

THROUGH IRISH EYES:
THE ECONOMIC EXPERIENCE OF
INDEPENDENCE IN EUROPE

by
John Fitz Gerald

October 1997

Working Paper No. 89

Working Papers are not for publication
and should not be quoted without prior
permission from the author(s).

1. Introduction¹

I would like to begin by saying how honoured I am to have been invited to give this Arthur Donaldson memorial lecture. Ireland and Scotland share a common concern about our geographically peripheral position within Europe and it is fitting that this issue should be discussed at this island venue. I know that my task to-day is to try and explain some of the apparently strange economic happenings in Ireland in recent years but to understand the economy it is important to reflect first on the wider social and political background which sets the context for economic policy. Some of the story I will tell will be familiar to you, in particular the importance of education and the educational system. In Ireland's case we have learnt from Scottish experience in the educational sphere so that our educational systems to-day have possibly more in common with one another than with those of Northern Ireland or England and are probably more successful in meeting the needs of citizens of a modern Europe.

When a major history of Ireland by Professor Lee of University College Cork was first published less than a decade ago (Lee, 1989) one of the many interesting questions he addressed was why Ireland was an economic failure. Now the question posed by outsiders looking at Ireland is why is it such a success. To those of us living through the experience there is a certain sense of bemusement at this rapid reversal of fortunes. However, it is now becoming clear that, whatever the causes, the Irish economy is truly undergoing something of a renaissance. In this lecture I will argue that it is not a flash in the pan but rather represents the fruits of a strategy that has been pursued for a number of decades with considerable consistency by successive Irish governments. The result may be no tiger but nor is it a tame pussycat.

In 1988 Lee was writing against the backdrop of an economy undergoing a severe recession and to some extent this may have coloured his writing. This highlights the danger for social scientists of being unduly influenced by current events and it is something we must keep in mind in looking at the future from the vantage point of to day. Even more than historians, economic forecasters have an inbuilt tendency to see tomorrow as being the same as to day. The pessimism about the Irish economy which prevailed in Ireland until very recently highlights the poor self-image that has persisted throughout much of the last decade influencing

¹ 12th Annual Donaldson Lecture - SNP Annual Conference, Rothesay, 27th September, 1997

economists, historians and politicians alike. Even if Ireland were truly a tiger we would be the last to see it.

Having begun my career as an historian I am conscious of the limitations of economics in explaining even the process of economic development. The cultural and social environment in which an economy is set plays such a vital role in determining the relative success or failure of economic policy that to ignore the background is to miss the picture itself. In the case of Ireland, its economic successes and failures since independence have been chronicled and reflected in the social and cultural development of the last 75 years. In this paper I want to focus first on a number of underlying social, economic and political factors which have contributed to Ireland's coming of age. I will then examine Ireland's recent economic record and the economic mechanisms which explain the current rapid convergence in Irish living standards to the EU average. In my final Section I want to discuss some of the problems and challenges which we face over the next decade.

2. Coming of Age

The Ireland of to-day has in a sense come of age, a process which is always difficult, and there may be some in the country who still hark back to the earlier days of the state in a protected environment. However, for most adults living in Ireland to-day their life time has seen profound changes in a number of different spheres. I first focus on that phenomenon central to the Irish consciousness over two centuries - emigration. I will then consider the role of the European Union in the coming of age process. In terms of domestic policy the failure to develop the education system in the first 50 years of independence was probably the new nation's most glaring mistake and the accelerated investment in education in the last 25 years is one of the country's major successes. The changing educational attainment of the population is having a very wide impact on Irish society, not least on the pattern of demographic change. It is this last feature, the demographic structure of Ireland, which still sets it apart from many of its EU neighbours.

2.1. Emigration

Central to the Irish experience has been the history of emigration. Going back to the 18th century, the tradition of emigration has been a continuing feature of the lives of all of the population, rich and poor, young and old. It had a particularly important impact on the economy in the 19th century and the despair and the tragedy which it symbolised is still deeply

ingrained. Just as the Highland Clearances have left their mark on even the physical appearance of the Scotland of to-day, the history of emigration has left its mark on Irish society. However, it is the gradual change in the nature of that experience which is both a symptom and a cause of the new Ireland.

Up to the 1950s the American wake was a central feature of Irish life; the family mourned the emigration of one of their children who would probably never be seen again. However, even by the 1950s the nature of the grief expressed at the wake was changing as the emigrants went to England and Scotland. Even if they would never live in Ireland, they would certainly be seen again on occasional holidays. The attitude of the emigrants was also changing. The contrast in the 1950s between the burgeoning economies of the UK, Germany and France and the economic depression of an Ireland where they could not find jobs left them bewildered and angry. This attitude is reflected in the writings of Edna O'Brien and Brendan Behan who were part of the exodus to the UK in the post-war years.

However, there was a gradual change in circumstances from the end of the 1950s which has greatly changed the current experience of emigration. This change is symbolised by President Robinson's gesture the day she took office of lighting a candle in the window of her house to welcome the returning emigrant. (This candle remained lighting throughout her term of office.) To-day emigration is still part of the experience of up to a quarter of each generation (and of every family) but the difference is that the emigrants of to-day are seen more as homing pigeons. The "best and the brightest" may still emigrate but the expectation and the experience suggests that the bulk of them will return.

In the post-war years the single most important factor driving emigration has been the difference between unemployment rates in Ireland and the UK. Set out below in Figures 1 and 2 is an analysis of net emigration classified by the educational attainment of the emigrants. They show a fairly similar pattern in the late 1980s to the late 1960s in terms of the proportion of the cohort of 15 to 29 year olds emigrating. However, the second half of the 1980s saw a big change in the educational attainment of the emigrants. Around a third of the emigrants had a third level education in the late 1980s compared to under 20% in the 1960s and in the late 1980s there was very little emigration by people with only a primary education whereas they accounted for the bulk of emigrants in the 1960s. This latter change reflects the fact that the Irish welfare system was more generous than that of the UK by the late 1980s.

Looking to the future there must be some doubt about the stability of the relationship which held in the past where the Irish unemployment rate was about 4 percentage points above the UK rate in equilibrium. Figure 3 compares Irish and UK unemployment rates for 1994 by educational attainment. It shows that for those with at least a leaving cert. (roughly equivalent to the Scottish highers) the gap in unemployment rates in 1994 was less than 4 percentage points and unemployment rates were lower in Ireland for graduates. With the proportion of the population who have reached at least leaving cert. standard of education continuing to rise, the result may be a reduction in the potential gap between unemployment rates in Ireland and the UK.

