THE IRISH ECONOMY: THEN, NOW AND NEXT

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Introduction

For those concerned with the future direction of the economy and indeed society, it is valuable occasionally to step back and consider where it has come from, and how it got from there to here. My retirement provides a suitable opportunity for me to remind myself, and I hope others, of what the Irish economy was like when I arrived in the sixties, and to recall some of the major developments in the past 35 years. Such an exercise is not pure nostalgia, for an understanding of what has happened over a longer period than most of us usually have time to consider should contribute to a more balanced assessment of future policy options. Obviously, within the given time constraint, this can be no more than an overview, but I hope that presenting even familiar concepts in an unfamiliar manner can provide some fresh insights.

Ireland in the Sixties

From the vantage point of modern Ireland, it is quite sobering to recollect just how under-developed the economy was in the early sixties. The 1961 Census shows that 36 per cent of the working population was still engaged in agriculture, with 25 per cent in industry, and 39 per cent in services. The relatively low productivity of agriculture is reflected by the fact that in terms of contribution to gross domestic product the equivalent shares were 24 per cent, 31 per cent and 45 per cent.

Other indications of the nature of the economy in 1961 is that live animals accounted for 32 per cent of the value of exports with industrial products representing only 45 per cent. Of total exports, 76 per cent went to the UK, with only 7 per cent going to west European countries and 16 per cent to the rest of the world, mainly the USA.

The excessive reliance on agriculture and on the UK market was exacerbated by the fact that the UK consciously pursued a cheap food policy, importing at world prices and subsidising its own farmers to maintain reasonable domestic incomes. It should similarly be noted that a high proportion of industry in Ireland at the time was in the form of protected production for the domestic market, perhaps best exemplified

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by the car assembly industry, where cars were built abroad, taken to pieces, and reassembled in Ireland.

However, while the structure of the Irish economy in many ways resembled that of a third-world country, in no way could Ireland reasonably have been classified as third world. The level of physical infrastructure was at that time well above what would normally have been associated with the income level of the country, and was undoubtedly European, rather than African or Latin American, in scope. Even more fundamentally, human infrastructure, in the form of health and education, were of a European nature, even if of a rather poor European standard.

TABLE 1: Economic Structure – Sixties to Nineties

	1961 %	**1998 %**
SHARE OF TOTAL EMPLOYMENT		
Agriculture. Forestry, Fishing	36.0	9.0
Industry	24.6	29.8
Services	39.4	61.2
SHARE OF GDP AT FACTOR COST		
Agriculture. Forestry, Fishing	24.4	5.3
Industry	30.7	39.1
Services	44.9	55.6
	1964 %	**1998 %**
SHARE OF EXPORTS OF GOODS		
Live Animals	22.3	0.2
Other Agricultural	34.6	6.4
Industrial	41.0	91.2
Miscellaneous	2.1	2.2
DESTINATION OF GOODS EXPORTS		
UK	71.5	22.2
Other EU and EFTA	12.8	48.5
Other	15.7	29.3
EXPORTS (goods and services) AS SHARE OF GNP	31.6	96.4

The economy in the first half of the sixties can thus best be described as that of a poor, agricultural, inward-looking region of the UK economy. But by the time of my arrival in 1964, the basic decision to move away from this situation had been made, and the first steps away from the failed policy of autarky, which had led to Ireland missing out on the post-war European boom of the fifties, had been taken.

The Transition

Because of the dramatic economic growth of the past five or six years it is sometimes overlooked that progress in transforming the economy has been a fairly steady long-term process, interrupted temporarily by the need to correct economic imbalances during the mid-eighties. Thus real GNP fell by an annual average of 0.2 per cent between 1981 and 1986, but in every other period since 1961 it increased by an annual average of at least 3.5 per cent. Between 1961 and 1998 the annual average growth of real GNP has been about 3.8 per cent. Although this might seem moderate compared with the 8 per cent average of the past five years, it is very substantial by long-term international standards, and implies a fourfold increase in real GNP over a period of 37 years.

