Politics, Institutions and Post-War Economic Growth in Ireland

Frank Barry
University College Dublin
July 2006

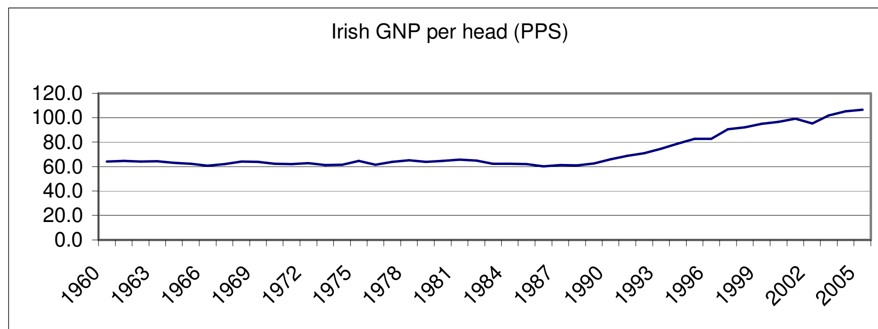
Introduction

Ireland has been one of the global success stories of the last 15 years. The transformation of the economy over this short period of time has been dramatic. Between the mid-to-late 1980s and the present, Ireland's national income per head rose from 65 percent of the Western European EU average to above parity; unemployment fell from 17 percent of the labour force – double the EU15 average of the time – to around 4 percent – half the current EU15 average – today; government debt fell from 120 percent of GDP to around 30 percent, and an increase of more than 70 percent in the numbers at work saw emigration give way to very substantial immigration.

GDP figures overstate Ireland's achievements as they include the massive profits recorded by foreign multinational corporations operating in Ireland. The national income measure cited above is based instead on GNP (and is adjusted for purchasing power differences). Irish GDP is more than 20 percent higher than GNP, a difference not reflected in the data for any other EU country.

Another necessary correction further reduces the scale of Ireland's recent success. Between 1987 and 2003, the merchandise terms of trade fell by some 10 per cent, which has a substantial effect on an economy as export-oriented as Ireland's, where the value of exports is close to that of GNP. Crafts (2005, Table 4) shows that this took 1 percentage point per annum from the growth rate of real GNP per person between these years. The growth phase nevertheless represents a very considerable achievement, especially when measured against the Irish record from the 1960s to the late 1980s, when – as seen in Figure 1 – no convergence was attained on Western European income per head. Ireland, furthermore, grew far less rapidly than its European neighbours over the course of the 1950s.

Figure 1: Irish GNP per head (PPS); EU15=100.



Source: Eurostat AMECO database; Central Bank of Ireland Quarterly Bulletins for Irish GNP relative to GDP.

The present paper analyses Ireland's post-war growth experience in four phases: the decade of the 1950s, the periods 1960-73 and 1974-86, and the subsequent "Celtic Tiger" era. Previous comprehensive discussions have been provided by Ó Gráda and O'Rourke (1996), who analyse the phase to 1986, and Barry (2003) who compares the Irish growth record to that of the other traditionally lagging Western European "cohesion economies" of Greece, Spain and Portugal. Following Abramovitz (1986), who highlights "social capability" along with "technological congruence" as factors determining the extent and pace of economic convergence, a specific focus of interest in the present study is on *institutional capacity* and its evolution in Ireland. Some attention is also devoted to the role of electoral politics in facilitating – at times – and at other times delaying the implementation of positive-sum economic policy changes.

2. The 1950s

Ireland remained protectionist for about a decade after most of the rest of Western Europe had moved towards freer trade. The post-war boom of the 1950s saw Western Europe achieving growth rates of almost 6 percent per annum while protectionist Ireland stagnated with a growth rate of less than 2 percent, an employment growth rate of less than 1 percent, and recurrent balance of payments crises precipitated by the need to import the more sophisticated capital and consumer goods that the country could not produce for itself. Over the course of the 1950s, more than 400,000 Irish people emigrated out of a total population of less than 3 million.

Maddison (1964, pps 167-8) charts the opening up of trade in Western Europe in the immediate post-war period. One driving force was Marshall Aid, which required

recipient countries to remove the mass of bilateral trade barriers and quantitative restrictions which had developed in previous decades by signing up to a code of trade liberalisation under the auspices of the OEEC (forerunner of the OECD). Non-agricultural quantitative restrictions had virtually disappeared in Western Europe by 1960. Payments arrangements were liberalised at around the same time by the establishment of the European Payments Union. Internal tariffs were cut within both the Common Market, established in 1956, and EFTA, which was created in 1959. There was also a general reduction of 20 percent in industrial-country tariffs as part of the GATT round of 1962. In the Irish case, by contrast, even after unilateral tariff reductions in 1963 and 1964 the average effective tariff level remained almost four times as high as in the country's trading partners in the mid-1960s and were about twice the average level in the run up to EEC entry in 1973.

Why did Ireland remain inward-oriented for longer than most of the rest of Western Europe? As elsewhere, the influence of external agencies was directed towards liberalisation, though only low-level pressures appear to have been exerted. Thus, while Ireland, though a non-combatant in the war, was in receipt of some Marshall Aid funds, the programme agreed under the Marshall Plan was accepting of protection to "enable industries to gain a sound foothold in countries underdeveloped industrially" (Ó Gráda, 1997, p. 49). Ireland joining the IMF in 1957 and submitted a loan application to the World Bank in 1958 though protection only began to be dismantled some five years later.

