EXPERIENCES IN SMALL EUROPEAN COUNTRIES AND REGIONS

COMMITTING TO GROWTH

John Bradley

The Allander Series

CONTENTS

SPONSOR'S FOREWORD

The Allander Series is succeeding in raising awareness of the major economic issues facing Scotland. The Series features strong analysis and suggests innovative ways to tackle a range of challenges so that we ensure continued growth and prosperity in the 21st century. It is important that we debate Scotland's economic future much more widely, and with the best information to hand.

Economic growth requires improved skills, first-class infrastructure and communications, and a commitment to encouraging innovation and competitiveness. In this paper, Professor John Bradley examines the challenge and opportunities concerning the economies of Europe's small nations and regions such as Ireland and Scotland.

Scottish and Newcastle is proud to be a part of this groundbreaking initiative. Scotland is already the home of some of the worlds best businesses but there is much that we can learn from the worlds finest economists. The Allander Series is an exciting development which will help to shape all our futures for years to come.

Sir Brian Stewart,
Chairman, Scottish & Newcastle plc.

Scottish & Newcastle

INTRODUCTION

By Wendy Alexander, MSP

Scotland has spent too long reflecting on her past glories and on futile attempts at recapturing them. It is time to start looking to a new future for Scotland. Many Scots have a growing conviction that as part of this new future the nation needs to focus on higher growth. The Allander Series is dedicated to responding to this opportunity by catalysing a debate about achieving improved, sustainable growth.

The Series brings together some of the world's leading economists to assess how Scotland can best respond to the challenge of globalisation, of European enlargement and of devolution. The authors were chosen not only because of their outstanding expertise in economics but also because of their understanding of its application to policy. In a world where the economic challenges facing nations are frequently common, global and complex, their papers will help set a policy agenda that brings the best global research insights to bear on Scottish circumstances. Scotland can become a place where, in future, new policy ideas and their creative implementation come together.

The Series, which is conducted under the auspices of the Fraser of Allander institute at the University of Strathclyde, is non-partisan and has attracted the support of leading corporations, entrepreneurs, academics and politicians. By focussing on how outsiders see Scotland it is designed to stimulate a far-reaching internal debate about the future of the Scottish economy and develop our understanding of the nation's future opportunities.

This the sixth pamphlet in the Series has been written by John Bradley, Research Professor at the Dublin-based Economic and Social Research Institute. An economist by profession, he draws inspiration from history, political science and business studies. He has acted as an adviser to government departments, the OECD and the European Commission and also worked extensively on the economic and business links between Ireland and the United Kingdom.

Professor Bradley recounts how the actual facts of poor performance are seldom in dispute. But what is crucial is the way that local (and sometimes international) policy makers and analysts think about those facts. In other words, the conceptual frameworks that underpin policy actions are all-important and a framework that is highly appropriate can have the power to energise people.

Reflecting on the contemporary challenges for Scotland and Ireland he notes that both find themselves with a broadly similar standard of living. Both economies now face a similar challenge: how to stay in the Premier League. He notes that is Scotland he as sometimes detected an unwillingness – sometimes an inability – to think of Scotland's potential in a truly international way.

Looking forward he prescribes four major strategic tasks that any government needs to tackle: assessing strengths and weaknesses: recognizing trade-offs between policy options; building a healthy business-government relationship and enhancing government-government co-operation. He argues that Scottish growth, development and renewal strategies need to be placed at the centre of government activity, and clearly distinguished from the day-to-day activities of social ministries. Secondly that the apparently high level of educational qualifications in Scotland should not blind policy-makers to the necessity of continuing to prioritise human resources in all aspects and thirdly that strategic regional economic policy design needs to be linked with industrial and service sector strategic policy thinking, and every effort made to ensure that they are mutually reinforcing.

Prof Bradley's paper, like that of the other contributors will feature in a book designed to set an agenda for growth, opportunity and governance for policy makers across Europe. A common EU pattern is emerging. Whilst monetary policy through Monetary Union is managed at supra-national level and fiscal management remains largely the preserve of nation states, it is at regional level where the greatest opportunities lie to develop new and innovative supply-side policies. Policy makers across the continent are looking for those interventions, at regional level, which can support higher productivity-led growth, and generate a consensus on policy reform.

Our conviction is that Scotland has a remarkable set of assets on which to build. So long as we are not beholden to our past Scotland can become a test bed for a unique mixture of both the American spirit of enterprise and of European solidarity. Scotland has much to offer, she is a natural home for knowledge-based businesses, a place of technological advancement and possesses a people who value and support skills and learning. Devolution has enhanced the possibilities for further economic, cultural and social change.

This Series aims to set the agenda for that change.

Do I dare
Disturb the universe?
In a minute there is time
For decisions and revisions which a minute will reverse.

T.S. Eliot

01 INTRODUCTION

To be offered the opportunity of reflecting on the Scottish economy is a particular pleasure for an Irish economist. We Irish follow the fortunes of the economies of the Celtic "fringe" of the United Kingdom with singular interest, having been constitutionally part of that fringe until 1922, and remaining locked into close business and economic relationships with Great Britain from then until well into the 1970s. After independence, British and Irish people continued to enjoy the benefits of a common work area, travelling back and forth unhindered by passport controls, with a frequency born of long-standing familiarity.

For reasons that are not part of our concerns here, Ireland parted company from the UK in 1922 and embarked on the task

The editorial group around the Allander Series of lectures provided an extraordinarily stimulating environment within which this paper was commissioned, written and revised. My sincere thanks go to Wendy Alexander, Jo Armstrong, Brian Ashcroft, Diane Coyle and John Mclaren, for sharing their enthusiasm and insights into the challenges facing Scotland and helping me see Ireland in a different light. They improved the paper beyond measure. My ESRI colleagues, John Fitz Gerald and Danny McCoy, were also an invaluable sounding board for ideas.

of running its own political affairs and building its own institutions. But my grandparents remained convinced that the break had been a dreadful mistake, and pined for the reassuring certainties of British life to the day they died. As a young child in the 1950s, they would take me on bus rides to the seaside south of Dublin, and to my excruciating embarrassment, would loudly ask the conductor for tickets to “Kingstown”, a place-name that Irish nationalists had long ago changed to “Dún Laoghaire”.

However familiar the British-Irish link remained to ordinary people, it proved more difficult to regularise at an official level. Indeed, it was not until the advent of the European Common Market that this was finally resolved. A modest externality of the European movement, grown out of the ashes of the Second World War, was that it provided an encompassing framework within which Anglo-Irish political and economic relationships could also become more relaxed, co-operative and mutually beneficial. Today it seems very natural to discuss the economies of Scotland and Ireland not only within the context of these islands, but also as archetypes of the kinds of entities that make up the European Union: small states and regions.

Scotland is a typical region of a great nation state, whose political institutions embed it in that state, but which leave its local policy-makers with a degree of autonomy. Scotland relates to the outside world mainly through the institutions of its encompassing nation state, even if devolution has relaxed this bond to a degree. This is so obvious and natural that it goes almost unnoticed. Yet it colours the way that Scotland views the world and responds to global opportunities.

Irish political institutions after independence in 1922 gave it the potential for considerable policy autonomy. But prior to the 1960s the carry-over of dependency on Great Britain placed severe physical and psychological restrictions on the practical exercise of autonomy. One symbol of dependence was that British and Irish notes and coins circulated freely alongside each other, with a strict one-to-one parity between them. Almost all of the mainly agricultural Irish exports were sold to Britain. Only after 1960 did the Irish economy begin to succeed in restructuring, diversifying and converging.