The principal engine of this growth was the steady rise in industrial production, reflected in rapid export growth. Industrial production and export volumes continued to grow substantially even during the recession years of the mid-eighties, as the massive adjustment needed to rectify the fiscal and current account imbalances of the early eighties fell almost entirely on domestic demand and on imports.

The growth of employment has been much less steady than the growth in output. This is partly because of the massive decline in the numbers engaged in agriculture, which fell by 200,000 between 1961 and 1990. It is also due in part to consistently strong productivity growth in the industrial and service sectors. The mid-eighties shake-out of industrial employment, mainly from the less-efficient companies serving the domestic market, left total employment in April 1989 only 34,000 higher than in 1961 and 59,000 lower than in 1981. It was only in 1993 that employment passed its 1981 peak of 1,146,000, although by March/May 1998 it had risen by a further 24 per cent, to 1,427,000.

TABLE 2: The Path of Transformation

OUTPUT				EMPLOYMENT (April)				
	Real GNP	Export Volume	Ind. Prod		Agricultur	Industr	Services	Total
	Annual Average Percentage Change						'000	
1961-1971	4.0	6.8	6.2	1961	369	259	415	1,053
1971-1981	3.5	7.2	4.5	1971	272	320	457	1,049
1981-1986	-0.2	8.5	5.0	1981	196	363	587	1,146
1986-1991	4.4	9.4	8.5					
1991-1998	6.2	15.2	12.9					
1982	-1.7	5.5	-1.1	1982	193	355	598	1,146
'83	-1.2	10.5	8.4	'83	189	331	604	1,124
'84	1.6	16.5	10.0	'84	181	319	603	1,103
'85	1.0	6.5	4.8	'85	171	306	602	1,079
'86	-0.7	3.1	2.9	'86	168	307	606	1,081
'87	4.4	13.8	10.4	'87	164	300	626	1,090
'88	2.6	8.9	12.3	'88	165	299	626	1,090
'89	5.4	10.3	11.7	'89	162	307	617	1,087
1990	7.3	8.7	4.7	1990	169	321	642	1,133
'91	2.5	5.3	3.2	'91	155	323	656	1,134
'92	1.9	13.5	10.2	'92	154	319	672	1,145
'93	2.6	9.1	5.4	'93	144	313	695	1,152
'94	6.3	14.7	12.8	'94	142	333	713	1,188
'95	8.0	19.6	20.1	'95	143	349	756	1,248
'96	7.2	11.8	8.2	'96	138	355	804	1,297
'97	9.0	17.0	16.6	'97	134	386	818	1,338
'98	8.1	20.5	16.7	'98	129	425	873	1,427

Causes of Trans-formation

1. Catch-Up

Given the under-developed state of the economy in the sixties, it is sometimes claimed that the subsequent growth has simply been a matter of catching up with the rest of Europe in terms of resource allocation, technology, and so on. While the catching-up process clearly enables above average growth for a considerable period, it is obvious nonsense to suggest that this process is automatic. If it were, there would be a constant tendency to convergence among the world's economies, rather than spectacular progress by a small minority of countries, including Ireland.

2. Global Trends

Throughout the period the world economy was growing fairly rapidly, although, of course, subject to occasional shocks, such as oil crises. There was also a fairly steady trend towards trade liberalisation, both within specific blocs, such as the European Union, and on a global basis. Most significant of all there were strong tends towards fast growth in products with relatively high value-to-weight ratios which incorporated a high degree of knowledge rather than substantial natural resources, and the development of multinational companies in these fast-growing industrial sectors. This international environment was clearly helpful to a small peripheral economy like Ireland's. It is hard to see how the Irish transformation could have taken place in a climate of international protectionism, or where the main global growth sectors still comprised heavy industry such as railway lines, locomotives, and weighty industrial machinery. However, as with catch-up, the response to a more favourable external environment was by no means automatic, and the opportunities could easily have passed by.