Figure 1

Figure 2

Proportion of Cohort Emigrating

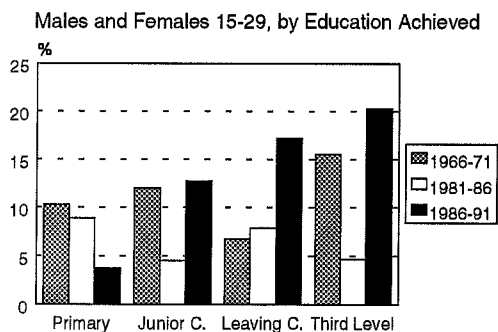


Figure 3

Education of Emigrants

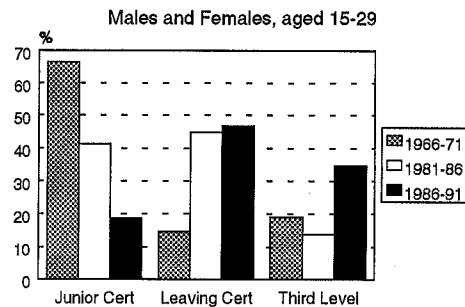
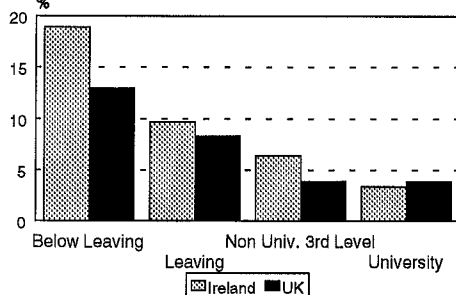


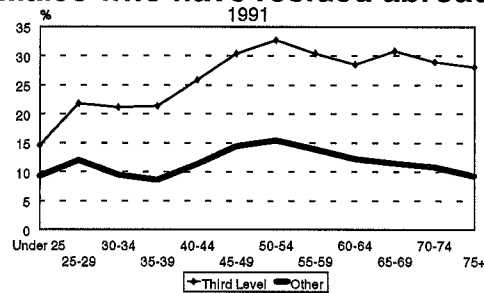
Figure 4

Comparative Unemployment Rates



Source: OECD Education at a Glance, 1996

Males who have resided abroad



Source: CSO Census of Population

While those with a good education are now more likely to emigrate than those with only a primary education, they are also more likely to come back. As shown in Figure 6, in 1991 over a quarter of all those in the country (males and females) with a third level education had lived abroad for at least a year. For all other educational categories the proportion was 10 or 15%.

While the latter figure is exceptionally high by the standards of other EU countries, it still suggests a much lower return rate than for those with third level education. It means that even in the face of continuing substantial gross outflows, the fact that individuals return with additional experience from working abroad may actually enhance the return from education.

Over the period 1991-96 there was a return to small net immigration reflecting the boom in the domestic labour market so that by 1996 nearly 20% of the 30-34 age group were returned emigrants. For the future it seems likely that there will not be a return to net emigration. There is even the possibility that there could be significant net immigration, including immigration of non-Irish citizens.

For a society which is exceptionally homogeneous in terms of race, religion and culture the returning emigrants have played an important role in introducing new experience, new ways of doing business, new expectations and a new vitality. In the 1950s when the traffic was all one way Ireland was a rather claustrophobic insular society. This was symbolised in the rather heavy censorship which was still exercised on literary works but it went much deeper than that. This is reflected in the literature of the time and the representations in the cinema of the period. Part of the transformation in society which has occurred must be attributed to the return of former emigrants.

2.2. *European Integration*

A vital feature of the changing Ireland is the opening up of the economy and society as whole to the wider European experience. In 1922 Ireland was the first of the British colonies to break away since the United States in 1776 and it had to write its own rules. In the first years of independence there was a learning process when new patterns of behaviour and new ways of thinking had to be developed. In the world of the 1920s and 1930s Ireland took the road of protection and self-sufficiency tending to close off the influence of the outside world. The fact that 2 of Ireland's greatest writers of the period (Joyce and Beckett) chose to live in Paris was symptomatic of this process. Its economic manifestation was the erection of very high tariff barriers to the outside world and its prime political manifestation was the decision to remain neutral in the second World War. Reading the speeches of de Valera of the time one gets the impression of a country that did not much like the outside world and reading some of the speeches of Churchill one gets the feeling that the response was mutual! This period of isolation left a serious economic and political legacy after the war.

Ireland of the 1950s was not only a very closed economy but it was also a very inward looking, even claustrophobic, society. This atmosphere seems to have proved stultifying for writers, artists and business alike. The advent of free trade from the beginning of the 1960s was only one, and probably not the most important, aspect of the opening up of the country to outside influences and ideas. The advent of television played an important role in opening up Irish society to new ideas. From the 1950s onwards the ready access to BBC television on the east coast helped keep people in touch with the rapidly changing post-war world.² It also helped raise expectations in terms of living standards and the level of provision of public services. However, probably the most important force for change in the economy and domestic politics was entry into the then EEC, along with the UK, in 1973.

Ireland was not unique in 20th century Western Europe in experiencing independence from a much larger and dominant neighbour; Finland and Norway have also shared this experience. In the case of both Ireland and Finland their experience of the first 25 years of independence has coloured their response to the European Union and European institutions. Public opinion in Ireland, and also in Finland, is much more favourable to the institutions of the EU than is the case, for example, in Sweden or the United Kingdom. Ireland and even more so Finland, suffered in their initial years of independence from the absence of a supranational framework of law to regulate their relations with their former Imperial power. In the case of Ireland, even in economic matters the relative generosity of successive UK governments eased the problem. However, up to Ireland's membership of the European Union its external economic relations were characterised by a dependent relationship with the UK. For Finland its relations with the Soviet Union proved much more traumatic culminating in the experience of the Second World War. As a result, for both Ireland and Finland, membership of the European Union is in a way the culmination of a long path to independence. The fact that certain powers and rights may be limited as a result of EU membership is more than offset by the benefit that each country is legally equal to its much more powerful neighbours and that the legal framework exists to enforce their right to protect their national economic and political interests.

I experienced the liberating nature of EU membership when I first started work in the Irish Department of Finance in 1972. One of my first jobs was to put away all the files on external economic relations which all dealt with relations with the UK. There were visits to London to

²Unlike all other citizens of the former USSR, Estonians had access to Finnish television for a number of decades prior to independence. This appears to have had a significant cultural impact differentiating Estonia from other parts of the USSR (and other Baltic republics).

find out how to do things; there were advisors from the UK and there were periodic negotiations with the UK on market access. These files were never again looked at after EU membership and instead the focus of attention shifted to a new multilateral world where Ireland was both legally and *de facto* equal to all other members. It took some time to realise that the UK was not always the opposition but often a friend and ally in furthering our common interests. Where the UK was an opponent it was only one of many and our allies might include France and Germany.

This changed environment not only strengthened Ireland's economic independence but it also provided new ideas, a stimulus to look at a wider world and a knowledge that there were many different ways of achieving our social and economic objectives. The cultural impact of EU membership has spread much wider than the civil service. For example, in the field of industrial relations it has also been an important factor bringing about change. Since the mid-1980s, while the UK pursued a rather contentious and legalistic approach to reform, Irish trade unions, employers and successive governments drew on the experience of their colleagues in Germany, the Netherlands and Denmark to develop a "partnership approach". This involved regular negotiations between the social partners which have resulted in a series of agreements covering not only pay rates, but also taxation policy and policy on publicly provided services. While this approach may have some draw-backs, it has contributed to a major change in wage formation and a period of relative peace in industrial relations over more than a decade.³ The rate of increase in real wage rates has been much lower than economic models based on the experience of the 1970s would have suggested but employees have benefited instead from a substantial reduction in the tax burden and a massive increase in numbers employed.

In the field of monetary policy Ireland's experience is also rather different from that of larger EU member states. Ireland since its independence has had little experience of attempting to implement an independent monetary policy.⁴ Even since 1979, when monetary policy was nominally determined by the Central Bank of Ireland, in practice it was the Bundesbank which played the crucial role in determining turning points in policy. As a result, there is a feeling that, in ceding the right to determine monetary policy to the European Central Bank, there is no loss of sovereignty when that sovereignty never really existed.

³ The fact that a number of the Trade Unions involved in this process were actually branches of UK unions is interesting.

⁴ Until 1979 Irish monetary policy was determined by the Bank of England. Since 1979 the Bundesbank has had the major role in determining policy.