But the detailed bilateral comparison of the economic performance and potential of the Scottish region and the Irish state is not this paper's central theme. It is more useful to focus on both of them as European archetypes of small regional and national economies, and to reflect on the implications that this has for the design of successful growth strategies. Within the European context, the economies of small nation states and regions have more in common than is often recognised. In earlier research that reflected on the Irish growth experience, Paul Krugman stressed the need for a better balance between a purely regional paradigm, with growth driven by an export base, and the kinds of macroeconomic and productivity-driven issues that matter for national economies, even small ones (Krugman, 1997). He explored the extent to which one has to look inside an economy, at its internal macroeconomic mechanisms and business interrelationships, in order to understand it. Ireland today has adjusted to thinking about its economy in national as well as regional contexts. Scotland is still engaged in that exercise.

Section 2 presents a brief interpretation of the recent Irish growth experience, since this has attracted attention in Scotland. The relevance for Scotland of the experience of a small country that converged from relative poverty to the EU average standard of living in less than 15 years is not obvious. Even if I sometimes detect an air of pessimism in Scotland about its future, remember that in modern times it has never strayed very far from UK living standards, which are exactly at the EU average. Scotland has never had to grapple with the challenge of convergence. Rather, it faces the more complex challenge of renewal.

I then reflect on the fact that policy makers, in particular regional policy makers, who think that they are pragmatists in quest of quick fixes, seldom if ever work in an intellectual or political vacuum. In the famous words of Keynes:

"The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood".

Developing this theme, David Henderson, in his 1985 Reith Lectures on the influence of economic ideas on policy, coined the phrase "do-it-yourself" economics, by which he meant ideas and beliefs which owe little to economics textbooks, yet still retain their power to influence people and events. And Paul Krugman has recently had some harsh things to say about "policy entrepreneurs", those who offer unambiguous diagnosis, even when professors are uncertain, and easy answers where professors doubt that any easy answers can be found.[1]

Since there is scope for misunderstanding the role of economic ideas in designing growth strategies, it is worth reviewing their history as they have been implemented over the past few decades in small states like Ireland. In Section 3, the point I stress is that the actual facts of underdevelopment are

[1] Krugman's "professors", of course, are a saintly and abstemious group, who play strictly by the rules of academic peer review, and never sin by making wild claims and predictions that are unsupported by mathematical models and empirical evidence!

seldom in dispute. But what is crucial is the way that local (and sometimes international) policy makers and analysts think about those facts. In other words, the conceptual frameworks that underpin policy actions are all-important. Failure to develop is usually associated with incorrect conceptual frameworks rather than with the absence of hard work. On the other hand, a framework that is highly appropriate seems to have the power to energise people.

In section 4 I turn to a wider European aspect of convergence, or – to use the EU term – "cohesion". It is a defining characteristic of European policy-making that the concepts of efficiency and equity are both taken seriously. Since the late 1980s the EU has implemented a major programme of regional investment aimed at promoting "cohesion" among the poorer member states. The member states whose performance lagged most – Greece, Ireland and Portugal – as well as the poorer regions of Spain, Italy, Germany and the UK, received generous levels of development aid. Ireland had the good fortune to be at the precise point of its development strategy that ensured optimal use of EU development aid. But in the case of Scotland, the role of the EU in the area of regional policy may simply be a distraction from challenges that would be best treated by the more effective use of Scotland's much larger local resources.

In section 5 I turn to the challenges of today, where both Scotland and Ireland find themselves with a broadly similar standard of living.[2] Ireland is newly promoted into the Premier League. Scotland has been in it for a long time, but do I detect a fear of relegation? Both economies now face a similar

[2] The assertion of similar Scottish and Irish standards of living has to be heavily qualified. It is merely a statement about the approximate equality of Scottish GDP per head and Irish GNP per head (smaller than GDP due to profit repatriation by foreign firms). Consumption per head remains higher in Scotland, but not spectacularly higher.

challenge: how to stay in the Premier League. The experience of small EU countries suggests that success is almost always associated with a far wider range of overlapping and mutually reinforcing strategic approaches than are normally used by economists, and that strategy best operates within robust and appropriate institutional frameworks that must be carefully designed and implemented. I conclude in section 6 with some reflections on the characteristics of good regional governance.

Perhaps I should signal up-front a perception that colours all of my analysis. Over the past decade, as I have interacted with Scottish and other UK regional economist colleagues, I have detected an unwillingness – sometimes an inability – to think of Scotland's potential in a truly international way. I am driven to interpret this phenomenon as a mindset induced by the sheer strength of the centripetal intellectual and financial pull of London, combined with the fact that Scottish Ministers, their advisors, and academics do not regularly have to sit around tables in Brussels and Frankfurt explaining themselves robustly to their peers, and listening in turn to other national and regional narratives. Nobody denies that the Edinburgh-London axis must remain a vital one for Scotland. Indeed, the Dublin-London axis also continues to be important. But the Irish Taoiseach (or Prime Minister) is also obliged every few years to act as EU President for six months, and Ministers as well as the entire civil service must perform on the EU and world stage. I hasten to add that nobody is foolish enough to imagine that Ireland is very influential in this role. But the process has an electrifying effect on the country and exposes it to a vast array of international challenges that might otherwise pass it by.

02 REFLECTING ON IRELAND'S "GREAT LEAP FORWARD"

Let me start with a somewhat downbeat interpretation of Ireland's convergence story. Since my purpose is to discuss policy frameworks for growth, it is appropriate to examine Irish economic performance in terms of the so-called "Lisbon Agenda". This important initiative arose out of a nagging realisation on the part of the European Commission and the major EU states that the Single Market, established in the late 1980s and early 1990s, was not delivering as dynamic a growth performance as had been expected. Based on a wide range of indicators, many of the European economies were failing to catch up with the USA, and some were even falling further behind.

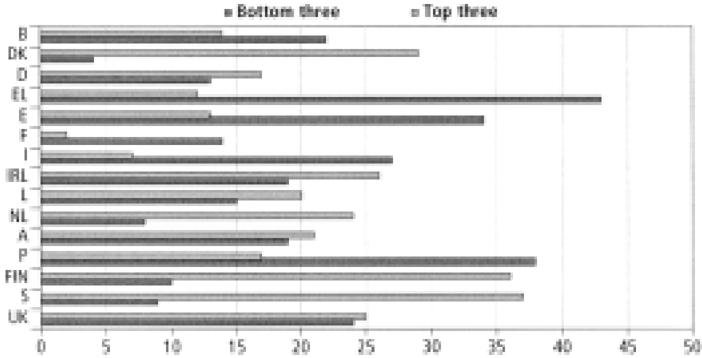
These concerns came to a head at the Spring European Council meeting held in Lisbon in 2000, where an ambitious programme was launched, entitled *An Agenda of Economic and Social Renewal for Europe*. After ten years of strong growth, we Irish were initially a little complacent about the Lisbon Agenda. After all, we had dynamic clusters of high technology sectors (mainly computers, software and pharmaceuticals); our growth had accelerated dramatically in a sustained way; we had slashed our unemployment rate from one of the highest in Europe to one of the lowest; and we believed that we had improved our social protection systems beyond recognition. But as we examined the Lisbon agenda, our complacency was not to last very long.