Part of the problem was ideological; another part must be ascribed to a failure of vision, which continued to see agriculture as the main engine of growth. The ideological impediment resided mainly in the negative attitude of the dominant Fianna Fáil party to foreign ownership.[1] The drive to attract foreign capital was initiated by the non-Fianna Fáil coalition governments of the periods 1948-51 and 1954-57. The first coalition government established the Industrial Development Authority within

[1] As Bew and Patterson (1982, p.70) point out, for nationalist ideologues "foreign capital was a far more explosive issue than protection. After all, protection was only a means to an end – the building up of a native Irish industry". The psychological impact of the shift in policy on foreign ownership, when it finally occurred, is apparent from the reaction of one leading Fianna Fáil deputy, who recalls that : "I was bewildered and shocked to find that the principle of Irish ownership of industry, which was central to the Republican policy as I had always understood it, was gone…" (quoted by Bew and Patterson , 1982, p. 121).

the Department of Industry and Commerce in 1949 to initiative proposals for the creation of industries and to attract foreign industrialists. The second coalition granted the Authority the power to offer industrial grants – which had hitherto been employed only as a means of diverting new industrial activity to the less developed western regions of the country – in furtherance of this mandate. It also took the crucial and imaginative step, in 1956, of introducing Export Profits Tax Relief which triggered the entry of foreign corporations and partly reoriented indigenous industry towards export markets.[2] A further important step was taken in establishing the Capital Investment Advisory Committee in 1956, with a membership of economists and representatives of agriculture, industry, finance and the unions. The Committee would ultimately recommend that grants, loans, subsidies and publicly-provided services be concentrated on export-oriented activities.

The Fianna Fáil party opposed many of these innovative measures while in opposition but fully embraced them upon returning to power, a phenomenon we will encounter again when we come to discuss the 1980s experience, the next major period of economic crisis in Ireland.

The policy shift implemented by the second coalition government began to bear fruit rapidly. Many analysts date the shift in thinking on outward orientation to the report on *Economic Development* prepared in 1958 by T.K Whitaker, the chief civil servant in the Department of Finance, which strongly influenced the government's *First Programme for Economic Expansion* which was published shortly thereafter. Whitaker himself, however, as quoted in Fanning (1978, p. 511), observes that Sweetman, the Finance Minister in the second coalition government, was singularly unfortunate in that his government was overthrown before the "ideas which he implemented could bear fruit".

There was relatively little in *Economic Development*, furthermore, about the failures of protectionism. It was concerned primarily with fiscal policy, emphasising the importance of 'productive' rather than 'social' investment and on the need for a

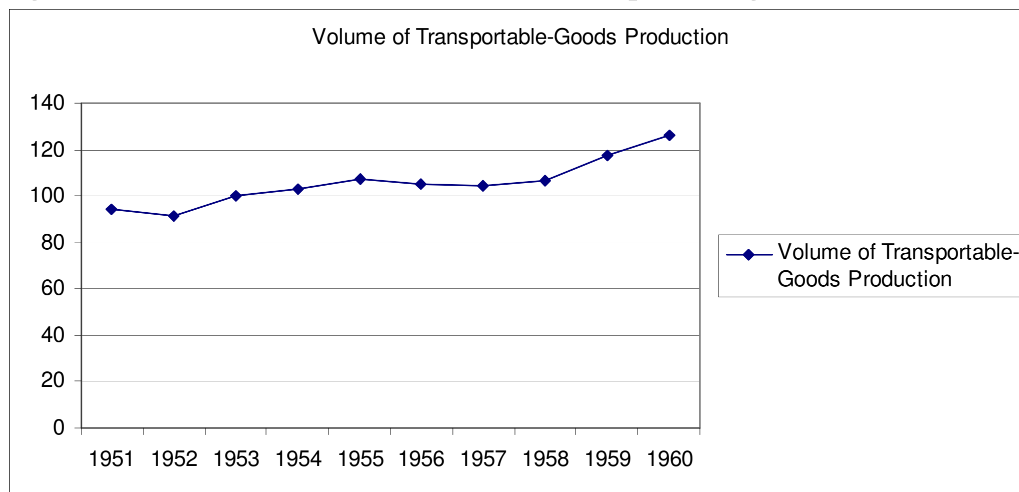
[2] The initial Act gave 50 percent tax remission on profits derived from increased manufactured exports. This was increased to 100 percent two years later. The move led to little diminution in the tax base, given that the vast bulk of the country's exports at the time were agricultural in nature.

significant reduction in taxation, while on sectoral issues it argued that "attention should be concentrated primarily on raising the efficiency and volume of production in agriculture and in industries based on agriculture". As Leddin and Walsh (2003, p.88) point out, few of the policy recommendations in *Economic Development* were subsequently implemented, while careful analysis reveals that the turnaround in economic fortunes occurred before the recommendations that were implemented would have had time to take effect.

Industry reoriented rapidly towards export markets in the wake of the policies implemented by the second coalition government, evidenced by a 30 percent increase in manufactured exports in 1957 and a 200 percent increase between 1956 and 1960.[3] Manufacturing employment, furthermore, began to rise inexorably from 1957, without – as Fitzgerald (1968) points out – any significant change in the external situation facing Irish agriculture or industry.

The turnaround in manufacturing is depicted in Figures 2 and 3.

Figure 2: Volume of Industrial Production, transportable-goods industries



Source: Kennedy (1971, table 2.2)

[3] O'Malley (1989, p. 68) and O'Hearn (1987) estimate that by 1960 the new export-oriented foreign firms established in the 1950s would have employed between 2300 and 3000 people in manufacturing industry.

Figure 3: Employment in Transportable-Goods Industries (thousands)

Source: Kennedy (1971, table 2.2)

The improvement in the conditions of industry influenced the overall assessment of the Committee on Industrial Organisation which had been established in 1961 and which reported on the prospects for individual industrial sectors under free trade conditions over the first five years of the 1960s. "Public opinion", according to Fitzgerald (1968, p. 64), "was struck by the conclusion of almost all these investigations that there was a viable industrial base, with individual inefficient firms, rather than a series of industries incapable of withstanding competition".

That the political pressures to maintain protection had lost substantial ground already by this time is further suggested by Fitzgerald (1968) in his analysis of the response to the 1957 publication of an OECD working party on the creation of a free trade area in Europe. He writes that "so rapidly were public attitudes on the issue reversed that those who had an interest in maintaining industrial protection…found it impossible to resist this movement of opinion, and the proposal (that Ireland would join the proposed free trade area) met with surprisingly little serious opposition".