The opening up of the Irish economy to the outside world with the reduction in tariff barriers from 1960 onwards was thus part of a wider process of change. This change was cemented by membership of the EEC in 1973. However, the adjustment to the changing circumstances had costs as well as benefits. The costs were seen in the closure of many businesses as the economy adjusted. This process of adjustment continued into the 1980s but it is now largely complete for the manufacturing sector and what problems remain affect the services sector. A corollary of this process of adjustment by existing industry was the introduction of new foreign owned businesses across a wide range of sectors, but especially in certain key areas of manufacturing industry. The new multinational industry came to Ireland because it offered access to the EEC market. Without such access Ireland would have been of little interest as a location for investment from the early 1970s onwards.

Membership of the EU was particularly important in the access it gave to the wider EU market for agricultural produce under the CAP. Even before membership in 1973 the impact of the impending CAP began changing Irish agriculture. While the CAP and the agricultural sector were crucial to the economy at the time of membership their significance has steadily fallen. Nonetheless the EU receipts as part of the CAP remain larger than all the receipts under the Structural Funds and the direction CAP reform will take in the next decade will still be a key issue for future Irish governments.

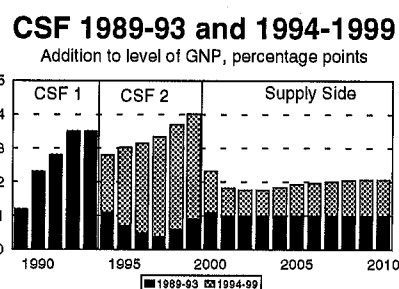
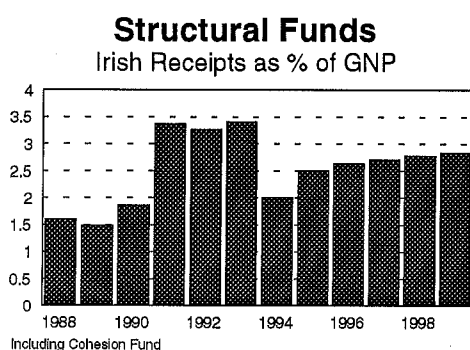
In the long run more important than any other economic feature of EU membership is the access to the single market. The single market reforms were expected to bring significantly greater benefits to Ireland than was the related increase in Structural Funds (Bradley *et al.*, 1992). The extent of the integration of the Irish economy into the wider EU economy means that Ireland's economic interests are now inextricably tied up with those of our EU neighbours. For example, Ireland paid part of the costs of German unification in the early 1990s as high interest rates cost up to 30,000 jobs (Bradley, Fitz Gerald and McCoy, 1991) but this was a small price to pay in terms of the wider benefits of EU membership.

In recent years the EU Structural Fund process has caught the public imagination (outside Ireland as much as in it) as a manifestation of the effects of EU membership. While Ireland benefited from receipts from the Social and Regional Funds from the mid 1970s the reforms introduced as part of the Single Market process resulted in a significant increase in receipts. These were further increased as part of the Maastricht treaty. Figure 5 shows how the receipts rose rapidly at the beginning of the 1990s. Since 1993 they have tended to fall and while they will continue significant out to 1999 they will not again attain their high level of 1992-93.

The growth in EU transfers from the Structural Funds from the late 1980s made a significant direct contribution to growth at an important time of economic change. On the demand side, as shown in Figure 6, the first Community Support Framework (CSF)⁵ from 1989-93 had raised the level of GNP by 3.5% above where it would have been if there had been no CSF (ESRI, 1993). If the EU transfers had been cut off after 1993 Irish GNP would in the long run have been up to 1% above its base level due to the continuing supply effects of the CSF funded investment (e.g. in roads and education). Because of the decline in significance of the CSF transfers in recent years the demand side stimulus will actually have fallen. Far from the demand side impact contributing to growth, the growth rate in 1994-95 was actually reduced by the fall off in transfers. Of course the supply side benefits of the new capital stock (human and physical) which is continually being put in place, funded under the CSF, is building up the economy's productive potential.

Figure 5: Structural Fund Receipts

Figure 6: The Impact of the CSF



At least as important as the actual investment has been the way the structural fund process has affected the administrative and political system. The increase under the first CSF encouraged the government to raise public investment from its extremely low level in the late 1980s. Without such a stimulus Ireland could have found itself suffering from underinvestment in the face of rapid growth in recent years.

The CSF process has forced the introduction of long-term planning. In the past there was a serious problem where investment projects stopped and started in line with short-term economic pressures on governments. This was very wasteful. Now an investment plan is formulated and subsequently implemented without major interruption. In addition, the need to satisfy the ghost

⁵ This is the name given to the EU programme covering the structural fund transfers.

of Mrs Thatcher and the more substantial ghost of Chancellor Kohl that their money is well spent resulted in the introduction of a fairly rigorous 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 was whether it had been spent in accordance with regulations. Now there is increasing interest in assessing how effective the expenditure has been.

In summary, the structural funds have played an important role in developing the economy at a crucial point in Irish economic history. However, they are now of declining significance and their contribution has been very much more limited than that of the other major driving forces discussed in this Section of the lecture. What is also important is that Ireland, unlike many underdeveloped regions in receipt of aid, has not become dependent on the transfers. For example, the Mezzogiorno in Italy has received huge transfers from the rest of Italy for decades, transfers which are essential in maintaining its standard of living. By investing the transfers Ireland has ensured that when they decline in the next decade we will have something left to show for it in the enhanced education of our work-force and the improved transport infrastructure.

2.3. The Educational Revolution

In the immediate post-war years all of Northern Europe, with the exception of the Republic of Ireland, made major changes in their educational systems. In Scotland, as in the rest of the UK, there was a substantial programme of investment undertaken, upgrading the educational system and greatly increasing participation in both second and third level. In Ireland, by contrast, the immediate post-war years saw no recognition of the need for change in this area. It took approximately 20 years before the policy of educational neglect was reversed in 1967.

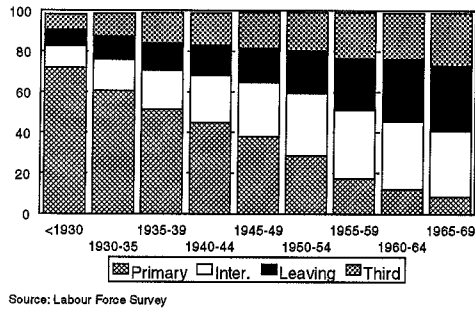
Following on the publication of *Investment in Education*⁶ in 1966 free second level education was introduced in 1967. This development signalled the start of a strategy of investing in education which has been pursued with consistency by successive governments ever since that date. Even in the 1980s, when many other sectors suffered severe cut-backs, the education system survived reasonably intact. In fact the rise in participation rates since 1980 has been even greater than that which occurred under the first 15 years of the “free education” policy.

⁶This study was undertaken with the help of the OECD. It was commissioned in 1962 and published in 1966. Among its authors were Professor P. Lynch of UCD and Professor M. O’Donoghue of TCD.

One area where Ireland has benefited by the experience of Scotland is in targeting the those whom the traditional education system was failing. Some of the more successful Scottish initiatives in this field have been introduced in Ireland.