As a means of giving substance to the task of monitoring progress on the Lisbon Agenda, the European Commission began to publish regularly a set of over one hundred socio-economic indicators, gathered into six main areas: general economic performance, employment creation, innovation and research, structural reforms, social cohesion and care of the environment. If you stand back from the details of the Lisbon indicators, some fairly robust conclusions emerge. Using the most recent data, Figure 1 shows the frequency of appearance of each of the 15 EU states in the top and in the bottom three of each structural indicator. In terms of appearance in the top three, the international pecking order is Sweden, followed by Finland, Denmark, Ireland and the UK. In terms of appearance in the bottom three, the order is Greece, followed by Portugal, Spain, Italy and the UK.[3]

But if you move from the indicators taken as a whole down to a more detailed level, a less comforting picture of Ireland emerges. Eighteen of our twenty-five “top three” scores arise in the areas of “general economic performance” and “employment performance”. One can designate these two areas somewhat loosely as “outturn” indicators, i.e., growth, exports, jobs. In the other four main areas, which might be loosely designated as “input” indicators, Ireland achieves very few “top three” scores, but many “bottom three”. So, we are presented with something of a paradox. Ireland is apparently a country that succeeded in delivering a top class performance in terms of a series of outturn indicators, while simultaneously displaying modest to mediocre performance in a series of indicators of quality inputs. The three Nordic countries – Finland, Sweden and Denmark – performed excellently in both output and input indicators.

[3] Unfortunately, the Lisbon indicators are not yet published at the EU regional (or NUTS 2) level, so we cannot pinpoint Scotland’s performance.

FIGURE 1: LISBON INDICATORS OF PERFORMANCE: FREQUENCY OF APPEARANCE IN THE TOP/BOTTOM THREE STRUCTURAL INDICATORS



What then drove Ireland's top class "outturn" performance, propelling it to convergence in terms of GDP/GNP per head? It was clearly not the expected Lisbon Agenda drivers: i.e., innovation, structural reforms, social cohesion and the care for the environment. How did Irish policy makers manage to leverage top class growth and jobs out of apparently so few top class inputs? Are there useful lessons for other states and regions, for the present as well as the future?

To tell this story properly, we need to examine three interrelated issues:

- The quest for smart policies that maximised the use of the limited policy autonomy and the constrained resources available to a small state like Ireland as it attempted to converge;
- The returns to a strategy of taking full advantage of an orientation towards EU policy initiatives and European markets at a time of great change and dynamism in the world economy;

- The sustainability of high performance in the longer term, as well as the payoff that can come from integrating all the different strands of policy-making within a coherent national strategy.

The first of these issues might appear to be of limited interest to Scottish policy makers, but it serves to highlight the importance of having an appropriate strategic policy framework. The other two are as important to Scotland as they are to Ireland.

03 IRELAND'S CONVERGENCE: WHY IT WAS NECESSARY, HOW IT WAS DONE?

Although the flashy performance of Ireland over the past decade attracts most attention, the origins of the success in convergence lie in the 1960s. The rapid recovery and growth of the main economies of Western Europe, after an initial period of post-war reconstruction, had cruelly exposed the stagnation of the Irish economy. Policy thinking until the early 1960s had been dominated by a decision taken in the 1930s to attempt to build an Irish industrial base behind high tariff barriers. Recall that the partition of the island in 1922 had split off the only heavily industrialised region, centred on Belfast, leaving the then Free State with the very modest remainder. The simple, unqualified and dogged embrace of protection by Irish policy-makers appeared to offer exactly what the country needed at that time, and was in tune with an unfolding political and economic drama being played out in the rest of the world as it lurched towards war.

In April 1933, at a lecture in Dublin, John Maynard Keynes commented favourably on the Irish switch to protection, declaring that:

"Ideas, knowledge, science, hospitality, travel – these are the things which should by their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, let finance be primarily national" (Keynes, 1933)

and concluded:

"If I were an Irishman, I should find much to attract me in the economic outlook of your present government towards greater self-sufficiency".

What is seldom quoted is what immediately followed these remarks, and heavily qualified them.

"But as a practical man and as one who considers poverty and insecurity to be great evils, I should wish to be first satisfied on (some) matters. I should ask if Ireland is a large enough unit geographically, with sufficiently diversified natural resources, for more than a very modest measure of national self-sufficiency to be feasible without a disastrous reduction in a standard of life which is already none too high".

Ignoring Keynes' caveats, the inward-looking import substitution policies were pursued into the post-war period, and continued until the late 1950s, with disastrous consequences. In the absence of a competitive and export-oriented industrial sector there was very little that could have accelerated an economic decoupling from the UK, and the consequences followed inexorably. In the words of the Norwegian sociologist, Lars Mjøset:

"Ireland became a free rider on Britain's decline, while Austria and Switzerland were free riders on Germany's economic miracle" (Mjøset, 1992)

The 1950s in Ireland were disrupted by a series of serious balance of payments crises that were simply the consequences of the fundamental lack of competitiveness of the manufacturing sector. This was exactly what Keynes had warned about back in 1933. Ireland was simply too small to continue as an inefficient producer of goods where it had no comparative advantage.

The policy changes that evolved during the crisis-wracked

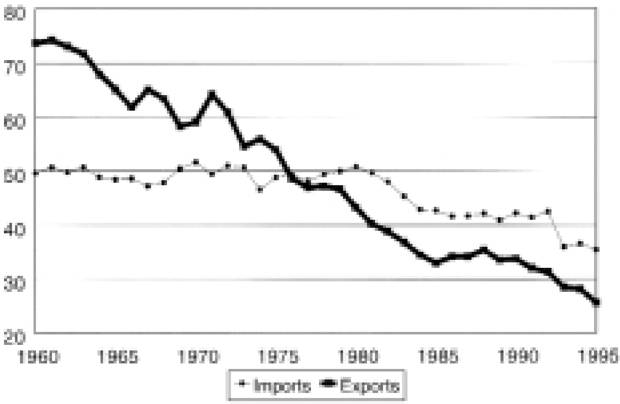
1950s were consolidated in 1958 in a seminal report, *Economic Development* and codified in a government White Paper, *First Programme for Economic Expansion* (Ireland, 1958). A diverse range of ideas and proposals was advanced, mainly in the areas of agriculture and the agri-food sector. But with the benefit of hindsight, we can now recognise this period as a transition between old and new perspectives, and not a whole-hearted embrace of a modern view of the economy. For example, the zero rate of corporation profits tax, combined with the liberalisation of trade and foreign investment as well as the freedom to repatriate profits, were to become crucial factors in a process that would inexorably lead to the decline of much of the inefficient indigenous manufacturing sector and the rise and eventual dominance of a new foreign-owned sector. Yet the corporation tax initiative lay buried in an appendix of *Economic Development* and was not even mentioned in the main text!

We also now understand better that when a mainly agricultural country attempts to modernise, the primary requirement is for the farming sector to shrink as a proportion of the overall economy, and for the manufacturing sector (and elements of services) to expand and develop in a way that drives export growth through improvement in cost competitiveness. Given Ireland's dismal record of native entrepreneurship in the post-war period, this ultimately involved attracting direct investment from America. Yet the vision of *Economic Development* was mainly agriculture-led export growth, with a continuing mainly indigenous manufacturing base. The official aim was to emulate Denmark. In fact, thirty years later we had became a bit like Massachusetts! While the official rhetoric of development stressed continuity with the agricultural past, the newly created state development agency (the Industrial Development Authority, or IDA) buzzed with excitement at the potential offered by the new policy regime (McSharry and White, 2000).

The policy changes made in the 1950s were a heady mix of a commitment to trade liberalisation, a range of direct and indirect grant aid to private firms, and the incentive of zero corporation profits tax on exports. The object was to give a kiss-of-life to the inefficient domestic industry, but that never happened. By the early 1980s, most of the old industries had either failed, downsized or been transformed. Luckily, this policy mix was precisely what was needed to ride the coming tidal wave of American foreign direct investment, in contrast to the declared policy aim of growing on the back of an expanding indigenous agri-industrial base. The policy thrust was uniquely appropriate to Ireland's development challenge, but the outcome eventually produced by these policies turned out to be very different from what was anticipated. This provides a nice illustration of the distinction between the factors that influence the design of policy and how the business community actually exploits the new freedoms. One cannot always predict the latter simply from a knowledge of the former.

