Why Ireland Boomed

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THE great economic success story of the past ten years has been the Republic of Ireland. At the end of the year 2000, Ireland could look back on fourteen years of uninterrupted economic growth, which had accelerated to nearly 10 per cent annually in the closing years of the 1990s [Table 1]. With this growth came markedly lower inflation, one of the lowest unemployment rates in the European Union (EU), and a growing government budget surplus. Most dramatic, however, was the return to Ireland of young workers in increasing numbers to fill new jobs awaiting them at home.

Contrast this happy state of affairs with that of the mid-1980s, when the unemployment rate reached 17 per cent, emigration soared, the government's finances were a shambles, and submission to a draconian International Monetary Fund (IMF) programme was considered as a means of getting the economy back on track.

How did the dramatic turn of events come about? What lessons, if any, might the Irish events teach others? In this article, I examine the sources of the apparent transformation of the Irish economy. How much was the result of conscious, far-sighted government policies? To what extent did historical trends or external events play a part?

The analysis here demonstrates that the adage 'fortune favours the well prepared' applies especially well to the Irish case. To be sure, Ireland had been well prepared by virtue of sound, sustained policies in matters such as taxes, education and telecommunications. These policies, though improvements, were not revolutionary by any standard, nor were they part of a grand, overarching plan. Even when dramatic results followed from the adoption of market-oriented measures, as in the case of deregulation of Ireland–United Kingdom air routes, the lessons were not applied with vigour elsewhere in the economy. In short, Ireland illustrates how large the payoffs from better policies can be in a few critical sectors in the presence of favourable external factors.

STARTING POINTS

The Republic of Ireland is a small, relatively new nation on the western edge of Europe. After emerging as the Irish Free State in 1922, following a long history of conflict with Great Britain, it promptly plunged into a civil war that lasted until 1923. At that time, the population included fewer than three million people and was dwindling. The new nation's desire to demonstrate economic 'self-sufficiency' as well as political independence contributed to the adoption of inward-looking, protectionist policies.

By the mid-1950s, the hopelessness of the situation, combined with the emergence of the Common Market (even though Ireland was not a member at the time) brought about the first significant change in government attitudes. Foreign investment, particularly in exporting industries, was made welcome. The effort to entice foreign, in particular American, investment in Ireland began to show measurable results by the end of the 1960s. During that decade, 350 foreign companies were established and rapidly became leaders in the export sector.

Ireland's long-anticipated entry into the Common Market in 1973 (along with the UK) set in motion important structural and psychological changes for the country at all levels. The immediate impact was a boom in agriculture as Irish exports gained free entry into a vastly expanded market at attractive prices. Between 1972 and 1978, real farm income rose more than 40 per cent, and land prices soared.

Foreign investment continued to grow, although not without problems. By some measures, the record of the 1970s constituted an improvement over that of the previous decade. Nevertheless, Irish economic performance, compared with that of other European countries, was well below average.

Table 1: Measures of Irish Economic Performance, 1981–2000 (Average Annual % Change)

	1981–86	1987–93	1994–2000	2000
Real GDP	2.1	4.8	9.0	10.2
Unemployment Rate	13.8	15.2	9.5	4.2

Source: OECD 1999, 2001; Central Statistical Office 2001.

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If analysts were gloomy at the end of the 1970s, they had even more cause to lack optimism throughout much of the 1980s. However, the necessary underpinnings for the extraordinary expansion of the 1990s were gradually being put into place. One highly visible initiative was a drastic change in fiscal policy in the face of extraordinarily high unemployment rates and growing concerns about the country's finances. In 1987, a new (minority) government took office. Much to almost everyone's surprise, it engineered substantial cuts in planned spending and abolished some cherished government agencies.

A noteworthy element in the new government's programme was an amnesty offer for delinquent taxpayers. The result was a IR£500 million windfall (approximately US$750 million) against a forecast of IR£30 million and an effective broadening of the tax base. The effective implementation of the government's budget was an important step in bringing its precarious financial affairs under control, shoring up the country's reputation among foreign investors, and setting the stage for reductions in marginal tax rates for both individuals and corporations in the 1990s.