Figure 7

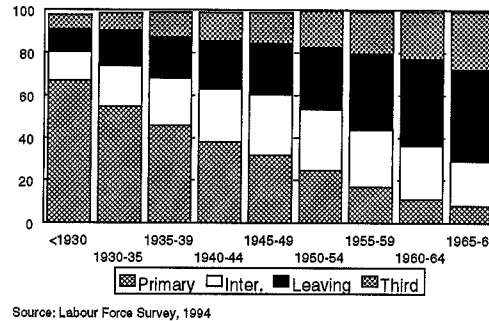
Educational Attainment, Males
1994, by age, % of population



Source: Labour Force Survey

Figure 8

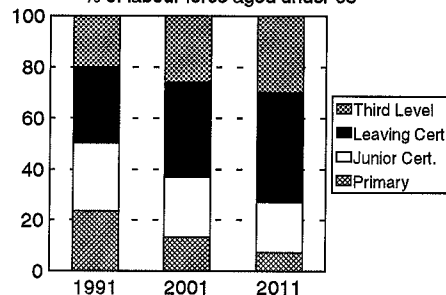
Educational Attainment, Females
by year of birth, % of total living in Ireland



Source: Labour Force Survey, 1994

Figure 9

Educational Attainment of Labour Force
% of labour force aged under 65



Source: Labour Force Surveys and ESRI Forecast

This change in policy has had a profound effect on the Irish economy and society and its full impact is far from complete with participation rates continuing to rise rapidly in recent years. The impact on the labour market has been complex but profound and this factor is vital in explaining the current rapid growth in employment. The fruits of a consistent policy of investment are only becoming clear in the 1990s. This issue is discussed later in the lecture.

This long-tailed impact of the change in educational policy is not surprising. Many of the other countries of Northern Europe, which invested heavily in education in the immediate post-war years, saw rapid rates of growth up to and including the 1970s. Ireland began 20 years late and is seeing the benefits of the investment 20 years after its Northern European counterparts.

The effects of the change in participation on the educational attainment of the population are shown in Figures 7 and 8. For those born 65 years ago, who are now reaching retirement age, approximately two thirds of the cohort left school with only primary education. On average women have been slightly better educated than men in the Republic throughout the last two generations but the gap has been relatively small.

For those born in the late 1960s, aged 25 to 30 in 1994, early school leavers were down to only 10% of the cohort with around 60% having at least a leaving cert.⁷ and around a quarter having some form of third level education. This increase in participation rates has continued apace with around 80% of the 1995 school-leaving cohort having a leaving cert. and over 50% continuing on to some form of third level education. The forecasts to the year 2011 are shown in Figure 9. This Figure illustrates how, even after a number of decades of investment in education, the impact of the continuing change in the level of human capital will affect the economy and society for some considerable time.

2.4. Demographic Change

The birth rate in Ireland in the period up to 1980 was well above the norm for most of Western Europe. Since then it has fallen fairly steadily (Figure 10). Even after 15 years of decline it is still above the rates common in other Western European countries. However, as shown in Figure 11, completed family size, (proxied by the Total Fertility Rate - TFR) is now close to that in the UK. This paradox of a high birth rate coinciding with relatively low fertility is explained by the fact that a relatively high proportion of the female population is, to use the demographers phrase, "at risk" (in the age group which potentially has babies). Figure 11 shows the implications of the continuing decline in fertility for Ireland in 2006. As can be seen from these data, on present trends Ireland is heading for a relatively low fertility rate, closer to that in Southern Europe than to the higher Scandinavian norm.

The future path of the fertility rate still remains very uncertain. The increasing prosperity and opportunities for skilled work will probably tend to reduce it further. The rising educational attainment of the female population is particularly important as it enhances their earning power and is a very important factor in increasing labour force participation. What is particularly interesting is the fact that for women aged 25 to 34 the labour force participation decision is

⁷Broadly equivalent to the Scottish "Highers".

now little affected by marriage. It is the decision to have children, whether the parents are married or not, which is associated with a change in participation.⁸ Marriage is proving to be a diminishing factor in explaining fertility in Ireland with one third of all first pregnancies occurring to single mothers. It is possible that the recent rapid fall in the birth rate may only represent a decision to postpone having children and that the forecast for fertility, shown here, could prove low.

Figure 10

Birth Rate

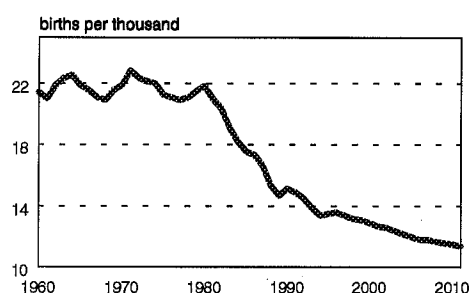
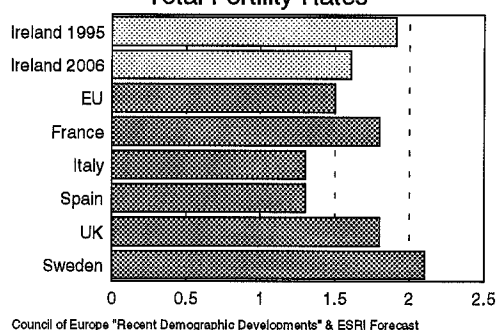


Figure 11

Completed Family Size
Total Fertility Rates



The effects of the "baby boom" of the 1970s can be seen in the cohort which will be aged 30 to 39 in 2011 (Figure 12). This cohort is currently aged 15 to 24 and it has benefited from the high birth rate of the 1970s and the low rate of emigration of families in the intervening years. The size of this cohort relative to all others will continue to influence the Irish population profile for decades to come.

The very rapid fall off in the population aged over 70 in 2011 (currently aged over 55) reflects not only expected mortality in the intervening years but more importantly the continuing effects of the very high level of emigration in the 1950s. This means that the number of people in the retired age groups (over 65) will remain relatively low for another 20 years.

A crucial factor in the growth in the labour force in the last decade has been the increased participation of women. Participation by women in the labour force was very low by European standards in 1980. Even today it is well below the EU norm. The pattern of participation by women is strongly affected in the long run by their educational attainment. It is also affected by

⁸See Walsh, B. M., 1993. "Labour Force Participation and the Growth of Women's Employment, Ireland 1971-1991", *The Economic and Social Review*, Volume 24 No. 4.

changing circumstances in the labour market. For women with a minimal education their participation rate is still very low, reflecting the fact that the costs of working (in terms of child care) are high and the potential gains have been low. In the younger age groups it seems likely that a significant number of these women have children and that this is affecting participation. For those women with a third level education the participation rate was traditionally much higher reflecting much greater financial incentives. Between 1988 and 1994 participation rates rose particularly strongly for those who had completed second level education.

Figure 12: Population Structure by Age, 2011

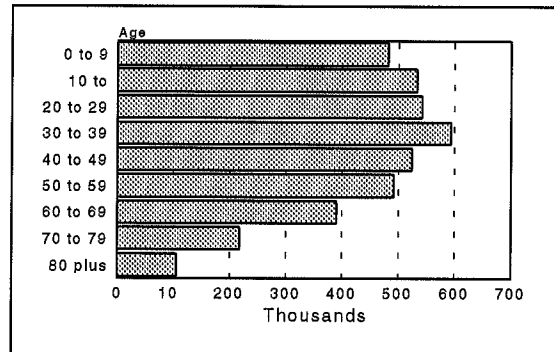
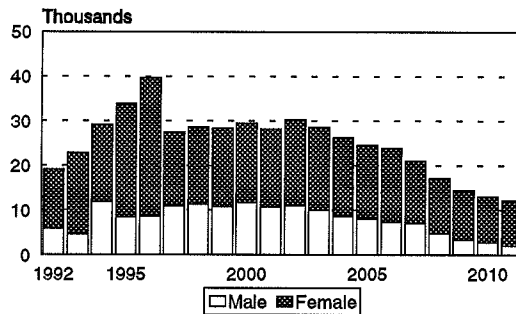


Figure 13

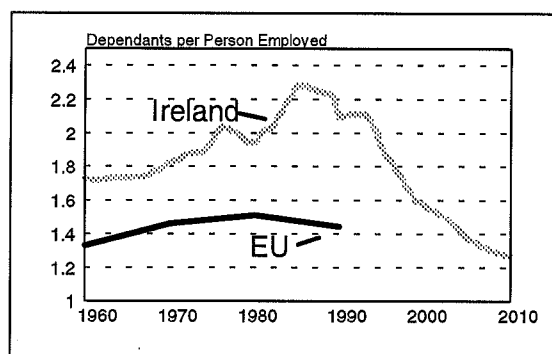
Change in Labour Force



The rapid rise in participation in education has had the effect of greatly reducing participation rates for men and women under 25. However, the rising educational attainment of successive cohorts of young men and women entering the labour force will tend to boost participation in older age groups. Generally, participation rates for women will continue to rise over the next decade. When taken together with the baby-boom bulge moving through the educational system, it means that labour supply will rise by more than 2% a year over the next decade (Figure 13).