We can see then, in outline, the constellation of factors that eventually promoted the reversal of protectionist policies. The change of government allowed new policy initiatives – particularly on attracting foreign industries – to be tried. Their subsequent success facilitated a change in ideology on foreign ownership and, by

stimulating growth, appeared to reduced fears concerning the removal of protection. The widespread respect with which the public service bureaucracy was regarded provided "political cover", which further facilitated the reversal of policy.[4] The growing interactions between government and external organisations and expertise, furthermore, operated in the same direction.[5]

3. 1960-72

As seen above in Figure 1, Ireland failed to achieve any convergence on average Western European income per head over the period 1960-72. Ó Gráda and O'Rourke (1996), who benchmark Irish performance against that of the rest of Western Europe, argue that factors such as the share of agriculture in the economy, the delay in dropping protectionism, excessive interventionism, low educational throughput and rent seeking in industrial relations all played a role in the poor Irish outcome. Barry (2003), however, shows that Ireland was in no worse a position than Spain or Portugal along most of these dimensions, yet these other economies achieved substantial convergence over the period.

Macroeconomic policies in each of the countries were conservative at this time. Ireland had a slightly higher share of agriculture in national product but less heavy state interventionism generally. It was the most export-oriented of the group and had begun, like the others, a delayed embrace of outward-orientation. Educational throughput, furthermore, was above the levels prevailing in either Spain or Portugal. Of the factors that growth theory typically focuses upon, only the operation of the labour market appears to distinguish Ireland from the other cohesion countries over the course of the 1960s.

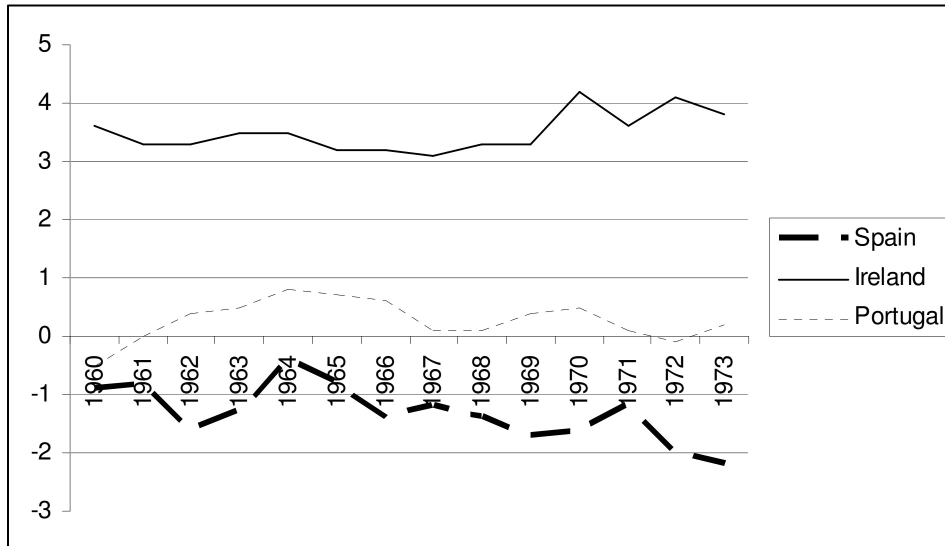
The unemployment experiences of these three economies (relative to the EU15 average) is charted in Figure 4. All three were characterised by high emigration.

[4] Fitzgerald (1968) points out that by publishing *Economic Development* shortly after the *First Economic Programme* was issued, "the government made it clear that the Programme was not, and was not claimed to be, a policy prepared by the government party, but was a national programme, prepared by the head of the civil service". This allowed it to be widely accepted as transcending party politics.

[5] The consequences of the growing contacts with international agencies would prove to be particularly important in the field of education, with the implementation of policies advocated in a 1965 report commissioned from the OECD.

Only in Ireland however was this associated both with high unemployment and with rapid real wage growth.

Figure 4: Unemployment rates in Ireland, Spain and Portugal (less EU15 average)



Notwithstanding Ireland's high unemployment and a productivity growth rate below that of the other cohesion countries (as well as the EU15), Irish real wages grew far more rapidly than in the other cohesion countries, as seen in Table 1.[6] O'Rourke (1995) points out that the labour-market disequilibrium prevailing in Ireland in the 1960s had long historical antecedents. For much of the previous century, in fact, Irish real wages appeared to have been at least as high as in the UK for equivalent occupations, while productivity was likely to have been substantially lower.

[6] The real wage data come from Williamson (1995). These present a different picture from the Eurostat data, but accord better with the reports of economic historians working on the various national economies.

Table 1:

		Spain	Ireland	Portugal	UK	EU-15
1960-73	Percentage change in GDP per person employed, at 1995 market prices	114.1	66.7	105.2	38.3	68.3
1960-73	Percentage change in real wage, relative to 1975 GB real wage	77.8	91.3	62.5	54.8	n.a.
1960-73	Ratio of real wage change to productivity growth	0.68	1.37	0.59	1.43	n.a.
1960-73	Investment as % of GDP	24.8	21.0	25.2	18.3	23.8

Note: Irish productivity, measured as GNP per person employed, grew by 66.3 percent, slightly less than when measured using GDP.

Daveri and Tabellini (2000) demonstrate the corrosive effects that disequilibrating real wage developments can have on economic growth and convergence prospects. They show in particular that when wage bargaining is driven by strong and decentralised trade unions an increase in labour taxes reduces labour demand and reduces the incentive to invest. The prediction of a resulting low investment rate is clearly borne out in both the Irish and UK cases shown above. Investment rates in Spain and Portugal, by contrast – where "state corporatist" regimes enforced wage moderation – were above the Western European average.