The strong web of dependency between Ireland and the UK that had endured relatively unchanged from independence until the late 1950s only began to weaken after the shift to foreign direct investment and export-led growth. Starting from a point in the 1950s when about 90 per cent of Irish exports still went to the UK, the share declined steadily thereafter, and stabilized at about 20 per cent by the mid-1990s (Figure 2).[4]

FIGURE 2: IRISH TRADE WITH THE UK: EXPORT AND IMPORT PERCENTAGE SHARES 1960–95



Source: Irish Trade Statistics, Central Statistics Office

The opening of the economy and the removal of tariff barriers were necessary policy changes for a kick-start out of stagnation. Free trade with the UK happened in the mid-1960s. Free trade with Europe came later when Ireland joined the then EEC in 1973. Irish economic policy-making since the late 1950s has always emphasised the need to face the consequences of extreme openness, to encourage export orientation towards fast-growing markets and products, and to be aligned with all European initiatives. Thus, we joined the European Monetary System in 1979, breaking a long link with sterling and its deep economic and psychological dependency. We embraced the Single Market of 1992, the Social Chapter of the Maastricht Treaty, and most recently, Economic and Monetary Union from January 1999. Perhaps this is the main legacy bequeathed to us

[4] Figure 2 also neatly illustrates the fact that the Irish share of imports from the UK declined only marginally over the 35 years between 1960 and 1995. Over their history, the Irish had developed a strong taste for British goods that only the recent strength of sterling against the euro has eroded. Exports, on the other hand, were to be an engine of convergence, and diversification beyond the UK market was essential.

by the prescient policy-makers of the late 1950s. Since then, the enthusiastic embrace of openness provided the strong and enduring strategic backbone of our economic planning.

Of course, the Scottish economy is also as "open" as the Irish, measured in terms of the ratio of exports to GDP (Fraser of Allander Institute, 2001). But almost half of these "exports" are external sales to the rest of the UK. In this sense the rest of the EU market is simply not as important as it is to Ireland. Combined with the pervasive "eurosceptic" views of many UK policymakers, it is easy to see why Europe and EU initiatives are likely to play a weaker role in the UK regions.

An attractive corporation tax rate and the absence of tariffs were only a start, and would not in themselves have made Ireland a major host for high quality foreign direct investment. Other factors came together to reinforce Ireland's eventual economic convergence and interacted to create a virtuous circle of superior performance that replaced the previous vicious circle of under-performance. Educational standards in the Irish work force had lagged behind the world. Policies were urgently needed to bring about a steady build-up of the quality, quantity and relevance of education and training, and this had been initiated by farseeing educational reforms starting in the 1960s. These reforms were later to be extended by the emphasis given to scientific and technical skill formation through the use of EU Structural Funds from the late 1980s.[5]

The Irish policy-making environment during this period can

[5] A Polish journalist recently asked me to explain how the Irish were so prescient as to prioritise investment in human capital over all other investments in the first two EU Structural Fund programmes during the Celtic Tiger years, 1989-1999. None of the other recipient states or regions had done so, preferring to focus on physical infrastructure. I found this a difficult question to answer, and could only reply that education and skill formation had been strategically prioritised as far back as the 1960s. It would have been simply inconceivable not to have prioritised human capital in the Structural Fund programme!

be characterised as having shifted from one appropriate to a dependent state on the economic periphery of the UK to that of an region more fully integrated into an encompassing European economy. Foreign direct investment renovated and boosted Irish productive capacity. The Single European Market provided the primary source of demand. All that remained was for a long overdue "big push" on improvement in physical infrastructure, education and training, and this arrived in the form of a dramatic innovation in regional policy at the EU level, with the advent of Structural Fund aid from the late 1980s.

It is clear that there were some special circumstances surrounding the Irish switch to trade liberalisation and active encouragement of inward investment. First, the manifest failure of the previous protectionist policies had been so obvious that no political party or domestic lobby favoured their retention. Second, the range of abilities and expertise available within the Irish public sector was considerable, in part as a legacy of our previous incorporation into the UK, but there was a willingness to learn from European experiences, in particular the indicative planning experiences of France (Chubb and Lynch, eds., 1969). Third, the completion of European reconstruction, and the growth in importance of the EEC, provided the opportunity to capture some of the rapidly-expanding flow of American investment into Western Europe. Fourth, rapid advances in technology and declining transport and communications costs during the 1960s facilitated the process of foreign investment by multinational corporations, which flourished spectacularly from the late 1980s.

Why is the example of the Irish policy inflection point of the early 1960s relevant to discussions today? In the confusion of daily political life, one can live with a certain lack of co-ordination; one can switch direction many times and experiment; one can be inconsistent. Tactical policy mistakes and errors can usually be detected before too much damage is done, and revised policies implemented in a learning game of trial and error. However, this is only the case when the strategic thrust of policy has been set correctly. Getting the medium-term strategy right is vital mainly because change is very difficult and errors are very costly, and sometimes terminal. When strategy is wrong, retribution usually follows, as it did in post-war Ireland. Could the paradox be that the extreme peripherality and vulnerability of the Irish economy forced its policy makers to become more thoroughly international in their outlook, while Scotland, a region with an enviable record of post-war modernisation and success, had to change less and was less aware of shifting global forces?

04 COHESION FOR ALL: THE EU TAKES ACTION

The desire for equitable development had been expressed in the Treaty of Rome, but prior to the late 1980s the EU budget was largely dominated by the need to finance the Common Agriculture Policy (CAP). The redistribution of the EU budget to reform and expand EU regional aid policy into a sophisticated system of National Development Plans (NDPs) and their accompanying Community Support Framework (CSF) treaties, was driven by two main factors.[6] First, the progressive enlargement of the EU after its foundation in 1956 brought about an ever increasing degree of socio-economic heterogeneity with the accession of Ireland (1973), Greece (1982), Portugal and Spain (1986). In addition to the process of enlargement, the parallel evolution from a common market into a more integrated economic union obliged EU policy makers to aid the weaker states and regions to meet the competitive challenges of the Single Market and Economic and Monetary Union.

While all nation states had previously operated internal regional policies of various types, what was different about the new EU regional policy initiatives was that very significant financial aid was made available by the wealthier member states (including the UK) to co-finance national and regional policy

[6] For simplicity, we will henceforth refer (somewhat inaccurately) to EU regional aid as "Structural Funds."

initiatives in a limited number of the poorer member states and regions. After 1989 there was a major shift of resources from the CAP to regional development aid directed at a limited number of countries, while remaining within a similar budgetary envelope (i.e., about one and a quarter per cent of EU GDP).

In Scotland (as well as in Northern Ireland) experience of EU regional aid has been as a rather minor addition to the much larger financial transfers that take place between the regions of the UK. For example, the EU contribution to the Highlands and Islands Structural Funds programme for the period 1994-99 was only 293 million euro, and total expenditure (EU, local public and private) was 696 million euro (ECOTEC, 2003). It has even been claimed that:

"*The Structural Funds, often regarded as a means of regional emancipation, in fact have the opposite effect. Since the UK does not recognise additionality at the territorial level, the effect of structural fund designation is to earmark a part of the block grant deemed to represent the European contribution and oblige the devolved administrations to allocate another tranche as 'matching funds'. These moneys are then ring fenced and unavailable for allocation to other priorities*" (Keating, 2001).

However important it is to have the Highlands and Islands designated as Objective 1, this is unlikely to bring about a fundamental change in the way public investment is planned and implemented in Scotland. But Ireland, together with Greece and Portugal, being considerably less developed than Scotland, obtained a much higher level of EU co-finance. The magnitude of the financial aid, combined with the requirement to take a medium-term strategic approach to public investment planning, brought about a sea-change in the way the Irish public sector approached this crucial aspect of development.