In examining the implications of population change for the economy, the starting assumption is that all human populations consist of some who are dependent, in that they cannot produce sufficient output to support themselves, and others who not only produce enough to support themselves but also, to varying degrees, generate a surplus which, in principle at least, is capable of meeting the needs of those who are dependent. The composition and relative size of the dependent and productive segments of the population determine its dependency level. Thus defined, this can be quantified in various ways, most simply by establishing the numerical balance which exists between the dependent and productive population segments – how many dependants there are per producer or per person employed. We refer to this as economic dependency.

Figure 14: Economic Dependency



Much of the concern about a demographic “crisis” in western countries has arisen from worsening dependency trends. Ireland is in the unusual position that its dependency levels are improving and are likely to be lower in 30 years time than they were at various points in the last 30 years. The proportion of young people in the population, which remained fairly constant between 1960 and the mid-1980s began to fall rapidly in the last 10 years, and it will continue to fall over the coming 15 years. The proportion of elderly in the population, which remained very stable since 1960, will not show a major change till after 2010. When taken together, these trends mean that, having had a high percentage of the population in the inactive age groups for 30 years, this position is now changing quite rapidly in a favourable direction.

Since the 1960s, Ireland has had economic dependency levels (defined as the numbers not working in the population compared to the numbers actually in paid employment) that were extraordinarily high by the standards of other western countries (Figure 14). In the early part of that period, Ireland's high dependency was caused mainly by the contraction in the active population as a result of young-adult emigration in the 1950s, coupled with a moderately high fertility rate and an elderly population that was large by the standards of the time. By the

1980s, the active population had recovered in size (partly because of return migration among those who had left in earlier decades), even though the child population had also grown rapidly. However, apart from a brief favourable period in the 1970s, economic dependency remained exceptionally high because of a combination of high unemployment and low labour force participation rates within the population in the active ages.

The mid-1980s witnessed peak levels of economic dependency. At that time, a small work force was supporting a very large child population, a very large number of unemployed and a reasonably large elderly population. The number of women in home duties was also very large. The majority of women in home duties should be counted as economically productive rather than dependent and as important providers of support within families. However, as an informal economic activity, housework is untaxed and does not contribute directly to public revenues. In addition, it is likely that a certain proportion of women in home duties were underemployed or 'hidden' unemployed.

The trend in economic dependency began to turn in a positive direction in the mid to late 1980s. The numbers in the dependent age groups began to fall and, at the same time, the numbers at work began to grow, so that the dependency balance improved considerably. This positive trend is likely to continue, especially over the next 10 to 15 years, so that economic dependency will be markedly lower in the next decade than at any time since the 1960s. At the peak of economic dependency in the mid-1980s, there were nearly 230 dependants for every 100 workers. According to the latest forecasts this ratio will have fallen to 125 dependants per 100 workers by the year 2010, well below the current EU average. Even though a certain degree of population ageing is likely to have occurred over that period, labour force growth will also mean a slight decline in the number of *elderly* dependants per 100 workers – from 35 in 1986 to 28 in 2010.

The combination of unfavourable conditions which created the extreme dependency levels of the 1960s through to the 1980s are now passing away and are unlikely to recur in as extreme a form at any point over the next three decades. Ireland is thus now moving into a new era of easing dependency burdens, no matter how those dependency burdens are defined or measured. This again reinforces the view that even in the long term, the outlook as far as dependency is concerned is a great deal more favourable than the record has been over recent decades.

3. Who Put the Tiger in the Tank?

In this Section I first want to outline what Ireland's record is on output and employment growth. In order to understand this record I first discuss the role of labour supply and I then consider factors affecting labour demand. At the end of this Section I will bring the evidence together to explain one of the key economic mechanisms underlying the rapid convergence of Irish living standards to the EU average.

3.1. The Record

In the late 1970s the then Irish government pursued a "dash for growth" policy which involved a huge fiscal injection. Even at the time economists warned that this was unsustainable and in the early 1980s, when the storm of world recession hit, especially in the UK, it almost wrecked the Irish economy. The result was a period of almost 10 years of fiscal retrenchment in the 1980s as successive governments (like "all the king's men") tried to put the economy together again. The process was extremely painful involving both major increases in taxation and a massive cut-back in state expenditure. In the 1987-88 period public sector employment was cut by 10%, a figure that no other OECD country has managed since the war.

Figure 15 shows the growth rate for GNP for each of the 5 year periods from 1960 to 1990. With the exception of the first half of the 1980s, when the fiscal retrenchment knocked the stuffing out of the economy, there was relatively little deviation from an apparent trend growth of 4% a year. For the more recent period 1990-95 the growth rate picks up to 5% and, as shown in Figure 16, the economy is currently growing at a rate well above its past trend. It looks as if the average growth rate over the 4 years 1994-97 will be over 7% and even next year when it begins to slow it will still be close to 7% giving an average for the second half of the 1990s of over 5.5% a year.

Figure 15

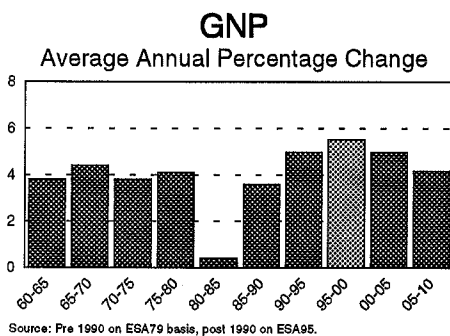
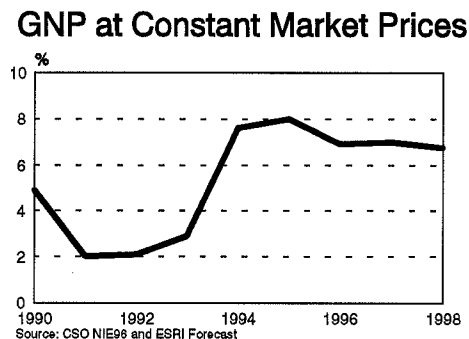


Figure 16



Probably more remarkable than the apparent pick up in the trend growth rate is the experience on employment growth. By contrast with a dismal performance in the 1980s, employment has grown and is growing at an unprecedented rate (Figure 17). The bulk of this employment growth is occurring in the private sector. However, there has been a somewhat smaller reduction in unemployment (Figure 18) reflecting a rapid rise in the labour force.