The Irish real wage levels of the 1960s appear to have been too high for labour-intensive industries to prosper. Domestically-owned firms, which were in low-skill-intensive sectors, failed to gain foreign market share while seeing their share of the home market eroded (O'Malley, 1989, 104-109). Only the significant levels of FDI entering the economy propped up Irish manufacturing.

What drove this excessive wage growth? Ó Gráda (1997, p.217) hypothesises that because of easy access to the British labour market "cheaper labour could do little to compensate for Ireland's relative backwardness and isolation, or to generate the investment necessary for faster economic growth". The high unemployment of the period suggests that other disequilibrating factors would also have been involved

however. The argument proposed here is that the situation was exacerbated by expansionary fiscal policies – associated with increasing labour taxes – in the presence of inefficient industrial relations structures.

The main recommendations of the 1958 Whitaker document on *Economic* De*velopment* were for a significant reduction in taxation and for public capital investment to be redirected from 'social' to 'productive' investment projects. Neither of these recommendations were pursued however. The Capital Budget in 1963-64 was 60 percent above that proposed in the First Programme, with only a small diminution the social investment share.

Bew and Patterson (1982) argue that the expansion in social investment represented a Fianna Fáil strategy to recapture its working class constituency in the aftermath of the election losses of the 1950s. Seán Lemass, who succeeded de Valera as Taoiseach in 1959, appeared to agree with the newly established Irish Congress of Trade Unions in the value of pump-priming the economy, even though this might be pro-cyclical.[7] "Within a year of Lemass becoming Taoiseach", according to Girvin (1994, p.126), "he had abandoned the cautious economic policy, and budgets began to expand with increased investment in those areas identified by Congress both in policy documents and in its private research".

The expanding share of government spending in GNP was associated with an increasing burden of labour taxation. Table 2, from Nickell (2004), provides data on developments in the Irish tax rate on labour over time.[8]

Table 2: Total Tax Rate on Labour (payroll, income and consumption taxes), %

1960-64	1965-72	1973-79	1980-87	1988-95	1996-2000
23	30	30	37	41	33

Source: Nickell (2004).

The situation in Ireland in the 1960s conforms to the Daveri and Tabellini (2000) model and contrasts sharply with that of Eichengreen (1996) who proposes that the

[7] Lane (1998) provides evidence that the pro-cyclicality of Irish fiscal policy dates back to the 1960s.
[8] Irish real labour costs, furthermore – according to Nickell (2004, Table 3) – exhibit amongst the sharpest increases in the OECD in response to increases in the tax wedge, arguably because of the openness of the labour market.

"social contract" established in continental Western Europe, which purchased wage moderation by guaranteeing construction of a welfare state and high private-sector investment promoted rapid post-war growth and convergence on US living standards.

The Irish industrial relations system of the time prevented the establishment of any such compact. As described by Hardiman (1994), "bargaining groups in the strongest bargaining position assumed a role of wage leadership, establishing the norm for the pay round which later entrants sought to emulate.[9] … No single bargaining group believed it had to pay any attention to the impact of its activities on the overall state of economic performance. Yet the cumulative consequences of everyone's bargaining practices were proving more and more harmful to overall economic performance. .. Divisions within the trade union movement contributed to the extent of wage inflation and the scale of industrial conflict. Sectional differences between skilled workers and the rest increased the potential for leap-frogging wage claims."

This closely conforms to the type of industrial relations system identified by Calmfors and Driffill (1988) as associated with the poorest macroeconomic outcomes. As they note, their hypothesis is related to Olson's (1982) notion that organised interests are most harmful when they are strong enough to cause major disruptions but not sufficiently encompassing to bear a significant fraction of the societal costs associated with pressing their own claims. [10]

Evidence of the poor industrial relations environment of the time is provided by the data on days lost due to strike activity (controlled for employment levels in non-agricultural activities) as seen in Figure 4.[11] Work days lost were at historically high levels during the 1960s and again over the 1977-81 period, which was also characterised by fiscal expansion. Irish strike activity, furthermore, was very high by European standards over this period.

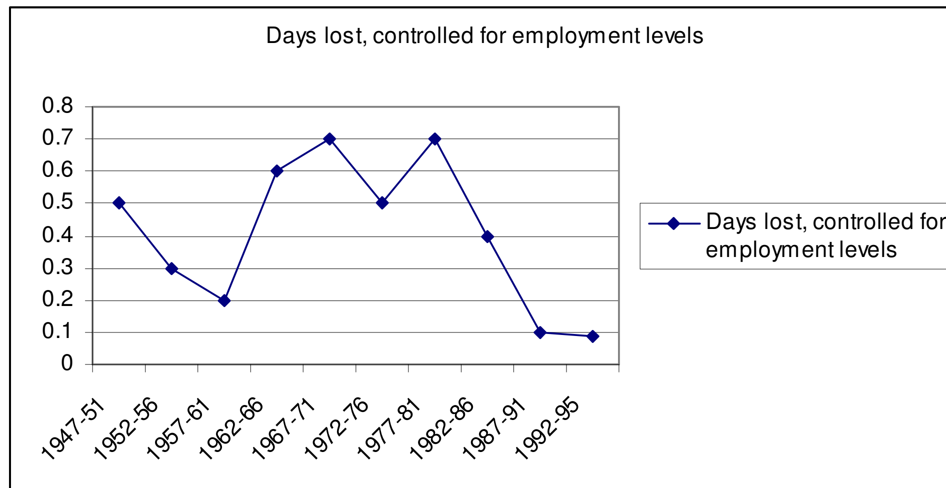
---

[9] The wage leaders were generally craft groups

[10] As a further reflection of this, Hardiman cites a trade union official who commented that "if there are 16 percent out of work, there are still 84 percent in work who are not too put out by the plight of the unemployed and who want their wage increase."

[11] McCarthy's (1973) detailed history of the major Irish strikes of the 1960s confirms Hardiman's description of the industrial relations environment of the time.