3. Small Size

There can be little doubt rapid change can be accommodated more easily in a small country, where the network of interpersonal relations permits greater flexibility than in larger more impersonal societies. Again however, this is an enabling factor and its utilisation was by no means automatic.

4. Demographics

Huge demographic changes have taken place over the past three and a half decades. Since 1961 the population has risen by 31.5 per cent and the labour force by 42.6 per cent. The birth rate has fallen from almost 22 per thousand in the sixties to around 14 per thousand in recent years, with nearly all of the reduction occurring in the course of the eighties. Allied to the fall in the birth-rate has been a substantial rise in the rate of female participation in the labour force, especially during the nineties. After rising to extraordinarily high levels during the eighties, the dependency rate has fallen dramatically in the nineties, so that it is now about the EU average and will soon become the most favourable in the EU. With hindsight it is clear that the steadily increasing labour force has been a major contributory factor in the transformation of the Irish economy. However, it is worth recalling that this has become fully apparent only in the last few years. Until well into the nineties the natural growth in the labour force was viewed as a problem rather than an opportunity, and over the period since 1961 as a whole a significant proportion of the natural increase was absorbed by net emigration. As with the previous factors, demographic change can be regarded as facilitating transformation, but certainly not as automatically causing it.

TABLE 3: Demographic Trends

BIRTH RATE PER '000 Annual Average																		
1961/71	**1971/81**	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
21.9	21.6	20.4	19.1	18.2	17.6	17.4	16.6	15.3	14.7	15.1	15.0	14.5	13.9	13.4	13.5	13.9	14.3	14.6

POPULATION AND LABOUR FORCE '000 April												
	1961	**1971**	**1981**	**1986**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
Population	2,818	2,978	3,443	3,541	3,526	3,554	3,574	3,586	3,601	3,626	3,661	3,705
Labour Force	1,109	1,110	1,272	1,308	1,342	1,360	1,378	1,400	1,430	1,475	1,517	1,581

PARTICIPATION RATES % Aged 15+		
	1991	**1998**
Male	71.1	69.4
Female	33.4	44.0
Total	51.9	56.5
DEPENDENCY RATE		
	1991	**1998**
Dependants per worker	2.11	1.60

5. Political Stability

Any study of economic development on a global scale throws into focus the fundamental importance of political, or constitutional, stability. Usually this stability can be taken for granted in western Europe, but in Ireland it could not, especially in the years around 1970. The decision not to get militarily involved in the Northern troubles was thus of key economic importance, as a necessary, although of course not sufficient, condition for economic transformation.

6. English Language

Much is often made of the importance of Ireland being English-speaking in the attraction of overseas industries and services. It is a factor which has undoubtedly been useful, especially in relation to US companies and their executives, but has hardly been decisive. Some English-speaking regions, such as the West Indies, have not achieved economic transformation, while many non-English-speaking countries have, frequently with the aid of US based FDI.

7. Policy Choices

This quick overview of some of the factors underlying the growth of the Irish economy has emphasised that none of them would have operated automatically to achieve the radical changes which actually occurred. The vital element in the transformation was a prolonged series of policy choices which harnessed the favourable trends and encouraged the responses which resulted in sustained progress.

Key Policy Choices

1. Progressive Opening of Economy

The vital decision to move away from the previous policy of self-sufficiency had been taken in the late fifties. In marked contrast with the attempted transformation of the former soviet economies, the process was deliberately gradual and progressive. Thus many new export-oriented companies had been established before major pressures decimated the older previously protected firms during the eighties. Of course, the adjustment was not entirely smooth, but the internationalisation of the economy and the role of exports and imports in GNP has been continuous.