GETTING IT RIGHT

At the same time that fiscal policy was finally moving in a constructive direction, efforts to tackle the country's most-pressing infrastructure problem began to bear fruit. In 1980, Ireland's telecommunications system was perhaps the worst in Western Europe. Operated as a government department, it was vastly overstaffed, its equipment was antiquated, its service was erratic, and its charges for both domestic and international calls were among the highest in Europe. It was the subject of regular questions in the Dail (Parliament) from members representing small towns that had been seeking community pay phones for a year or more (residential installations typically took even longer). Customers were required to prepay a year's fixed charges.

Even more ominously, foreign investors' complaints had become more severe, as such users compared service in Ireland with that obtainable elsewhere in the EU. Factories had extreme difficulty in keeping telex lines open to their customers and to their home offices, charges were excessive, and billing was chaotic. In this situation, the Industrial Development Authority [IDA], established in the 1950s, became an important lobbying force for change, emphasizing to ministers, mandarins in the Department of Finance, and parliamentarians in the Dail the linkages between creating new jobs and upgrading a primitive telecommunications system.

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The Irish government, however, chose to rock the boat as little as possible. In 1979, it committed itself to a major capital-spending programme designed to achieve 'state-of-the-art' service. Equally important, in 1980 responsibility for telecommunications services was removed from the Post Office Department and from the civil service and given to an independent entity, An Bord Telecom which, in 1984, was transformed into a self-financing state enterprise, Telecom Eireann. A leading businessman, Michael Smurfit, was appointed to control the new organization, and he immediately secured the services of the senior IBM manager in Ireland as CEO. Together, they set clear, aggressive goals for service levels, debt reduction, and profitability that drove the organization throughout the 1980s.

By 1988, the government could tell the members of the Dail that international service 'had been improved to such a degree that it is now a major contributing factor to present day successes in wooing foreign firms to our shores'. By the end of the decade, Telecom Eireann had established itself as a recognized leader among European telecommunications entities, especially with respect to international services and charges, although the company remained a state-owned monopoly that guarded its privileges jealously.

A major necessary ingredient for the boom of the 1990s now had been put in place. In arriving at this point, the managers at Telecom Eireann had not simply responded to IDA and to their sophisticated, demanding customers in the export-oriented industries. The European Commission was laying out a long-run plan for greater competition in the telecomm sector that Ireland would have to follow. As Smurfit noted in the 1988 and 1989 annual reports, Telecom Eireann could not afford to rest on its laurels but would have to become more flexible in advance of competitive challenges sure to come in the near future.

DISCOVERING THE MAGIC OF THE MARKET

A quite different approach, with spectacular economic results, followed from the one significant step toward deregulation that Ireland took in the 1980s: the breaking of Aer Lingus's near monopoly on cross-channel flights to England. In 1984, the government proposed legislation ▶

to restrict the discounting of air fares in order to protect the state-owned airline. However, it decided at the end of 1985 to take precisely the opposite approach with respect to Ireland–UK routes: it adopted full decontrol of both fares and flight frequencies.

The impact of Ryanair's subsequent entry into the market was dramatic: its unrestricted fare of IR£95 amounted to a 54 per cent reduction from Aer Lingus's IR£208. Advanced fare purchases gave travellers a saving of as much as 75 per cent. The overall market expanded dramatically: passenger volume on the Dublin–London route increased 65 per cent between 1985 and 1987, in contrast to growth of only 3 per cent between 1980 and 1985. Sea fares between Ireland and the UK were also affected, falling 40 per cent in real terms between 1987 and 1995 and thus generating a substantial increase in marine travel.

The broader economic impact of deregulation was impressive. An Irish government paper estimated that over the period 1987 to 1993, deregulation generated a 60 per cent increase in visitors, additional tourist earnings of £560 million, and an additional 25,000 jobs. English tourists and Irish immigrants in the UK alike responded to the lowered costs of transportation to Ireland; businessmen at both ends found that the cost of developing markets across the Irish Sea had been reduced suddenly and drastically.