Figure 4: Days Lost due to Strikes



Source: Brannick, Doyle and Kelly (1997)

While it would take another 15 years for changes in the Irish industrial relations system to begin to yield better outcomes, more benign subterranean developments were taking place elsewhere in the economy, particularly with respect to education. Growing outward orientation was reflected in an increased desire to benchmark against international standards. Thus, Ireland, recognising that the changing occupational structure associated with the growth of manufacturing would place significant demands on education and training systems, volunteered to have its entire educational system surveyed by the OECD (White, 2001). The subsequent report, *Investment in Education*, issued in 1965, made newspaper headlines when it reported that over half of Irish children left school at or before the age of thirteen, a far higher proportion than for most of Western Europe. 'Free' second-level education and free access to special transport networks for all second-level school pupils were introduced shortly thereafter. Thirty years later the numbers at school had trebled, with 80 percent completing the full cycle (compared to only 20 percent in 1965). Numbers at third-level, meanwhile, had increased even more substantially – by a factor of six.

4. 1973-86

Ireland, like the other EU cohesion countries, failed to achieve any convergence on average EU15 income per head over the period 1973-86, which was dominated by the two oil crises. Barry (2003) shows that the cohesion countries exhibited greater macroeconomic instability than the European average in the wake of the oil shocks

and suggests that, if this phenomenon – of poorer countries losing macroeconomic control more easily that richer countries under difficult global conditions – is found to be more widespread, it may account for generally poorer convergence performances over periods of global slowdown. The oil shocks were exacerbated in all the cohesion countries by concurrent wage explosions. While the causes of the wage explosions differed – Spain, Greece and Portugal, after all, each returned to democracy over this period – the events of the late 1970s in Ireland illustrate even more dramatically than in the case of the 1960s the costs of pro-cyclical fiscal expansion combined with unsustainable wage increases.

Table 3: Growth, Inflation and Fiscal Outcomes, 1974-86

	Ireland	**EU15**
Growth in income per head	1.6	1.7
Inflation	13.1	9.6
Net borrowing by general government as % of GDP	10	3.7

Leddin and Walsh (2003) provide a detailed account of the budgetary strategies adopted by the numerous fragile governments of the period. In line with the behaviour of many other governments, the Irish government of the time responded to the first oil shock by increasing spending in an attempt to maintain aggregate demand. It lost an election however when it attempted to reverse policy as the economy recovered. The ensuing (Fianna Fáil) government of 1977, in a bout of naïve Keynesianism, instituted a major pro-cyclical fiscal expansion, which it described – in the belief that the increased growth achieved would generate sufficient tax revenues to quickly eliminate the budget deficit – as a “self-financing fiscal boost”.

As a later Finance Minister (from the same political party) was to astutely observe: “All the benefits…. in the ill-fated 1977 Fianna Fáil manifesto….were front-loaded, and the payback never came. Tax cuts were delivered in anticipation of pay moderation rather than in response to it…It was all carrot and no stick”; MacSharry and White (2000).

With the rise in world interest rates in the wake of the second oil shock, the deficit quickly spiralled out of control. Governments from the early 1980s responded by

raising taxes, with Ireland exhibiting the fastest growing tax-to-GNP ratio in the OECD. The tax burden raised wage demands however, exacerbating unemployment and raising social welfare spending. Political wranglings, however, prevented the implementation of expenditure cuts, since trenchant opposition criticism encouraged the defection of government coalition partners or the withdrawal of support for minority governments.[12] How the fiscal crisis was eventually resolved will be discussed in the next section of the paper.

As seen above in our analysis of the 1960s, even in the face of macroeconomic underperformance some positive subterranean institutional developments were still in progress and these would set the scene for the "Celtic Tiger" expansion of a later period. Some of the most important developments in the tertiary education sector in Ireland, for example – particularly within the vocational element of the system – occurred over the course of the 1970s. The cornerstone of this element consisted of the Regional Technical Colleges (RTCs), five of which were established in 1970 and a further four between 1971 and 1977. These colleges, offering mainly short-cycle and sub-degree level programmes, concentrate on the provision of courses in engineering, construction and business studies, applied science, and art and design. From having had a tiny short-cycle third-level sector before 1970, by 1981 Ireland had internationally, after the Netherlands, the highest proportion of third-level students taking sub-degree courses. The significance of this expansion will be addressed when we come to consider the later "Celtic Tiger" era.

Table 4: Enrolment in various elements of the tertiary education sector

	mid-1960s	early 1970s	early 1980s	early 1990s	late 1990s
Total number enrolled (thousands)	21	27	43	73	112
Of which (%):					
…Universities	75	75	55	54	54
…Vocational, Technological & RTCs	5	9	26	39	37
…Other	21	16	19	7	9

Source: White (2001, Appendix 1).

[12] Even the political party that won the election of 1987 and implemented far sharper spending cuts than the previous government had campaigned on the slogan that "health cuts hurt the old, the poor and the handicapped".

Another institutional development over this period is the growing influence of the Industrial Development Authority (IDA) within the public-sector bureaucracy. The IDA evolved into an important channel of knowledge transmission from the multinational business sector to government. It played a major role, for example, in forcing through the modernisation of the country's telecommunications infrastructure in the late 1970s and early 1980s in response to MNC complaints. This allowed Ireland emerge thereafter as a leading location for traded-services offshoring from the US and elsewhere.

It also played an important role in national manpower policy through the establishment of a forum in 1978 for dialogue between the agency and the educational institutions. The agency, concerned by the looming disparity between electronics graduate outflows and its own demand projections, convinced the government to fund a massive expansion in educational capacity in these areas. The output of engineering graduates, as a result, was raised by 40 percent between 1978 and 1983, while the output from computer science increased tenfold over this same short period.[13]

5. 1987 - the present

A fortuitous combination of changes in policy and the external environment occurred in the late 1980s. The effects were dramatic, giving rise to the 'Celtic Tiger' sobriquet. Real national income per head rose from less than 65 percent of the EU average to achieve rough parity by the end of the 1990s. Unemployment tumbled from a high of 17 percent in 1987 to less than 4 percent in the early years of the new millennium, while numbers at work expanded by more than 70 percent.