What was special about the Structural Fund policies was their ambitious goals, i.e., the provision of financial aid (in the context of a domestic co-finance requirement) to implement policies whose explicit aim was to transform the underlying structure of the beneficiary economies. Policies moved far beyond a conventional demand-side, cyclical stabilisation role of public expenditure, and were directed at the promotion of structural change, the acceleration of medium-term growth, and the eventual achievement of real convergence mainly through efficiency improvements in supply-side processes.

EU financial aid was made available within explicit multi-annual investment programmes that started as National Development Plans, and when approved by the European Commission, were codified into formal development aid treaties, or Community Support Frameworks. An important consequence for public investment planning was that a more strategic approach could be taken. In the Irish case, this allowed successive administrations to break with annual capital budgeting and put in place systematic development plans of longer duration (i.e., for five, six or seven years).

Recent advances in the study of spatial economic processes imply that the conditions required for automatic convergence to take place are increasingly seen as not to hold in practice (Krugman, 1995; Fujita, Krugman and Venables, 1999). Policy has come to focus attention on the importance of such factors as the initial level of regional physical infrastructure, local levels of human capital, or on the fact that regions that start off at a structural disadvantage may never converge in any reasonable time period. Research has even suggested that the removal of barriers to trade and factor movements may lead to a relative deterioration rather than an improvement for some regions.

Regional policies can be justified in many ways and every EU member state operates a wide range of such policies. Some of these operate automatically, such as the income support mechanisms of the social welfare transfer system. Others are more discretionary and involve policies designed to address specific problems (such as regional de-industrialisation) and often targeted at specific underdeveloped regions (such as Northern Ireland, Merseyside and the Scottish Highlands and Islands in the UK; the *Mezzogiorno* region of Southern Italy, and the Eastern länder of Germany). At the level of the EU as a whole, it was the lagging states and macro regions on the southern and western periphery that constituted Europe's "regional" problem and called for European regional policies.

Influenced by growth theory, and by a desire to implement policies with long-term benefits, the EU-inspired Structural Funds came to dominate Irish policy-making during the 1990s, and had three main priority areas of investment. Direct support for productive investment improved the environment for enterprises. Infrastructure expenditure offset structural and geographical disadvantages. Spending on human resources augmented human capital. The Structural Funds have influenced the evolution of the Irish economy over the past 15 years. But the evolution of the economy also influenced the redesign of successive programmes. Table 1 shows the percentage shares of each of the three main categories of public investment, for each of the three cycles of Irish Structural Funds that have operated since 1989.

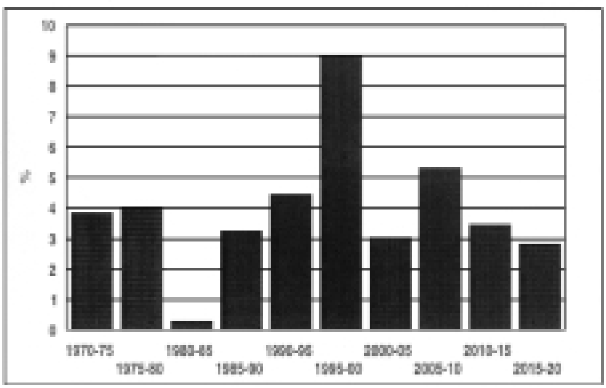
The first programme focused heavily on direct aid to the productive sectors, with a strong emphasis on human resources, and a substantial programme of investment in physical infrastructure. It was designed at a time when the economy had

Table 1: Main economic categories of Irish Structural Funds (Percentage shares of total)			
Economic Category	CSF 1989-93	CSF 1994-99	CSF 2000-06
Aid to productive sector	56.0	47.0	16.0
Human resources	25.0	32.0	36.0
Physical infrastructure	19.0	21.0	48.0

not fully emerged from the crisis of the 1980s, and the direct aid sub-programmes appeared to offer the fastest and best immediate return, while the other sub-programmes built up offering the promise of longer term returns. By the time of the second Structural Fund programme, the increased emphasis on human resources (up from 25 to 32 per cent) reflected concerns about the continuing high level of unemployment, and had a strong "equity" element that complemented the "efficiency" element. The third programme was designed at a time when the convergence of the Irish economy was apparent. By the late 1990s Ireland had moved to what was effectively full employment, and major infrastructural deficits had been exposed by the rapid growth in the volume of traffic on the congested road systems both in the major cities, and connecting these cities. In order to address these bottlenecks, there was a major shift to infrastructure investment, the share going to human resources also increased, with a focus on upgrading skills, and there was a reduction in direct aid to the now booming productive sectors.

It is not sufficient to point to the step-change in economic performance (Figure 3) and to assign all the improvement to the Structural Fund interventions. In fact, the impact of Structural Funds in isolation is relatively modest, but when added to the impact of the Single Market, foreign direct investment, and fiscal reforms, the effects are much larger (ESRI, 1997). Analysis suggests that a ranking in terms of effectiveness is topped by Ireland, followed by Portugal, Spain, and with the smallest impacts on Greece (ESRI, 2002). In the EU "macro" regions (the Italian *Mezzogiorno*, Northern Ireland and East Germany), the Structural Funds appear to have had only modest impacts. It has been suggested that the effectiveness of Structural Funds depends on "conditioning" variables, and the most important of these is economic "openness" (Ederveen et al, 2002). The Irish economy is the most open in the EU, on the measure of exports to GDP. The Scottish economy is as open as that of Ireland, but the UK effect dominates. Portugal is also quite open, relative to its size. Spain is less open, but Greece is the least open. Structural change in an economy – involving openness, institutional quality, etc. – is driven by forces beyond the Structural Funds. These funds may serve to accelerate change, but it is the wider challenges of EU membership that probably dominate.

FIGURE 3: IRISH GDP GROWTH, BEFORE AND AFTER STRUCTURAL FUNDS (INCLUDING FORECASTS)



Source: Bergin et al, 2003

After almost a decade and a half of Structural Funds and the Single Market, how have the so-called "cohesion" countries performed? In Table 2 we show the convergence experience of these four countries, with the UK and Denmark as additional benchmarks.

Table 2: Relative GDP per capita
Purchasing power parity: EU15 = 100[7]

	1960	1973	1986	2003
Ireland[8]	63.2	60.8	65.8	122.4
Greece	43.8	71.1	62.9	68.4
Portugal	39.6	58.4	54.2	68.8
Denmark	126.2	120.9	117.8	113.8
UK	123.3	104.2	101.1	104.4

Source: European Economy, No. 4, 2003 (pp 120-121)

Adaptation to the competitive rigors of the Single Market and efficient use of Structural Funds undoubtedly underpinned the dramatic resurgence of Irish growth. Operating in the context of a draconian fiscal restructuring in the late 1980s which provided the basis for nominal convergence (in terms of inflation, interest rates, borrowing, etc.), this combination was a primary force driving real convergence (in terms of growth, income levels and unemployment). But the policies also operated in the wider context of public support for growth in human capital that went back to the mid 1960s, a social

[7] Scotland's performance on this uniform EU basis is not available. But the UK Regional Accounts show that its GDP per head tracks at about 95 per cent of the UK average, and the UK itself is just above the average of EU GDP per head. Since there are unlikely to be differences in purchasing power parity between the British regions (i.e., differences in regional price levels), this is probably a good measure of Scottish performance on the EU basis.

[8] It should be noted that GDP overstates Ireland's national income (or GNP) by about 15 per cent, due to large-scale outflows of corporate profits of foreign-owned multi-national firms that operate in Ireland.

partnership that ensured that the transition to high growth would take place with harmonious industrial relations, and a determination to move towards deeper monetary union in Europe. This distinguished Ireland from, say, Greece, which faced a broadly similar convergence challenge, but which was very late in embracing internationalisation.