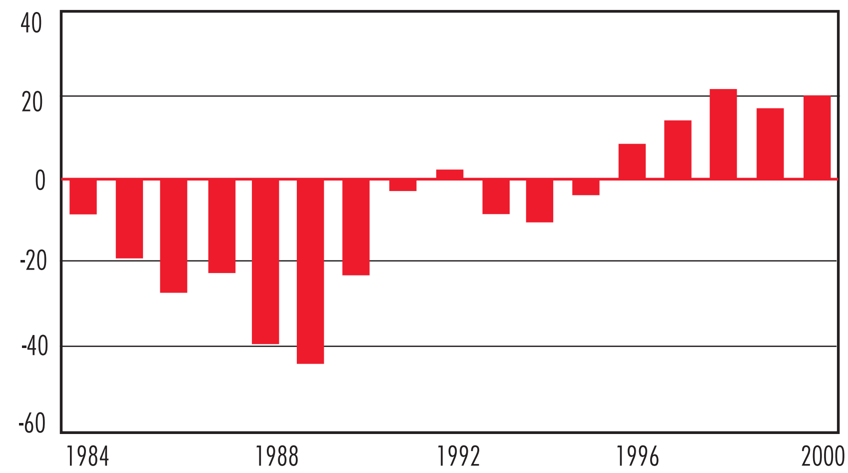
One other important change was taking place gradually during the 1980s: the expansion and reorientation of state-funded higher education. By 1993, the share of science and technical graduates in the 25 to 34 age group of the labour force in Ireland was the highest of the 25 OECD countries. In 1996, 66 per cent of those in the 25 to 34 age group were graduates, in contrast to only 30 per cent of those in the 55 to 64 age group. This change represented an improvement well in excess of that experienced by the average OECD member. The growing percentage of university graduates has shown a similar pattern.

It is important, however, to view changes in the state-run educational system as *enabling* factors in the acceleration of economic growth in the 1990s, not as causal factors.

For Ireland, yearly estimates of net migration provide a graphic picture of the 1990s and a measure of economic performance [Figure 1]. The first half of the 1990s saw a halt to the substantial outflows of the late 1980s. Then, in the second half of the 1990s, for the first time since the early 1970s, a sustained inflow occurred as job opportunities in Ireland became abundant. This change is reflected clearly in the pattern of employment growth. A comparison of Irish growth and the EU average highlights Ireland's exceptional and sustained performance in job creation [Figure 2].

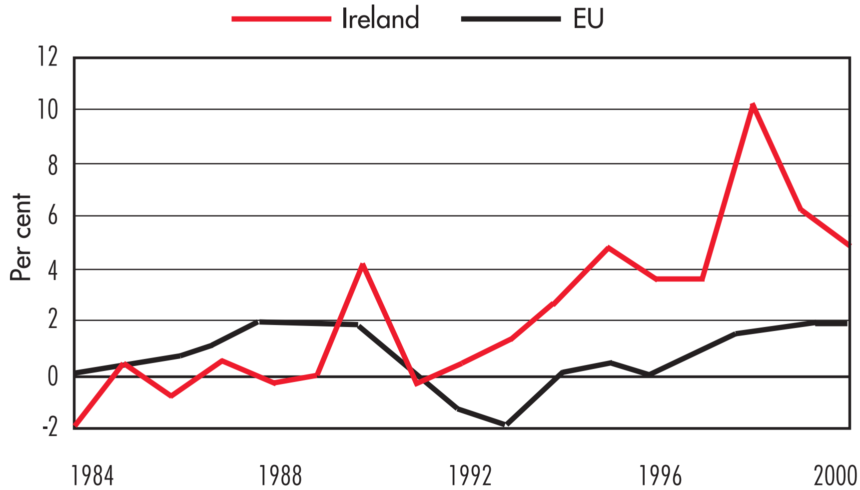
Foreign-owned firms continued to account for the bulk of new job formation in the 1990s, although indigenous firms, particularly in the software sector, also recorded substantial job gains. Surveys by the government business development agency Forfás suggest that nearly 70 per cent of employment gains in the

Figure 1: Ireland: Net Migration, 1984–2000 ('000s)



Source: Central Statistical Office 2001. Data for 1997–2000 are preliminary

Figure 2: Employment Growth, 1984–2000 (% change over prior year)



Source: OECD 2000.