The beneficial shocks included a change in fiscal strategy in 1987 which created space for future tax reductions. These, in combination with the country's newly developed 'social partnership model' of wage determination, bolstered cost competitiveness. The doubling of the EU Structural Funds in 1989 allowed a rapid resumption in the badly-needed infrastructural projects which had been put on hold as part of the change in fiscal strategy, while the lead-up to the Single Market saw a

[13] Further examples of its influence would surface later: for example in the government decision to reduce the rate of corporation tax on services substantially in the face of European Commission demands to harmonise rates across sectors, and in the massive increase in funding of science, technology and innovation policy instituted over the last decade.

huge increase in FDI flows both into and within Europe, of which Ireland captured a sharply increased share.[14] We discuss each of these factors in turn.

Since the early 1980s successive governments had attempted to reduce the government budget deficit through tax increases since expenditure reductions would have been too costly at the political level. A combination of factors in 1986-87 paved the way for a new and ultimately successful stabilisation attempt, which relied on cuts in government spending instead. Supportive developments included a currency devaluation, which improved cost competitiveness against the UK, and a lift-off in the world economy and especially the UK in 1987, which meant that the Irish expenditure cuts were (benignly) counter-cyclical.

Two other factors – one institutional, the other political – enhanced the space for fiscal consolidation. The first was that the agreement of the social partners on the necessity for fiscal consolidation had been secured in 1986, and the second was the agreement of the political opposition to support the expenditure cuts. These latter factors have been acknowledged by the Finance Minister of the 1987 government, who writes that:

> In 1987, for the first time, a political consensus on fiscal policy was beginning to emerge to underpin the economic consensus already outlined in the NESC report *Strategy for Development 1986-1990*, which had been published the previous November.[15] The NESC analysis of what was wrong and the prescription of what needed to be done was agreed by all the social partners – including employers, trade unions, farmers and others – without dissent. The NESC described the economic and social problems facing the country as "extremely grave" and set debt stabilisation as a minimum objective of fiscal policy, while relying on public-spending cuts – not taxation – to achieve that adjustment. This was the most critical part of its overall strategy. The boldness of the NESC approach, the consensus of the social partners in backing it, and Fine Gael's generous promise of political support on fiscal policy all created a new opportunity to tackle, finally, the public finances.[16] [R. MacSharry, writing in MacSharry and White (2000, p.62)].

[14] Another factor which has received less attention is the deregulation of airline access to the country (in 1986), which facilitated a more than doubling of tourist numbers over the following decade.
[15] NESC – the National Economic and Social Council – can be loosely described as the social-partnership secretariat.
[16] Fine Gael is the country's second largest political party. It has led all non-Fianna-Fáil coalition governments.

The year 1987 also saw the introduction of pay determination via social partnership, with government, unions and employers coming together every three years to chart a course for future wage increases.[17] Successive governments have used the process to purchase wage moderation via the promise of future tax reductions, with tax cuts estimated to have accounted for about one-third of the rise in real take-home pay since the partnership process began.

This corporatist structure stands in sharp contrast to the way pay rates had been determined in the 1960s and 1970s. In terms of the Calmfors-Driffill analysis discussed earlier, the new system meant that participants in the negotiations were now sufficiently encompassing to take into account the macroeconomic consequences of the pay deals struck.[18]

In line with this analysis, Baccaro and Simoni (2004) find that social partnership changed the wage leadership process. Wage increases pre-1987 had been driven by the rapid productivity growth of the foreign-owned modern sector, while increases over the partnership period have been driven instead by the much slower productivity growth of the largely indigenous traditional sector, leading to substantial reductions in overall unit costs.

The process of social partnership was influenced by ongoing change within the structure of the trade union movement (as well as by declining union membership). Crafts unions, which had played a major wage leadership role in the 1960s and which were amongst the most militant of trade unions, accounted for a steadily declining proportion of total union membership, while a further steady decline – this time in the number of unions – reduced the potential for conflict between different unions which had been a characteristic of the unsettled industrial relations environment of earlier periods. The process of negotiating the partnership agreements, furthermore, has been

[17] As unemployment fell from the high of 17 percent prevailing at the time of the first partnership agreement, a declining proportion of the workforce have been bound by the partnership agreements.
[18] Hardiman (1994) quotes the then Minister for Enterprise and Employment, speaking in 1992, to the effect that "the trade union commitment in relation to the social dialogue … must be and is driven by the demands of their own members, very largely members who are at work and have strong political clout. On the other hand, politicians…have an obligation to the entire labour force, including those out of work".

argued to promote a shared understanding of how the economy functions and of the appropriate response to different economic shocks.

The timing of the expansion in EU Structural and Cohesion Funds (SCF) from 1989 was also fortuitous. Besides raising the level of FDI inflows that the economy's infrastructure could handle, the aid would also have impacted on the type of FDI Ireland was able to attract, with the human-capital-development elements of SCF expenditures (which accounted for a higher proportion of SCF spending in Ireland than in the other cohesion countries) contributing to the skill levels of the Irish workforce.[19]

The Structural Funds also contributed to organisational learning within the bureaucracy. As FitzGerald (1998) notes:

> "the need to satisfy the donor countries, through the EU Commission, that their money is well spent has resulted in the introduction of a set of evaluation procedures which has helped change the way the administration approaches public expenditure. In the past the only question, once money had been voted by parliament, was whether it had been spent in accordance with regulations. Now there is increasing interest in assessing how effective the expenditure has been."