Looking at the way poorer countries and regions in the EU can seek to accelerate their growth rate in order to catch up, the Irish experience suggests a process involving interlocking beneficial externalities:

(i) There was an initial clustering of similar industries, kick-started in Ireland early in the 1960s by incentives based mainly on very low rates of corporate taxation, and a range of other attractive incentives towards investment and training. Two such clusters grew strongly in the 1980s: pharmaceuticals and computer equipment. Although mainly foreign-owned, local suppliers of specialised inputs rose as well.

(ii) These clusters generated a Marshallian local labour market for skilled workers which further facilitated growing clusters. The early focus on human capital during the 1960s and 1970s was enhanced by the training and human resource policies of the Structural Funds, providing a vital boost to ensuring an elastic supply of highly trained labour during the 1990s. Remember that most children in the 1950s and 1960s were the first generation to grow up in an urban environment. Education in traditional "grammar" schools was the norm, since the apprentice training schemes typical in UK's industrial cities were non existent. Farmers' children tend to have a more utilitarian attitude to education and training, particularly when the private returns to technical and business skills are high.

(iii) Spillovers of information and skills from the high technology clusters further encouraged growth in high technology areas and provided the basis for additional clustering effects, often in traditional areas that could benefit from new technologies in their supply chains (e.g., food processing, music and films, high fashion clothing, etc.). It became important to facilitate internal transport and communications, and the urgent need for improvements in physical infrastructure and in the productive environment supported by the Structural Funds became crucial.

(iv) Finally, the efficiency externalities operated against the background of a consensual process of social partnership, put in place to ensure that there were as few losers as possible in the fiscal and wider economic restructuring required to drive a virtuous circle. The result was that growth was less likely to be choked off by industrial unrest.

Thus, openness to the full rigors of competition in the international marketplace was a necessary condition for Irish economic success, but was not sufficient. Nor did the availability of EU development aid guarantee rapid convergence, as the comparison of Ireland with Greece illustrates. The barriers to faster growth needed to be correctly identified, a broad growth-promoting policy environment had to be put in place, and the specific Structural Fund public investment policies had to be appropriate, efficient and effective.

The sheer complexity of the convergence challenge demanded a concerted national focus on breaking out of the previous regime of slow and erratic growth. In small peripheral countries like Ireland, it became important to develop and articulate a culture of excellence in economic and business analysis so realistic policies could be identified which would command broad agreement among the Social Partners. Regional policy *within* EU member states, on the other hand, often tends to be “palliative”, in the sense that it attempts to make the regional disparities easier to endure rather than making any serious attempt to eliminate them. The main policy instrument used is income support transfers from richer to poorer regions, a process that does not exist to anything like the same extent between richer and poorer countries of the EU. It appears to be politically difficult to design regional policies that introduce fundamental differences between regions of a nation state other than in terms of the level of income redistribution. But if the Scottish economy is to be renewed (Krugman’s “second wind”), big innovations are precisely what are needed (Krugman, 2003).

05 STAYING AHEAD: TOUGHER THAN CONVERGENCE?

Today on the global economic map, the lines that matter are those defining "natural economic zones", which can be regions or states. With falling transportation and telecommunication costs, economies have become increasingly interdependent, where:

"The real economic challenge … [of the nation or region] … is to increase the potential value of what its citizens can add to the global economy, by enhancing their skills and capacities and by improving their means of linking those skills and capacities to the world market." (Reich, 1983)

This process of global competition is organised today mainly by multinational firms and not by governments. Production tends to be modularised, with individual modules spread across the globe so as to exploit the comparative advantages of different regions. Hence, individual small nations and regions have less power now to influence their destinies, other than by refocusing their economic policies on location factors, especially those which are relatively immobile between regions: the quality of labour, infrastructure and economic governance, and the efficient functioning of labour markets.

Thus far we have been using a mainly economic framework of analysis. But there are severe limitations to using a purely economic perspective on transformation and renewal. In the case of a UK region like Scotland, a major constraint on its freedom of action is the rather limited range of significant policy instruments that it can use, since Scotland is integrated into the UK fiscal and monetary union. But does a small state like Ireland really possess many policy options that would be denied to Scotland? A low rate of corporation tax? But this was essentially a once-off Irish initiative taken almost half a century ago, at a time when the economy was one large green field, and the population was emigrating in droves. The changes since then have been modest, and largely dictated by EU law.

Far from being a "free lunch", the low rate of corporation tax condemned the long-suffering Irish tax payer to decades of penal rates of direct and indirect taxation. The societal choice was that you could have a job in Ireland with a foreign-owned multinational (rather than in London, Manchester, Glasgow or Boston), but you paid for it by high personal taxes. With that exception – and I admit that it is a rather important one – one can ask if there is much else that an Irish government can do in the economic sphere that could not also be done by a Scottish government today, without necessarily incurring the wrath of the UK Treasury. An unsettling feature of public policy debate in Scotland is the air of uncertainty that seems to surround its scope for policy autonomy. In a recent report of the Scottish Executive, attempts were made to achieve lower Scottish tax rates by persuading the UK government to reduce UK tax rates. These proposals were slapped down by the Treasury in a peremptory fashion. (Scottish Executive, 2003).

Rather than searching for ever cleverer fiscal tricks, I believe that a better way for Scotland is to accept the constraints of being in the UK fiscal union, and to broaden the debate beyond the strictly economic issues. Economic policy research tends to be directed at issues and challenges that arise at the level of regions, nations or even groupings of nations such as the EU. Business policy research, on the other hand, is focused on the performance of individual firms or groups of firms, and Michael Porter has stressed that it is more helpful to consider firms as competing in *industries*, not in *nations* (Porter, 1990). This simple insight lies at the heart of the differences between the mainly regional/national-based perspective of economic researchers, and the mainly firm-based perspective of business researchers, particularly in matters concerning the design and execution of industrial strategy. This is particularly relevant in small countries and regions, where the economic research agenda is often heavily influenced and distorted by trends in international monetary and macro economics, and where regional problems, including industrial strategy tend to be neglected.

For example, the experience of the Scottish Economic Policy Network (Scotecon) over the past few years suggests that it may be difficult to persuade Scottish economists to direct their research towards tackling important regional problems (industrial strategy, regional development, the scope for greater fiscal autonomy, differential regional performance, labour markets, etc.). The UK-wide Research Assessment Exercise (RAE) also tends to crowd out local topics in favour of more “publishable” national topics.

One might characterize a key challenge of industrial policy making in any small nation or region as that of blending the techniques and insights of the predominantly economic analysis of what one might call the “outer” business environment with those of the business analysis of the “middle” ground of strategy. These two areas are often studied in isolation from each other by non-overlapping groups of researchers. Seldom are the two different perspectives looked at as being entirely complementary. Seldom are they both invoked to guide policy-makers.

At the level of the individual firm or corporation, strategy is usually formulated in a context where government policies are largely exogenous, and firms address the challenges of assessing the business portfolio and identifying strategic goals. The crucial role of management is to formulate a corporate strategy aligned with the nation's or region's wealth-building strategy. So this issue is usually examined largely from the point of view of domestic or of regional companies adjusting to national strategy.

In Ireland, however, causality as often as not runs in the opposite direction. In other words, the Irish industrial development agency – the IDA – constantly scans the world for inward investment in high technology sectors, even when the domestic environment is not sufficiently attractive to persuade leading-edge firms to locate in Ireland. But information on firms' expressed needs are fed back to the Irish government by the IDA, and major policy changes can be executed quite rapidly. A case of information feed-back was the transformation of the Irish university system in the mid-1970s, when massive resources were put into the enhancement of electronic engineering and chemistry to create a skilled labour force for potential inward investors (MacSharry and White, 2000). A more recent example was the provision of generous resources to the university system to fund basic research in the areas of electronics and biotechnology, when a lack of such skills was identified as a potential bottleneck to future investment opportunities.