The result of this relatively rapid period of growth will be that Ireland, which in 1990 had a GDP per head of around 74 per cent of the EU average will, by the year 2000, be around 111 per cent of the EU average. A more appropriate measure is GNP per head (which excludes profit repatriations); on this measure Ireland can also be seen to have narrowed the gap in living standards compared to the EU as a whole from 67 per cent in 1990 to an expected 95 per cent in 2000 (Figure 19). On the basis of the *Central Forecast*, using GNP, Ireland should achieve the average standard of living in the EU around 2005, exceeding that in the UK between 2000 and 2005.

Figure 17

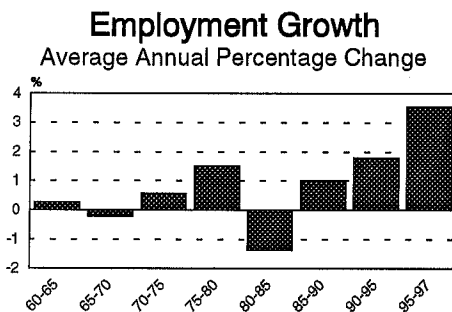
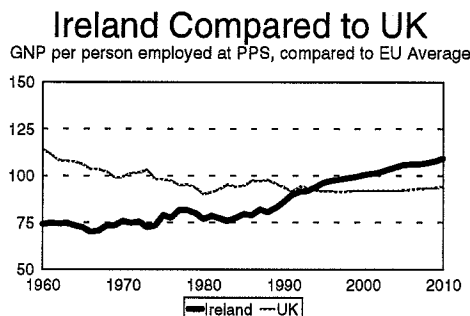


Figure 18



Figure 19



The pattern of development shown in Figures 15 and 19 suggests a marked change in gear around 1990; between 1960 and 1990 there was little change in Ireland's position within the

EU measured in terms of GNP per head. However, it now seems possible that over the next 15 years Ireland may achieve a standard of living among the highest within the EU.

While this may appear to be an exceptional rate of convergence in living standards measured as GNP per head, the situation looks rather different when considered in terms of output per person employed – national productivity broadly defined. On this measure the Irish economy has been converging towards EU standards of productivity fairly steadily since the 1970s. While we are presently seeing some acceleration in the rate of convergence, this is not out of character with the past 30 years. The explanation for the contrast between the two measures, GNP per head and GNP per person employed, lies in the movement in the economic dependency ratio – the ratio of the population not in paid employment to those who are at work. As discussed earlier, while Ireland still has an economic dependency ratio well above the EU level it will actually fall below the EU average some time in the next decade. This contrast, and its related effects on living standards represented by the movement in GNP per head, reflects the window of opportunity which Ireland faces over the next 20 years. The declining dependency ratio at a time when the ratio is rising elsewhere in the EU will make possible a rapid rise in living standards in Ireland.

3.2. Labour Supply

Whereas the rapid increase in the supply of labour has traditionally been Ireland's "problem" it now looks like being Ireland's opportunity. As discussed already the natural increase in the population together with the rapid rise in female labour force participation is giving rise to a 2% a year growth in the potential labour force. This does not guarantee a similar growth in employment; in the past it just gave rise to emigration. However, it provides the potential for rapid growth in employment and, therefore, in output.

Over the last 30 years the Irish labour market has been profoundly affected by a number of different policies pursued domestically which have altered the structure of the supply of labour: changes in the education system and changes in the social welfare system. These have had the effect of increasing the supply of skilled labour and gradually reducing the supply of unskilled labour.

In the 1950s, at a time when the UK had developed a sophisticated social welfare safety net, no such protection was available in Ireland. As a result, unskilled labour in Ireland faced a choice between emigration to the UK, generally to take up employment there, or employment at any

price in Ireland. However, over the period from 1960 to the early 1980s there were substantial improvements in the Irish rates of social welfare payments. By the early 1980s the rate of social welfare payments set a minimum wage pulling up the market wage rate for unskilled labour. The result was a fall in unskilled employment.

The impact of the investment in education was also to reduce the supply of unskilled labour as children remained longer in the educational system emerging eventually as skilled members of the labour force. The combination of a rapid growth in the underlying population of young labour force entrants and the transformation of such entrants by the educational system has resulted in an unprecedented increase in the supply of skilled labour in Ireland.

3.3. Labour Demand - Industrial Policy

Changes in the world economy have affected the demand for labour in Ireland. In 1960, with a high level of protection, the demand for unskilled labour in the economy was high. There was little competition from suppliers in the Far East who faced much lower labour costs. However, over the past 30 years labour costs have risen in Ireland at the same time as the Irish and the EU economy has opened up to world-wide competition resulting in a fall in demand for unskilled labour in Ireland. By contrast, the demand for skilled labour has risen world-wide. In Ireland the interaction of these different forces has determined the rates of return for different kinds of labour and the numbers employed.

Simultaneously with these changes in the supply of unskilled labour there was a fall in demand. The opening up of the economy to competition meant that those companies operating in the tradable sector which depended on unskilled labour faced increasing competition. Since the early 1970s the absolute number of unskilled labourers has been cut by almost 50%, with smaller declines in other categories of unskilled labour.

While firms employing unskilled labour in the tradable sector have continued to experience pressures from manufacturers outside the EU, the demand for unskilled labour in certain parts of the services sector (retailing and catering) has risen rapidly in the face of the rapid growth in domestic demand. While still not attractive to those eligible for social welfare⁹, pay rates are continuing to rise and may impact on the numbers of unemployed in the future. Alternatively,

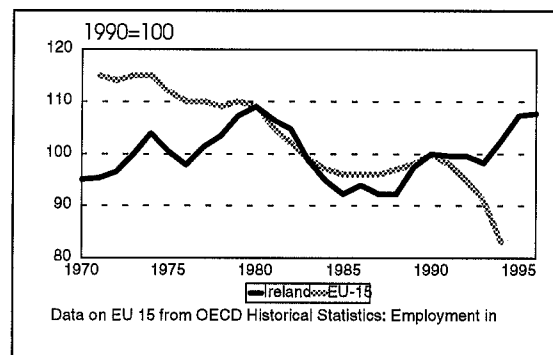
⁹Much of the supply of labour at these rates has come from women or students working part-time who may not be eligible for social welfare payments.

the rates may prove attractive to unskilled labour from outside the country resulting in immigration of people to fill vacancies.

The high proportion of foreign direct investment in the Irish manufacturing sector and its export-oriented development makes the Irish economy quite unique among the EU peripheral members. This development is a result of a deliberate strategy pursued by policy makers. Since the late 1950s Irish industrial policy has offered significant tax incentives and financial packages to foreign companies to locate production here. This became particularly attractive to foreign investment since Ireland's accession to the EU in 1973. The policy was outward-oriented, more generous tax advantages were offered to exporting firms in the 1970s, and gradually became concentrated on selected sectors, notably the electronics (including software), health care and pharmaceuticals sectors.

The result of this outward-oriented strategy was that there was a significant restructuring of the manufacturing sector, especially in the 1970s and 1980s. Production in manufacturing shifted from dominance by a largely indigenous, low-technology group of "traditional" industries which had strong links to the domestic and UK market to the current dominance by a group of "high-technology" industries, concentrated in electronics and pharmaceuticals. This group is largely foreign-owned and export-oriented.

Figure 20: Manufacturing Employment 1970-1996



During the 1980s this restructuring resulted in a sharp decline in employment in manufacturing (Figure 20) and led many commentators to question the wisdom of deliberately courting foreign firms. It was argued that the relatively low labour-intensity of production in the foreign-owned sector, and its low linkages with the domestic economy, signalled a danger that the indigenous sector was being crowded out and that the economy was becoming increasingly reliant on foot-loose foreign multinationals.