1990s took place in foreign-owned companies. Fifty-one per cent of the job gains took place in internationally traded and financial services. Clearly, Ireland benefited to a disproportionate extent from the US and global investment boom in the computer, software, and telecommunications industries.

SOURCES OF THE IRISH BOOM

It is useful to classify the factors bringing about the Irish boom of the 1990s into three categories: (1) inherited factors, over which the Irish authorities of the past two decades had little near-term control; (2) policy factors, for which the authorities were largely responsible; and (3) external events. It is also useful to distinguish between factors responsible for initiating the boom and those responsible for sustaining it.

Of all the inherited factors, demographic variables probably have been the most important. Extremely high birth rates (by European standards) until recently have made Ireland an exceptionally 'young' country. Previous out-migration also turned into a plus factor as job opportunities, particularly in the high-technology areas, expanded in the 1990s. Trained information technology graduates who had left the country for jobs in the 1980s now returned, in many cases to start their own firms.

A second inherited factor is an attitudinal one: a relative openness to foreign investment, particularly from the United States. Although elements of tension always have been present, Ireland has erected far fewer formal and informal barriers to large-scale foreign investment than most European countries. This openness—along with the legacy of language and a common-law legal system from England—has contributed significantly to a high degree of comfort for investors and expatriate management, especially those from the United States.

Among the policy decisions that have played critical roles in recent Irish growth are four 'structural' initiatives: (1) the early decision to adopt low corporate profit tax rates (and then expand their coverage) to encourage foreign investment; (2) the more recent emphasis on reducing the effective tax rates on individuals; (3) the establishment of the Regional Technical Colleges and the choice of RTC curriculum; and (4) the investment programme and the restructuring of the telecommunications system in the 1980s. Each of these 'supply-side' steps was a necessary precondition for the boom of the 1990s.

A fifth important policy decision affecting the 1990s boom was the significant change in government fiscal policy in 1987, described earlier. That policy was instrumental in reassuring foreign and domestic investors. It provided evidence that the country was not taking the road to a 'banana republic' status.

The impact of the unexpected, whether good or bad, in countries' economic performance is often underestimated. For Ireland, the catalytic event over which policymakers had no control was 'the death of distance', beginning in the late 1980s. This phrase, which first appeared in *The Economist* in 1995, refers to the fact that over a short period of time modern technology (and fierce competition in the marketplace) essentially has eliminated distance as a cost factor for data, images, voice, music, engineering or architectural drawings, books, control of instruments or machinery—anything of value that can be created and 'digitized' or transmitted electronically. The death of distance had a disproportionately favourable impact on Ireland because the country was well situated and well prepared to take full advantage of it. (Recall that 51 per cent of the jobs gained during the 1990s appear to have been in internationally traded and financial services, where telecommunication is a critical factor.)

CONCLUSION

In many ways, Ireland's economic performance in the 1990s can be summed up in the aphorism 'fortune favours the well prepared'. A technological discontinuity, which brought about plummeting costs in telecommunication services, was the chance element completely external to Ireland. Although it seems highly probable that the country would have performed satisfactorily (at slightly better than the 4 per cent growth rates experienced in the 1960s and 1970s) without such an event, it is difficult to see how a rate twice that high could have come about without the direct and indirect impacts of the telecommunication revolution.

Being well prepared to take advantage of this technological discontinuity was largely the happy result of prior decisions centring on education and telecommunication investment, combined with significantly improved government tax and spending policies that encouraged investment and work. These decisions were largely piecemeal and driven more by pragmatism than by a widely shared consensus on redefining the role of government. Historical trends and decisions also contributed to Ireland's propitious preparation: demographic patterns, the legacy of English law and language, and a series of decisions going back to the 1950s that opened the economy to foreign trade and investment and culminated with entry into the Common Market in 1973.

In short, Ireland serves as a valuable case study to illustrate how large the payoffs can be from better economic policies in the presence of favourable external factors. The lessons learned may have particular relevance for smaller countries and for regions within larger ones, where the dependence on 'external markets' is extremely high and monetary policy in large part is determined elsewhere.

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