given the conditions of contemporary Ireland, where the area of desirable investments lie. If one imagines a spectrum of possible investments ranging from "Clearly Profitable" to "Clearly Unprofitable" then it is not difficult to locate the major investment projects in this spectrum. At one extreme, it is safe to say that agricultural investments leading to the development of the fat-cattle industry would be profitable. The climate and vegetation peculiar to parts of Ireland allow cattle to be wintered on grass for many more months than almost anywhere else in Europe. Grass can also be conserved for winter keep. Because of the low level of grassland management, present average stocking rates are far below the potential. Moreover, although the demand for food-products in general is held to be price and income inelastic, the demand for beef is likely to grow rapidly in Western Europe. Irish whiskey, pottery, and glassware are examples of products which are sufficiently differentiated to insulate themselves from price competition while at the same time demand for these products is likely to be elastic with respect to income. Yet the quantities exported remain negligible in comparison to the potential - and even actual - foreign demand.

Because of the literally unlimited future demand for computing machinery, combined with low (relative) transport costs, the possibilities of attracting such an industry to Ireland on a considerable scale might be investigated.

At the other extreme, it is equally clear that such projects as shipbuilding and steel-making are unprofitable. Not only are they themselves unprofitable but they contribute to the high costs of Irish firms using their products. If the Government's new fertiliser project at Arklow is expected to be profitable, might it not have been undertaken using private capital and private management?

It should naturally be the function of the Plan to control - or at least supervise - the allocation of public capital funds - to both private and state enterprises. The mistake should not be made, as it is in so many countries, of assuming that investments undertaken by public enterprises are somehow better for the country than private investment. In fact, both logic and experience support the presumption that public enterprises are inefficient. Once having been established, their principal function is naturally to perpetuate themselves, if necessary by insulating themselves from the price mechanism and relying on Exchequer funds to undertake unprofitable investments. Assuming that the price mechanism works reasonably well, then private enterprises in similar circumstances would be forced to close down as the social interest requires. Once again, one feels that the impression created by the Plan - or perhaps the climate of opinion in Ireland - emphasises the desire that output and employment should be increased without regard to what is being produced and whether it is efficient. If this is so, it is a short-run view. However, nothing which has been said here should be interpreted as a defence of stagnation in the interests of financial purity. It is far better that resources should be used inefficiently than not at all.

It is sometimes suggested that investment should be directed towards projects which are labour-intensive rather than towards those which are profitable, in order to maintain the overall level of employment. Again this is a very short-term view. In any given sector of production there is a constant tendency for capital to be substituted for labour over time. It is the principal process by which labour productivity, and thus money wages, are increased. This does not mean that the redundant labour must necessarily remain unemployed. In fact, an economy in which real wages are rising is one in which specialisation of labour continues and new kinds of goods and services are provided. There is, in other words, a continuous change in the industrial distribution of labour. On the other hand, an economy which tries to maintain employment in a fixed pattern can do so only at the expense of low money wages, tariffs, subsidies and other fiscal devices which mean constant or falling real wages.

One function of the plan should be to increase the mobility of labour and capital between occupations. As far as geographic mobility is concerned, it seems as if there may be greater mobility between parts of Ireland and the U.K. than within Ireland itself. The plan might therefore concern itself with improving the internal capital and labour markets. The arrival of London merchant banks and U.S. commercial banks, despite the already large number of Irish commercial banks, indicates there is considerable room for improvement in the capital market. Possibly a system of labour exchanges might equalise labour shortages in Dublin and labour surpluses in the West.

If the pattern of economic development in Ireland follows that of other countries, then it appears that the demand for services will increase. Services are generally labour intensive but a large proportion of these services require skilled labour. It may not be too soon to investigate the future possibility of a scarcity of trained labour and a surplus of unskilled labour. In manufacturing also, the most rapidly growing industries in the more developed countries are those using skilled labour.

It is worth noting that planning is necessarily being carried on within a statistical framework which was established, as Dr Geary has pointed out, at a time when most industries were agriculturally oriented. The Report notes that the grouping of firms used in the Census of Production does not always coincide with the groups which the firms themselves form for discussions and negotiations. With the rapidly increasing importance of diverse new industries, it may be time for a re-organisation of the industrial classification scheme.

The Report recommends a more detailed analysis of the building and construction sector. Perhaps the same suggestion may be applied to the transport and distributive trade sector. This is an enormous sector of the economy about which very little is known. There would appear to be considerable scope for reducing costs (and thus the prices of consumer goods) by reorganising retail trade.

The number of advisory bodies concerned with the building industry is almost exceeded by the number which are concerned with economic development. It is hard to trace their effectiveness or demarcate their functions. The Report describes the tendency of representatives of industry to take the opportunity of discussions with the Government to lobby for their particular interests. One wonders whether it is not politically feasible for the government representatives to impress on industry their own view of the structural changes which are desirable. These changes would be of two kinds, changes in size and changes in distribution. For example, in a given sector certain firms should combine, while others should go out of business. Secondly, there should be some official view of the long-run pattern of manufacturing industry in Ireland. A random scatter of new industries is excellent in the short-run, but in the long-run growth depends on the evolution of a group or groups of related industries, based perhaps on food-processing, chemicals, (brewing) or electronics. Should the Government not press for the establishment of such industries and plan their future development?

The anti-planners who form a vocal minority of economists in most Western European countries, (and perhaps in a majority in West Germany and Switzerland), emphasise that the role of the Government should be confined to creating the right environment for economic growth. This criticism should not be regarded as completely negative. The best-laid plans will be frustrated if the system of incentives (prices, wages, tariffs, subsidies) is not working in the same direction and if the labour and capital markets are inefficient and the adjustment mechanism of the balance of payments does not work smoothly. These and other such structural problems should be regarded as essential to the realisation of the plan itself.