However, the restructuring within the traditional group of industries was an inevitable consequence of the progressive opening of the economy to international trade. External pressures from low-wage competing countries forced many inefficient industries out of production. Similar adjustments occurred in the manufacturing sector of most developed countries. Viewed in this context, the pro-active industrial strategy pursued by Irish policy makers was central to the long-term development of a strong industrial base. Indeed Irish employment in manufacturing between 1975 and 1991 grew more strongly than the EU average despite its poor performance in absolute terms. The long-term downward trend in EU manufacturing employment can be seen in Figure 20.

In more recent years employment in manufacturing has picked up strongly. Between 1985 and 1996 employment in manufacturing increased by 36,000, an increase of almost 17 per cent. Significantly there has also been positive employment growth within the indigenous sector. The shift towards high-technology production has also led to a significant increase in the skill intensity of employment.

The concentration on a small group of sectors means that Ireland is emerging as a major location for specific industries. This leads to spill-over effects into the indigenous sector both in terms of received expertise and technological know-how and direct linkages with the domestic economy and local labour market. For example in the software sector recent evidence suggests that many small indigenously owned firms have established niche activities within this sector.

In summary the benefits of a prolonged and consistent policy of targeting foreign investment has helped in the process of establishing a modern, internationally competitive industrial base in Ireland. In particular it has meant that Ireland has experienced a major increase in demand for skilled labour. When taken together with the rapid growth in the private services sector in areas which also require skilled employees the combined effect on the demand for skilled labour has been very great.

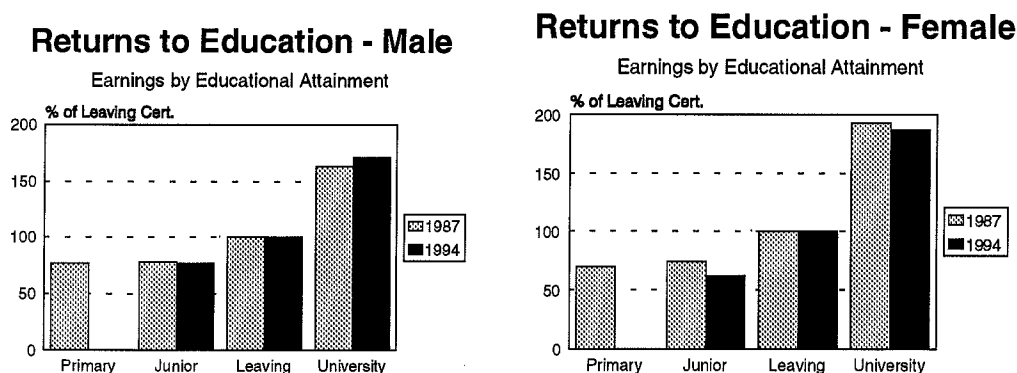
3.4. *Competitiveness and Employment*

In addition to the rise in the average level of human capital of the population and of the labour force, the past high birth rate and the rise in female participation in the labour force have meant that the potential numbers in the labour force have risen rapidly in recent years. In the past such a rise in numbers has not necessarily translated into increased employment. For those who could not find employment in Ireland they chose to emigrate if their education was sufficiently

good to guarantee them a job elsewhere. However, in the last 5 years the increase in supply of labour, predominantly skilled, has found ready employment in Ireland. Over the 1990s the labour force will rise on average by around 2% a year. Around 1 percentage point a year of this rise is due to increased female participation and 1 percentage point a year to the natural increase in the population.

If the demand for the two kinds of labour had remained unchanged over time, the wages of skilled employees relative to unskilled would have fallen. This fall would have been particularly acute if many of the skilled were unable to find skilled employment and were forced to work in unskilled jobs. Figure 21 shows the average earnings of those employed in 1987 and 1994 classified by their level of education (Callan, 1993 and Callan and Wrenn, 1994).¹⁰ These data suggest that there was little change in the differential over that seven-year period. Given the very substantial increase in supply of skilled labour over the same period this would indicate that the demand curve for skilled labour must also have shifted outwards, offsetting any tendency for the increase in supply to reduce the return to the investment.

Figure 21: Average Earnings by Level of Education

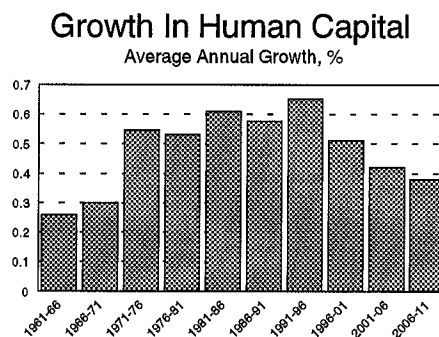


The effect of the investment in education and the factors driving the increased demand for skilled labour has been to maintain the benefits to the individual (through wages) and to the economy of the increasing skills of the labour force. For the generation retiring to-day two thirds of them had only the benefit of a primary education and this was reflected in their earnings and their output. However, 80% of the generation which replaces them have

¹⁰ These data are the average earnings of those with the different education levels. It is possible that changes in other variables, such as the average experience of the labour force, could have distorted the results. A full analysis such as that carried out by Callan, 1993, for the 1987 data is required for the 1994 sample before we can be sure that the rates of return to education did not change over the period.

completed second level education and 50% of them have participated in third level education. The result of this shift is a major increase in the value of output, even with no change in the absolute numbers employed. Figure 22 shows an estimate of the effect on the growth rate of the increasing human capital of the labour force. In the first half of this decade the education effect was contributing between 0.5 and 0.75 percentage points to the annual growth rate. The availability of a similar exercise for Germany and Austria tends to confirm the assertion made earlier that the benefits from investment in human capital are occurring later in Ireland than in other Northern European EU members. While the contribution to the growth rate from this source is falling over time, as the average educational attainment of the labour force rises, it will still be rising at around a third of a percentage point a year at the end of the next decade. It would suggest that currently around 0.5 percentage points of the growth rate may be attributable directly to the rising educational attainment of the labour force.

Figure 22: Growth in Human Capital



In addition to this direct effect on the productivity of labour, the policy of investment in education has had a major indirect effect on the supply of labour through two channels. By transforming those members of the labour force who would have been unskilled and unemployable into highly skilled and eminently employable workers it has had a direct effect on the unemployment rate and the rate of emigration. The second channel is the effect of increasing educational attainment on female labour force participation. Without the investment many fewer women would have been in the paid labour force than are currently involved with a consequential loss of measured output.

When the increase in labour supply is added to the growth in human capital it would suggest a rise over the decade in the effective supply of labour of 2.5% a year. This contrasts with the situation in many other EU members where the labour force is growing quite slowly and where the major benefits of the post-war investment in human capital have already been reaped. This

factor, when taken together with the range of social and economic factors described earlier, explains why the Irish economy is growing more rapidly than those of most other EU members. However, it is also clear that the benefits of the key supply side factors currently boosting growth will fall gradually over the next 15 years bringing the Irish economic experience back into line with that of its neighbours. By then the task of bringing the Irish standard of living up to that of its neighbours will have been completed.

4. Conclusions

4.1. *The Irish Agenda*

The story of the Irish economic renaissance is not yet finished and if it is to have a happy ending there is much that still needs to be done. The falling dependency ratio represents a window of opportunity which will last for fifteen or twenty years; after that the ageing process will change the character of the economy and of society, just as it has changed Germany and Japan. From the middle of the next decade the driving factors behind the rapid growth will begin to slow and the rate of growth in output will gradually decelerate towards the EU average. The first priority for future Irish governments must be to ensure that the potential for further growth is realised. There is then the issue of how best to use the fruits of success. Finally there are a range of long-term strategic issues arising from Ireland's changing economic and social structure; what does this imply for its future role in Europe?