Thus the national wealth creation strategy in Ireland often adapts to the requirements of firms in the global corporate environment, and not the other way around. The strategic challenges facing small open economies like Ireland and also Scotland are thus very different from those facing large developed nations like the US, Japan, Germany, France, the UK. A question that one might ask is whether Scottish Enterprise has quite so close and symbiotic a relationship with the highest policy-making levels in the Scottish government as the IDA has had with Irish policy-making. How quickly can the Scottish administration develop the cross-economy networking skills that were less in demand before devolution but will be crucial in the future?

The success of the Irish industrial strategy was due in large part to the innovative and flexible behaviour of government policy makers as well as to the expertise and dynamism of the state's development agency (the IDA). However, policy makers are usually most effective when they are, so to speak, swimming with the tide of events rather than against it. Irish policy making is, to a considerable extent, pragmatic and opportunistic. But it is characterized by a form of pragmatism that appears to be singularly in tune with the best thinking on international industrial policy frameworks. To dismiss the Irish strategy as "picking winners" is to misunderstand its fundamental thrust. Perhaps "picking winning environments" might be closer to the mark. A winning environment is essentially a public good, and is a legitimate target of public policy.

Sophisticated policy making requires sophisticated policy makers. On the basis of what I have read of Scotland's experience, I find it difficult to believe there is much difference in the level of administrative and technical competence as between Scotland and Ireland. Indeed, given the greater number, and world class nature of Scottish universities, one might expect a higher level of expertise in Scotland. But Brussels is much further away from Dublin that London is from Edinburgh! Perhaps what Irish policy makers lack in terms of narrow administrative and technical expertise they more than compensate for in terms of a willingness to test the extent of their limited autonomy and experiment with novel solutions to apparently intractable problems. If one plays broadly according to the international rules, Brussels seldom interferes. But more pervasive checks on policy innovation in Scotland may extend beyond Whitehall's blocking role. For example, Whitehall could not prevent the evolution of an innovative form of Social Partnership in Scotland. But local trade unions, employers organisations and politicians could and possibly would.

Luck also plays a large part in industrial strategy. The expected external conditions needed to support success do not always conveniently arrive, and their absence may frustrate otherwise admirable policy initiatives. Nor is the true significance of the internal elements of a strategy always fully understood even by its own designers (as we showed in section 3). But chance, however random, is best handled within well thought-out frameworks which take full account of the nature of the external environment (opportunities and threats) as well as realistic views of domestic capabilities (strengths and weaknesses). Industrial policy frameworks such as those of Raymond Vernon, Michael Porter and Michael Best do not provide all the answers.[9] But they can help policy makers in both the public and private sectors to bring focus and synergy to

[9] For policy frameworks, see Vernon (1979), Porter (1990), Best (2001). For a description of how the three business strategy frameworks can be used to illuminate Ireland's experience, see Bradley (2002).

the disparate policies that make up broad industrial strategy in small open economies like Scotland and Ireland.

At the risk of oversimplification of what are very complex issues, the recent industrial performance in Ireland shows that the intelligent combination of economic policy and business strategy has generated huge synergies in terms of rapid national growth and convergence. To achieve these synergies requires a certain degree of economic policy autonomy that can be used, for example, to exploit opportunities and remedy weaknesses shown up by frameworks such as Porter's and Best's. In this case, Ireland was lucky in that it could build a growth and convergence strategy around its Structural Fund programmes, and articulate them in National Development Plans. Perhaps what the Scottish dilemma illustrates is that circumstances were never quite so dreadful as to precipitate a dramatic sea-change in the direction of policy. Could it be that an unwritten and perhaps subliminal condition of funding the Scottish public sector through a Barnett-type formula (i.e., fair shares for all), is that you are not meant to be too innovative about the way you spend the money?

06 CHARACTERISTICS OF GOOD REGIONAL GOVERNANCE

Perhaps the most striking aspect of the Irish development experience is that it assigned such an important role to the public sector in an era when the dead hand of government interference is almost universally castigated, at least in the Anglo-American world. The role of government as "strategic organizer" in a global economy driven by market forces is very different from the previous role of Communist governments as "central planners". Government as "strategic organizer" carries out its functions in *collaboration* with private businesses and not as a *substitute* for the market economy. An Irish government must decide its own strategic policy priorities, since there is nobody else waiting to carry out the task. The Scottish situation is made more complicated by the division of responsibilities between London and Edinburgh. What are the major strategic tasks that any government needs to tackle? I believe that there are four key elements:

(a) Assessing strengths and weaknesses:

The state must play a crucial role in shaping and reshaping the conditions within which the market operates, through providing public goods and promoting research, analysis and dialogue. In Ireland this is perhaps easier to implement politically than in Scotland, since Irish politics is only weakly differentiated on a left-right axis. Irish political parties (with the exception of Sinn Féin) tend to present themselves as "national managers" of a mainstream globalised economy. The great nationalist debates are now over, and there never was much of an ideological debate. There is a broad understanding of the strategic needs of the economy, and governments are judged on how well they appear to be implementing the agreed strategy.

Drawing on a wide range of local policy research, it is clearly understood in Ireland that concepts of national competitiveness need to be deepened to embrace local inputs of infrastructure, skills and entrepreneurship, and that many of the foreign firms that came in the 1980s will move offshore to lower cost locations. Successful Irish-owned firms are themselves becoming international investors as the Irish business environment continues to restructure in the global economy. Thus, EU enlargement is seen both as an opportunity (new markets for Irish firms) and a threat (other small states are rapidly upgrading their infrastructure and human resources).

Irish economic policy researchers tend to regard the local economy, the global economy, and the relationship between the two, as defining the scope of their work. Universities and research institutes play a vital role in this process, both with EU academic collaborators and in association with the local business community. Academic economists quickly learned to market their work for international publication in terms of the analysis of a small, open economy (which is of universal interest), rather than in terms of Ireland (which is not)! My experience of Scotland suggests that the integration of the Scottish university system in the UK-wide Research Assessment Exercise (RAE) may induce a reluctance to explore Scotland's strategic challenges through policy research, because it is thought to be of lesser status or of limited interest to other European regional economists. This needs to change radically if Scottish administrations are to build on the possibilities of devolved power.

(b) Recognizing trade-offs between policy options, and building coalitions for action:

The dilemmas to be faced here are complex, and involve issues such as efficiency (or growth) versus equity (or redistribution); sectoral diversification versus sectoral concentration; the optimal pace of change and renewal (shock versus gradualism); inward investment versus domestic "bootstrapping", etc. Policy frameworks must be put in place to support these market decisions. Political decisions are not always to the liking of economists, but seldom entirely ignore the implications of solid research. Good research makes it harder for policy-makers to get away with bad decisions.

For example, during the 1960s there was a major public debate in Ireland about whether inward investment ought to be concentrated into a few large cities, with a view to reaping agglomeration economies. But the efficiency benefits of growth poles were rejected at that time in favour of greater spatial equity (Bradley, 1996). More recently, the rise of urban agglomerations about Dublin and Cork has revived this debate, as it becomes obvious that certain sectors (computers and software in Dublin and pharmaceuticals in Cork) only thrive in large urban areas. Spatial policies are central to economic success, but are the most difficult to implement in practice.