TABLE 4: Openness

KEY DATES

1965	Anglo-Irish Free Trade Agreement
1973	Accession to EC
1993	Single European Market
1999	Single European Currency

DEGREE OF OPENNESS

	1998 % GNP		**1995 % Foreign Share of Manufacturing**
Exports (Goods & Services)	96.4	Gross Output	65.2
Imports	83.0	Employment	47.1
Net Factor Flows	14.3		

NET RECEIPTS FROM EU – % GDP

1973/76	**1977/80**	**1981/84**	**1985/88**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
2.0	5.2	3.7	4.4	4.0	5.1	6.3	5.2	5.3	3.7	3.6	3.7	3.8	2.7

Joining the European Union added extra dimensions to the opening of the economy; by implying the acceptance of externally determined standards and regulations, and by setting in place a significant net inflow of funds.

2. Attraction of Foreign Direct Investment

From the outset of the opening process, it was recognised that the attraction of foreign direct investment would be a key element. The actual policy initiatives evolved over time as development targets became more sophisticated, but an essential continuity was preserved. The outstanding features of industrial policy have been as follows.

i. Tax Advantages: Initially in the form of total export tax relief, these were modified after EU entry to the 10 per cent corporate tax rate on manufacturing, subsequently extended to some traded services. A gradual simplification of the corporate tax system removed overlapping allowances and rendered the 10 per cent the actual effective rate.

ii. Free Remission of Profits: This might seem utterly unremarkable now, but in the climate of international exchange controls which existed when the policy was first implemented, the freedom to repatriate profits required a conscious decision by the Irish authorities against considerable domestic opposition. Various potential competitor regions did not at first offer this freedom, which made it an important part of the Irish package.

iii. An Effective Agency for Managing FDI: The concept of a development agency was not fully defined when the IDA was first set up, and it has frequently been in the forefront of international practice in its field. Its steady evolution into a pro-active agency, defining the precise industrial areas it wishes to see developed and actively seeking to recruit leading firms in these areas, has been a vital factor in the transformation of the Irish economy. Its choices of sector and its policy of seeking a broad spread of activities within each sector have proved very effective.

iv. Availability of Grants: Although less fundamental than tax incentives, grants have generally proved necessary in the attraction of firms, especially the crucial industry leaders needed to attract further investment in particular sectors. Even in times of fiscal stringency, funds have generally been made available for this purpose.
v. Macro-Economic Management: If other incentives are right, some export-based direct investment is likely to flow into even a badly-managed economy. However the flow is likely to be much larger and much steadier if the economy is well-managed. The consensus economic strategy and the associated improvement in the public finances have thus encouraged a substantial increase in the quantity and quality of FDI over the past decade.

3. Investment in Human Capital

The role of education in Irish economic growth has been well rehearsed, and needs no elaboration here. In summary, the move to general second level education came much later to Ireland than to most other European countries, as did the subsequent expansion in the provision of third level places. In consequence, Ireland has a particularly rapid increase in human capital. Of the generation now retiring, roughly 60 per cent had no more than a primary education, while of the generation entering the labour force almost half have third level education and well under 10 per cent only primary. Allied to the fact that entrants to the labour force greatly outnumber retirements, this means that the average educational attainment of the labour force is increasing steadily and substantially. While objective measures are difficult to interpret, the subjective indicator of employers' satisfaction suggests that the quality of education is high.

4. Investment in Physical Infrastructure

Ireland entered the period with a fairly generous endowment of economic infrastructure in relation to its stage of economic development and its income level. As steady economic growth took place, the provision of many forms of infrastructure tended to lag behind. However, in certain key areas, most notably telecommunications, heavy investment in extending and modernising the system was maintained, even during periods of maximum financial stringency. More recently a much broader range of infrastructural investment has been undertaken, but the rate of economic growth has been such that serious bottlenecks have emerged.

Key Interactions

None of the policy choices or underlying factors just discussed can be said to have been the particular cause of Ireland's economic transformation. It is the interactions, some deliberate and some fortuitous, between the different trends and policies which provide the key to understanding Ireland's economic success.

In particular the strategy of encouraging foreign direct investment, and then refining the sections sought, would have failed were it not for the growing trend towards globalisation. However, the sectoral refinement was consciously chosen to match the emerging pattern of global development, linking Ireland to several of the fastest growing sectors of the world economy.