The final beneficial shock to which the economy was subject was the development of the Single European Market. This led to a doubling (in real terms) in the amount of investment undertaken by US firms in the EU between the early and the late 1980s, and a quadrupling of Ireland's share. In part this may have been due to the playing out of Marshallian agglomeration and bandwagon or demonstration effects in the newly enhanced environment. Perhaps even more important however was the liberalisation of public procurement policies that the Single Market entailed. This prevented larger EU countries from using the threat of blacklisting publicly-funded purchases of a firm's products as a lever to influence their location decisions, a practice which had previously operated to Ireland's disadvantage. Ireland has also been attracting a

[19] The high share allocated to human capital development in the Irish case was arguably influenced both by the national focus on FDI and the successful use of the much lower levels of EU regional aid available in the 1970s in developing the RTC element of tertiary education.

substantial share of newly-offshoring international services sectors over the course of the 1990s, particularly in the areas of computer software and international financial services. Both of these factors have solidified Ireland's position as the most FDI-intensive EU economy.

Of course, the increasingly high-tech nature of the FDI attracted to Ireland over this period would not have occurred had the educational attainment levels of the workforce not been increasing rapidly. Ferreira and Vanhoudt (2002) conclude that increased educational throughput – especially given the vocational/technical slant of the skills provided at third level – and the sectoral (high-tech) composition of the increased FDI inflows were self-reinforcing factors that proved decisive for the boom.

Conclusions

Besides providing a description of the major factors determining Irish growth performance over the decades since the Second World War, this paper has explored the role of institutions and of electoral politics in occasionally facilitating and at other times delaying the implementation of positive-sum economic policy changes.

The interlocking system of parliamentary, judiciary, press and civil-society scrutiny of government that characterises democratic electoral systems is clearly not sufficient to ensure that positive-sum economic policy decisions are always made expeditiously. One of the benefits of a democratic political system appears however in our analysis of Ireland's move towards outward orientation in the 1950s. The Fianna Fáil party had long been committed to domestic ownership of Irish business. The success of the policies adopted by a non-Fianna Fáil coalition government to attract export-oriented foreign businesses facilitated Fianna Fáil in adjusting its ideology upon returning to government. Something similar can be seen in the legacy bequeathed to subsequent Labour governments in the UK by the Thatcher administration. The policy learning process may take much longer in non-democratic or effectively single-party systems, as evidenced by the prolonged economic failures of Mao in China or the long stagnation of Northern Ireland under Unionist Party domination.

A less benign outcome associated with democratic politics appears however in our analysis of the difficulties in having expenditure cuts implemented over the course of

the Irish fiscal crisis of the early to mid 1980s. Because the remedy was painful, political considerations prevented it from being implemented. The necessary political cover was eventually provided through the newly emerged social-partnership process, which saw employers, trade unions, farmers and others agree, without dissent, that debt stabilisation should be effected through expenditure cuts rather than continued tax increases.[20] The emergence of social partnership represents an example of the concept of *institutional learning*, which refers to "improvements in the quality of interactions between organisations that relate to each other in a given context".

The task for democratic political systems is then to develop institutions that prevent political parties from being locked into such prisoner's dilemmas in the future.[21] Many of the constraints entailed by EU or WTO membership function in this way. In the case of the EU for example, Buiter at al. (1993) note that external fiscal commitments such as the Stability and Growth Pact can serve as a useful scapegoat in helping politicians to resist domestic factors that systematically induce excessive deficits and ratchet up current spending. The internal market, too, strengthens the hand of government by limiting its freedom to provide state aid, as do requirements on the independence of competition authorities and regulatory agencies. This is what Friedman (2000) refers to as "the golden straightjacket".

Some institutions then – notably "social partnership" in Ireland in the late 1980s and, by some accounts, the fact that Whitaker's *Economic Development* report of the late 1950s emerged from within the civil service – have been effective in depoliticising or providing political cover for necessary policy changes. Two other important roles of public-sector institutions have also been identified. The IDA and its sister agencies have been important in acting both as buffer and as channel of communication between the private sector and government. Private-sector interests lobby governments for either of two reasons: to achieve benefits for themselves at the expense of others in zero- or negative-sum games, or to convey genuinely useful asymmetric information that can, if accepted, trigger positive-sum government

[20] The courage of the then leader of the opposition in promising political support for expenditure cuts must also be mentioned and is widely acknowledged.
[21] Vide FitzGerald (2000), a former Irish prime minister: "Democratic national governments tend to be subject to such strong pressure from vested interests within their own territories that many of their decisions operate against the interests of society as a whole."

responses. An efficiently-functioning public-sector bureaucracy can help government in distinguishing one form of lobbying from the other.[22] The other related role, as sent up by the "Sir Humphrey" character in the TV series *Yes Minister*, is in acting as a repository of organisational learning for government.

Bureaucracies exhibiting certain key characteristics – namely meritocratic recruitment and predictable, rewarding long-term careers and career ladders – are found to perform these functions well. Thus Evans and Rauch (1999) find that these characteristics significantly enhance a country's prospects for economic growth, even when initial levels of GDP per capita and human capital are controlled for.[23] Ó Riain (2004) has recently evaluated the Irish civil service and industrial development bodies on the Evans and Rauch (1999) scale which measures the extent to which they conform to best-practice principles. He finds that they compare favourably to the bureaucracies of countries such as Singapore, South Korea and Taiwan, the highest scoring of the 35 "developing countries" to which Evans and Rauch confine their analysis. Significantly, many new policy initiatives are thought to emerge from within best-practice public-sector bureaucracies. White (2001, p. 174), for example, in his history of the Irish tertiary-level education system, suggests that a particular named senior civil servant was the main driving force behind the promotion of non-university higher education in the period from 1966 to 1980. This element of the system has been argued to have been of particular importance in attracting manufacturing-sector FDI to Ireland. While many discussions of the comparative performance of exclusively Western economies take institutional capacity as given, it clearly has a critical role to play in economic development more generally.