.Making it Happen

- The development of a political consensus in the 1980s on tackling Ireland's critical fiscal problems, was very important in the ultimate success of the Irish economic recovery. Sustaining and reinforcing this partnership approach to income determination so that it survives the pressures from rising expectations is vital. In the 1950s and 1960s Ireland decided it wanted a UK standard of living before it had a UK level of productivity, with serious consequences for employment. For the future we must not aspire to a German standard of living before we have earned it. Unfortunately talk of the "Celtic Tiger" whets expectations making them ever more difficult to realise in practice.
- Adequate investment must be undertaken to provide the infrastructure essential to future growth. There is a serious need for additional investment in public transport as well as in other forms of public infrastructure. While Ireland may be approaching a UK level of income, its physical infrastructure, part of national wealth, still lags behind. Without the

new transport investment or new investment in housing Ireland will not remain an attractive place to live and this would adversely affect growth prospects.

- The rapid rate of economic growth can not but have noticeable effects on the environment. The extent to which these effects will add to or detract from the quality of life – the fundamental aim of growth – will depend on the choice and balance of policies for environmental protection. In addition to the need for properly functioning protective laws where appropriate, economic instruments will need to be at centre stage if we are not to burden the economy with unnecessary costs of protection. The pressures on the environment will have to be controlled if economic growth is to produce a real improvement in welfare..
- While investment in education is paying handsome dividends, it still continues to fail up to 20% of the population. Finding an effective means of dealing with this problem is of crucial importance to prevent the growth of an ever more excluded permanent minority of unemployed.

.The Fruits of Growth

- Over the next decade there will probably be the opportunity of making an impact on major social problems. For example, there is a pressing need for measures aimed specifically at improving the skill levels of the long-term unemployed;
- The “demographic dividend” should be invested to provide for long-term needs in twenty years time when Ireland will begin to grey.
- The changing educational composition of the population has important implications for regional policy; future regional success will depend as much on where people want to live as on where the jobs are. The changing expectations of the population affect the type of jobs which they are prepared to accept. It also affects the type of lifestyle which they will seek. In the past the principal instrument of regional policy may have been government intervention through different kinds of subsidies to encourage firms to relocate to less desirable or sought after locations. In the future this is unlikely to be as successful as in the past. Instead, among the factors which will determine where economic activity prospers will be where the young labour market entrants of tomorrow wish to live. The promotion of a balanced regional development must rely more on policies which enhance a region’s attractiveness to young adults: for example, the provision of affordable housing,

entertainment for the increasingly varied tastes of that cohort, and satisfactory infrastructure, ranging from transport systems to child-minding facilities.

.Future Strategy

Ireland's "coming of age" will require a reorientation of a number of key features of the strategy that has produced the current renaissance.

- The price of success is the prospect that Ireland may become a net contributor to the EU by the end of the next decade. Adulthood brings new responsibilities within the EU, to future new members in Central Europe, and also to third world countries. This change in circumstances requires a re-examination of Ireland's policies within the EU. For Ireland, more painful than the process of weaning from the EU Structural Funds is likely to be the need to radically reform the CAP to allow an expansion of EU membership. However, EU membership and the completion of the Single Market, by providing the platform for the construction of a modern economy, have been much more important than the transfers we have received. Access to new markets in Central Europe will provide new opportunities.
- The consistency with which our industrial policy has been pursued over the last 40 years is now bearing fruit. However, we must remember that Scotland got 100 good years out of shipbuilding and Northern Ireland got 100 good years out of linen. However, one can not expect the current high technology industries which have been so important for Ireland's success to survive as long. Thus it is important that too much emphasis is put on one or two sectors. This need to maintain balance in our economic success may prove difficult to achieve. The role of the education system should remain that of preparing our citizens for a lifetime which will see them work in a number of different jobs and a number of different sectors.
- Finally, for two centuries the Irish have sought access, and got it, to the best labour markets in the world. Changing circumstances may now see Ireland appearing as just such a labour market to many in the rest of Europe and elsewhere. The need to approach this issue with generosity and to ensure that future population movement brings cultural stimulation rather than social tension is another challenge for the new century.

4.2. Lessons for the Periphery

Ireland achieved its independence in 1922 on foot of a Sinn Féin - ourselves alone - programme. The relative failure of that strategy, especially in the post-war years contributed to the depression of the 1950s which permeated Irish society. The success of to-day owes much to the enthusiasm with which Ireland has subsequently approached the globalisation of its economy and the opening up of its society to outside influences. In viewing EU membership as essentially liberating it has created a positive outward looking attitude which affects business, the educational system, and politics. In the past there was concern that Ireland might lose its identity either within the English speaking world or more recently within the EU. Such concerns are much less frequently expressed as a new self-confidence takes over.

- It is this cultural change which is probably the single most important factor underlying the current Irish economic renaissance. The factors which brought it about are clearly very specific to Irish society and they do not translate to other countries or regions. However, the importance of the process embracing the outside world probably does have relevance for Scotland and other European nations.
- A second feature of the Irish experience is the importance of following a consistent strategy over a long period of time. The broad social and political consensus behind the industrial and educational policies followed over the last 30 years has ensured a high level of continuity. Talking to economists from the developing Central European economies I find that this is one aspect of Ireland's experience which it is important to stress. Ireland's current success is built on investment over 30 to 40 years and also on the pain of a major restructuring of the economy in the 1980s. There is no quick fix for problems of underdevelopment though there is every reason to believe that the process can be accomplished more efficiently, with less pain and in a shorter time than has been the Irish experience.
- The centrality of investment in education to the process of economic growth does have relevance for other countries. It may have less relevance in the case of Scotland as it has long been a feature of Scottish society, even if certain constraints were placed on its implementation! The changing nature of the world economy appears to be favouring those with very high levels of education over the least educated and those regions of Europe which ride the crest of this wave may reap the major benefits. The strength of the economies of countries such as Germany and the Netherlands owes much to this factor.

- In the case of industrial policy, pursued consistently over 40 years, there have been failures as well as successes. The concentration on tax incentives has probably in the past unduly favoured foreign firms over domestic firms. The policy begun in the late 1970s of targeting particular sectors also carried significant risks. However, we are now seeing the benefits of critical mass in certain key sectors where the investment has succeeded. The presence of a very active labour market in people with information technology skills makes it possible to attract more and more investment in this area. A second aspect of industrial policy has been its focus on sectors which are in the ascendant and the very limited attention given to attracting investment or protecting existing firms in what are essentially declining sectors - don't throw good money after bad.
- Ireland has had two advantages which may not be available to all peripheral regions - the English language and the existence of a core of employment in sophisticated services sectors which are in the ascendant internationally and which require skilled labour. In the case of the English language all Irish people find that travelling abroad it is a great advantage to speak English but not to be English, something which this audience has also experienced! It is no accident that the IT sector which is dominated by the English language has been a sector in which Ireland has done well. In the case of sophisticated services both Ireland and Scotland share the advantage of having a core of employment in sophisticated legal services and the financial sector. this advantage is not shared by many other peripheral regions - such as Wales. It has provided a foot-hold in an area of economic activity which is growing rapidly internationally.

In considering the lessons to be drawn from the Irish experience what strikes me is their paucity rather than their significance. It is clear that an important ingredient of success stories is luck. in so far as we make our own successes each nation has to find its own path. It is this diversity of experience which is both a stimulus and a challenge. I am greatly enjoying this opportunity to be stimulated and challenged by the Scottish experience and in the future, as in the past, I think we have much to learn from it.