At the same time the selection of the fast-growing knowledge-based sectors from the eighties onwards fitted well with the demographic and educational developments within Ireland, and with the concentration on improving the telecommunications infrastructure.

The gradual pace of EU integration and liberalisation was also helpful to the evolution of Ireland's FDI-based industry. Initially, common tariffs or other barriers were sufficiently high to act as an incentive to US firms to establish a European base, and even as the barriers were lowered, the other advantages of European, including Irish, manufacturing facilities remained apparent.

These interactions helped to keep FDI relatively strong, and industrial exports growing, even during the difficult years of the eighties. However, the improvements in economic management and the establishment of a formal consensus encompassing industrial peace and pay moderation encouraged a substantial increase in FDI, which itself provided the conditions under which the consensus approach could be maintained.

Similarly, the interactions between the EU and the Irish economy are quite complex and mainly beneficial. Obviously, Irish membership was fundamental to the attraction of FDI to serve the general European market, while growing integration has assisted the marketing of new products throughout Europe. The Common Agricultural Policy, by establishing relatively high output prices and a complex system of subsidies, greatly eased the problems of agricultural decline and assisted the process of non-agricultural rural development.

Most of the non-agricultural funds flowing from the EU have dovetailed well with the requirement to invest in physical infrastructure and in education and training, and have thus raised the productive capacity of the economy at a vital period when perceived fiscal constraints would have prevented domestic funding on an adequate scale.

The most fundamental effect of EU membership has almost certainly been its contribution towards the gradual improvement in national self-confidence. The shift from an inward-and backward-looking, rather self-pitying, self-denigrating, national self image to the present outward-looking, confident, and perhaps slightly smug and vainglorious, national self-belief has been one of the most striking features of the past thirty-five years.

The Economy Now

It is obviously impossible to encapsulate the complexity of any economy or society in a paragraph or two. Quite apart from the multiplicity of facets which should be observed, the impact of even major trends on individuals will vary enormously according to their own particular circumstances.

With that caveat, however, it remains worthwhile to summarise a few major features, especially those which tend to differentiate Ireland from other European countries.

1. Strengths

The sustained rapid economic growth is an acknowledged strength of the economy, and most of the underlying and policy causes which have enabled this growth remain in place.

Whether or not one regards low inflation as beneficial in its own right, it is an uncontrovertible fact that an inflation rate substantially above that in partner countries in a currency union would be very damaging. Thus the low inflation rate which has obtained in Ireland since the late eighties must be regarded as a strength.

The most dramatic manifestation of economic strength in recent years has been the massive improvement in the public finances. With a current budget surplus (excluding privatisation receipts) in the region of 5½ per cent of GNP and a general government surplus, after net domestic public capital spending, around 2½ per cent of GDP, it is fair to say that in strictly fiscal terms the public finances are no longer a specific constraint on policy decisions.

2. Strains

Not surprisingly, the prolonged period of rapid growth has produced several strains, some of which could prove damaging in the near future.

The bottlenecks which have emerged in parts of the infrastructure, especially transport and housing are due largely to a combination of a collective failure to foresee the scale and persistence of growth and delays imposed by an inefficient planning system. Although highly visible, these bottlenecks are essentially temporary, and in time will ease under a combination of policy decisions and market forces.

More likely to cause lasting problems is the weakening of the consensus on economic strategy which has been so beneficial over the past twelve years. It is only natural that a consensus originally based on fear should become eroded by a lengthy period of success, and this process has been exacerbated by a widespread and justified perception that the benefits of success have not been equitably distributed.

Re-establishing a consensus is rendered more difficult by domestic misconceptions that the strength of the public finances has somehow removed the resource constraints (rather than merely the fiscal constraints) on public spending and on tax cuts. The re-emergence within the public sector of the old fallacy that there was once a time (different for different groups) when relativities were fair and proper is another damaging misconception.

Complicating life for policy makers are foreign misconceptions concerning the condition of, and prospects for, the Irish economy. Applying inappropriate models to a small open economy, especially one which is now part of a currency union, some international organisations offer mistaken advice, and some foreign financial investors make wrong investment decisions, both of which could prove mildly damaging.