[22] Evans (1995) identifies the "embedded autonomy" of the bureaucracy as key to insulating "the developmental project" from clientalism and interest-group pressures. Embeddedness – in agency clients and constituencies – is necessary to be able to mobilize the private sector to support the developmental project. Agency autonomy, on the other hand – in the form of performance requirements, constant informal monitoring and formal evaluations – is necessary to prevent the overembeddedness associated with clientalism and corruption.

[23] See also Rauch and Evans (2000).

References

Abramovitz, M. (1986), "Catching Up, Forging Ahead and Falling Behind", *Journal of Economic History*, 46, 385-406.

Baccaro, L. and Simoni, M. (2004) ‘The Irish Social Partnership and the ‘‘Celtic Tiger’’ Phenomenon’, Discussion Paper 154/2004, International Institute for Labour Studies, Geneva, ILO. (available at www.ilo.org/inst)

Barry, F. (2003) “Economic Integration and Convergence Processes in the EU Cohesion Countries”, *Journal of Common Market Studies*, 41, 5, 897-921.

Bew, P., and H. Patterson (1982) *Seán Lemass and the Making of Modern Ireland 1945-66*, Dublin: Gill and Macmillan.

Brannick, T., L. Doyle and A. Kelly (1997) “Industrial Conflict”, in T. Murphy and W. Roche (eds.) *Irish Industrial Relations in Practice*, Dublin: Oaktree Press.

Buiter, W., G. Corsetti and N. Roubini (1993) “Excessive Deficits: Sense and Nonsense in the Treaty of Maastricht”, *Economic Policy*, 16, 58-100.

Calmfors, L., and J. Driffill (1988) “Bargaining Structure, Corporatism and Macroeconomic Performance”, *Economic Policy*, 3, 6, 13-61.

Crafts, N. (2005) “Interpreting Ireland’s Economic Growth”, Industrial Development Report 2005 Background Paper Series, Vienna: UNIDO.

Daveri, F., and G. Tabellini (2000) “Unemployment, Growth and Taxation in Industrial Countries”, *Economic Policy*, 30, 47-104.

Eichengreen, B. (1996) “Institutions and Economic Growth: Europe after World War II”, in N. Crafts and G. Toniolo (eds.) *European Economic Growth*, Cambridge: CUP.

Evans, P. (1995) *Embedded Autonomy*, Princeton University Press.

Evans, P., and J. Rauch (1999) “Bureaucracy and Growth: A cross-national analysis of the effects of "Weberian" state structures on economic growth”, *American Sociological Review*, 64, 5, 748- 7654.

Fanning, R. (1978) *The Irish Department of Finance 1922-58*, Dublin: Institute of Public Administration.

Ferreira, L., and P. Vanhoudt (2004) “Catching the Celtic Tiger by Its Tail”, *European Journal of Education*, 39, 2.

FitzGerald, G. (1968) *Planning in Ireland*, Dublin: Institute of Public Administration.

FitzGerald, G. (2000) “Diluting Lobbies and Unleashing Growth”, in R. O’Donnell (ed) *Europe: The Irish Experience*, Dublin: Institute of European Affairs.

FitzGerald, J. (1998) “An Irish Perspective on the Structural Funds”, *European Planning Studies*, 6, 6, 677-694.

Friedman, T. (2000) *The Lexus and the Olive Tree*, New York: Farrar, Straus & Giroux.

Girvin, B. (1994) “Trade Unions and Economic Development”, in D. Nevin (ed.) *Trade Union Century*, Dublin: Mercier Press.

Hardiman, N. (1994) “Pay Bargaining: Confrontation and Consensus”, in D. Nevin (ed.) *Trade Union Century*, Dublin: Mercier Press.

Kennedy, K. (1971) *Productivity and Industrial Growth: the Irish Experience*, Oxford: Clarendon Press.

Lane, P. (1998) “On the Cyclicality of Irish Fiscal Policy”, *Economic and Social Review*, 29, 1, 1-16.

Leddin, A., and B. Walsh (2003) *The Macroeconomy of the Eurozone: An Irish Perspective*, Dublin: Gill and Macmillan.

MacSharry, R. and White, P. (2000). *The Making of the Celtic Tiger: the Inside Story of Ireland’s Booming Economy*, Mercier Press, Dublin, Ireland.

Maddison, A. (1964) *Economic Growth in the West*, London: George Allen and Unwin.

McCarthy, C. (1973) *The Decade of Upheaval: Irish Trade Unions in the 1960s*, Dublin: Institute of Public Administration.

Nickell, S. (2004) “Employment and Taxes”, CesIFO Working Paper No. 1109.

Ó Gráda, C. (1997). *A Rocky Road: the Irish economy since the 1920s*, Manchester: Manchester University Press.

Ó Gráda, C., and K. O’Rourke (1996) “Irish Economic Growth, 1945-88”, in N. Crafts and G. Toniolo (eds.) *European Economic Growth*, Cambridge: CUP.

O’Hearn, D. (1987) “Estimates of New Foreign Manufacturing Employment in Ireland 1956-72”, *Economic and Social Review*, 18, 3, 173-188.

Olson, M. (1982). *The Rise and Decline of Nations,* New Haven: Yale University Press.

O’Malley, E. (1989) *Industry and Economic Development: the Challenge for the Latecomer*, Dublin: Gill and Macmillan.

Ó Riain, S. (2004) *The Politics of High-Tech Growth: Developmental Network States in the Global Economy*, Cambridge: Cambridge University Press.

O'Rourke, K. (1995) "Emigration and Living Standards in Ireland since the Famine", *Journal of Population Economics*, 8, 4, 407-421.

Rauch, J., and P. Evans (2000) Bureaucratic Structure and Bureaucratic Performance in Less Developed Countries." *Journal of Public Economics*, 75 (1), 49-71.

White, T. (2001) *Investing in People: Higher Education in Ireland from 1960 to 2000*, Dublin: Institute of Public Administration.

Williamson, J.G. (1995) "The Evolution of Global Labor Markets since 1830: Background Evidence and Hypotheses", *Explorations in Economic History* 32, 2, 141-196.