(c) Building a healthy business-government relationship:

When this relationship is with locally-owned businesses, political tensions can easily arise. But in the case of Ireland, the crucial internal relationships are between government and the social partners (i.e., trades unions and employers' organizations) on the one hand, and with foreign multinational firms, on the other. The Irish and Scottish experience shows that this relationship can be mutually beneficial and these firms have a long record of providing long-term, secure and well-paid employment. In exchange, they expect that their requirements will be taken seriously, and lines of communication will work efficiently. In Ireland, the internal Social Partnership underpins the efficiency of the economy, mainly by ensuring that conflicts are discussed and resolved (where possible) in a context where the costs of failure are widely understood.

There is a huge pay-off to such formalised relationships in terms of disseminating information throughout the economy. Students have a better understanding of where the job opportunities might be, and select careers accordingly. Educators find it easier to design relevant courses. Researchers have a ready audience for their output, and get better feedback. Employers have better information to feed into their business planning. Foreign investors become more familiar with how the region functions, and can take very long-term decisions in a more predictable environment. Policy-makers, who are most in need of guidance, tend to make more sensible decisions. In a Smithian way, all these actors pursue their own self interest, but somehow the outcome seems to be better than if relationships are adversarial and knowledge is hoarded or absent.

(d) Enhancing government-government co-operation:

Government-government co-operation in Ireland takes place almost entirely under the auspices of the EU, where Irish government Ministers and civil servants negotiate with other member states, and are part of external EU negotiations where their domestic interests are affected. With the exception of Structural Funds (which are coming to an end in Ireland), and the CAP price supports (which are applied to all EU member states), the Irish relationship with Brussels deals more about policy than directly about money. Scottish policy-makers have to deal with London in a very different context: one where major decisions on fiscal matters are decided over their heads. But the price for loss of fiscal autonomy is a guaranteed share-out of UK tax revenues. No such arrangement exists at the EU level.

As I review the performance of successive Irish governments, these are the four key strategic issues I monitor. We in Ireland are very conscious that the European Union is about to be enlarged by ten new states, many of which have made rapid and successful transitions to liberal policy regimes, and will soon become remarkably attractive alternative locations for inward investment. The quality of Irish strategic thinking as much as the efficiency of its businesses will be what determines future performance.

How is strategic thinking likely to evolve in Scotland? Will it continue to focus on its role within an encompassing UK-wide policy context, and try to extract the maximum benefits from this relationship through UK regional policy instruments? I hope that I will not be misunderstood if I call this an “easy” option, one that is likely to guarantee a performance and a standard of living that is only modestly below that of the UK as a whole. Is that an acceptable goal for Scottish policy makers? Alternatively, will they increasingly exploit existing devolved powers or take on and exploit greater local powers, and use them to diversify within the UK in a wider European context?

If Scotland takes the second – more challenging – option, then there is much detailed work to be done that would be impossible to explore in this paper. But I conclude by highlighting three themes that will be crucial:

a) Scottish growth, development and renewal strategies need to be placed at the centre of government activity, and clearly distinguished from the day-to-day activities of social ministries. If this is done – as with the EU-aided National Development Plans and Structural Funds in Ireland – there is a real chance of a step-change in economic performance. But such strategies need to be animated by careful research rather than considered merely as aspects of public expenditure (Burnside and Wakefield, 2003).

b) The apparently high level of educational qualifications in Scotland should not blind policy-makers to the necessity of continuing to prioritise human resources in all aspects: education, technical skills, re-integration of the socially excluded, basic business research and training, etc. What matters in today's globalised economy is as much the "software" of human capital as the hardware of fixed investment. Optimising this "software" is probably the single most important act of any modern government.

c) Strategic regional economic policy design needs to be linked with industrial and service sector strategic policy thinking, and every effort made to ensure that they are mutually reinforcing. Within the EU there are dramatic differences between the approach adopted by the successful small Nordic states (e.g., Finland, Denmark and Sweden) – based on building indigenous industrial strengths – and the path taken by Ireland – based mainly on success in attracting high quality foreign direct investment. Scottish researchers and policy-makers need to engage in this European debate, rather than drawing mainly from the narrower UK regional policy agenda.

REFERENCES

Bergin, A., J. Cullen, D. Duffy, J. Fitz Gerald, I. Kearney and D. McCoy (2003). *Medium-Term Review: 2003-2010*. Dublin: The Economic and Social Research Institute.

Best, M. (2001). *The New Competitive Advantage*, Oxford: Oxford University Press.

Bradley, J. (1996). *An island economy: exploring long-term economic and social consequences of peace and reconciliation in the island of Ireland*, Dublin: Forum for Peace and Reconciliation.

Bradley, J. (2002) "The computer sector in Irish manufacturing: past triumphs, present strains, future challenges", *Journal of the Statistical and Social Inquiry Society of Ireland*, Volume XXXI, pages 25-71.

Burnside, R. and S. Wakefield (2003). *Cross-cutting issues: economic development*, SPICe briefing, 03/80, October 2.

Chubb, B. and P. Lynch (eds.) (1969). *Economic Development and Planning*, Volume 1, Readings in Irish Public Administration, Dublin: The Institute of Public Administration.

ECOTEC (2002). *Ex-post Evaluation of the Objective 1 Programme 1994-99: UK Member State Report*, Report submitted to DG Regional Policy, ECOTEC, October.

Ederveen, S., J. Gorter, R. de Mooij and R. Nahuis (2002). *Funds and Games: The Economics of European Cohesion Policy*, CPB Netherlands Bureau for Economic Policy Analysis, The Hague.

ESRI (1997): *Single Market Review 1996: Aggregate and regional aspects: the cases of Greece, Ireland, Portugal and Spain*, London: Kogan Page, in association with the Office for Official Publications of the European Communities, Luxembourg.

ESRI (2002). *The ex-post Evaluation of Objective 1, CSF 1994-1999:* States and Macro-Regions, Report prepared for DG Regional Policy, Brussels.

Fraser of Allander Institute (2001). *Tracking the bigger picture: baselines, milestones and benchmarks for the Scottish economy, 2001*, report produced for the Scottish Enterprise Network by the Fraser of Allander Institute, March.

Fujita, M., P. Krugman and A. Venables (1999). *The Spatial Economy: Cities, Regions, and International Trade*, Massachusetts: The MIT Press.

Ireland (1958). *Economic* Development, Pr. 4803, Dublin: The Stationery Office

Keating, M. (2001). *Devolution and Public Policy: Divergence or Convergence?,* Report on a joint IPPR/ESRC Devolution Programme project, Department of Social and Political Sciences, European University Institute, October.

Keynes, J.M. (1933). "National Self Sufficiency", *Studies*, 22, 177-193

Krugman, P. (1995). *Development, Geography, and Economic Theory*, Cambridge, Massachusetts: The MIT Press.

Krugman, P. (1997). "Good News from Ireland: A Geographical Perspective", in A. Gray (ed.), *International Perspectives on the Irish Economy*, Dublin: Indecon Economic Consultants.

Krugman, P. (2003). "Growth on the Periphery: Second Winds for Industrial Regions?", The Allander Series of Lectures.

MacSharry, R. and P. White (2000). *The Making of the Celtic Tiger,* Cork: Mercier Press

Mjøset, L. (1992). *The Irish Economy in Comparative Institutional Perspective*, Report No. 93, Dublin: National Economic and Social Council

Porter, M. (1990). *The Competitive Advantage of Nations*, London: Macmillan.

Reich, Robert (1993). *The Work of Nations: A Blueprint for the*

Future, London: Simon and Schuster.

Scottish Executive (2003). *Update to Scottish Executive response to Nurturing Wealth Creation: A Report by the Scottish Manufacturing Group*, Department of Enterprise and Lifelong Learning, November.

Vernon, R. (1979). “The product cycle hypothesis in a new international environment”, *Oxford Bulletin of Economics and Statistics*, Vol. 41, No. 4, pp. 255-267.