3. Immediate Outlook

With interest rates externally determined, and likely to remain below optimum from an Irish viewpoint, an autonomous crash of the Irish economy, or even of Irish asset prices, remains most unlikely.

Far more likely, and indeed worryingly probable, is that the prospects for prolonged steady growth will be frittered away through excessive wage increases leading to too great a loss of competitiveness within the currency union. While such an outcome is still far from inevitable, its prevention will require the speedy rediscovery of a united sense of national economic purpose.

Some Future Issues

It is not my aim in this overview to present forecasts for the future. The outline analysis of how we got from the sixties to the end of the nineties does however raise some obvious questions concerning future developments.

1. Should the Past Strategy Continue?

The key strategic element of seeking FDI to raise output and employment in fast-growing high-tech. sectors should be continued. However, strategy as a whole needs to be modified to reflect both changing domestic priorities and evolving global trends.

2. Can the Strategy Continue?

Threats from unduly rising domestic costs and from external resentments need to be consciously countered. However, many fundamental advantages remain, and should enable continuation, even in the context of EU expansion.

3. Can the Strategy be Adapted?

So far as adaptation to changing global trends is concerned, there seems no good reason to suppose that the IDA will lose its proven ability to spot trends early and to act accordingly. So far as adapting to changing domestic trends and altered factor endowments is in question, it is much less certain that appropriate decisions will be taken by the government and the social partners over the next few years.

4. Can a Specific Irish Approach be Maintained?

Over the past few decades a specifically Irish approach to economic organisation has evolved. While some aspects of this should disappear, such as the cavalier attitude to fiscal legalities and the "poor-mouth" gambit in financial relations with the EU, there is much in the approach which it would be desirable to maintain. This includes the balance maintained between the continental social-market model and the harsher open-market model of the major English-speaking countries, the mixed economy with the balance between public and private ownership determined pragmatically rather than ideologically, and a desire for consensus where this can reasonably be achieved. There will be institutional pressures from within the EU and financial pressures from international capital markets to move towards economic models which may well be much less appropriate than our own. The former threat might need to be countered by an ever-stronger advocacy of subsidiarity within the EU, and the latter, as in the past, by demonstrating that the model we operate is highly successful, even if it deviates from standard monetarist thinking.

5. Can Social Inclusiveness be Fostered?

Part of the threat to the current consensus is due to Ireland sharing in the global trend towards greater income disparities and an apparent lack of concern for a disadvantaged minority. Both for its own sake, and because it would improve the chances of restoring some unity of purpose, early steps to foster greater social inclusiveness are desirable. The relaxation of the fiscal constraint should make such moves feasible, but underlying resource constraints mean that the moves need to be carefully planned and realistic in scale.

6. Can the Physical Environment be Preserved?

Rapid income and output growth tend to be accompanied by increased pollution of land, air and water. Such an association has been present during the current boom, although to be fair, the rise in pollution appears to have been slower than the increase in output. Both for our own sake, and in response to international pressure, it is certain that extra resources will need to be devoted to environmental protection or restoration in future, and that a wide range of decisions will need to be taken in a full awareness of environmental implications. An early extension of public awareness of such developments appear to be necessary.

7. Can We Decide Our Desired Path?

Most of the development of the past three and a half decades did not result from formal agreements between the social partners or from conscious democratic choice. The key decisions were taken by a small number of administrators, politicians, business men, and so on, and, crucially, were subsequently validated by the electoral process. Since the late eighties the economic strategy has been defined by formal agreements and by a remarkable degree of political consensus.

With no single overriding threat now facing the economy, it will be much more difficult to define the aims of a consensus strategy. While it remains most important that the correct key decisions are taken centrally, it would certainly be preferable if this were in the context of an agreed consensual package of aims. Such a package can only emerge from debate, and I hope that the majority of those present will encourage and participate in such a debate.