

**SYMPOSIUM ON THE ECONOMIC IMPLICATIONS OF PEACE IN  
IRELAND**

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**1. INTRODUCTION**

Contrary to the impression conveyed by the rather ambiguous title of this evening's symposium, Ireland (the "South") has effectively been at peace since the end of the Civil War. Northern Ireland (the "North") is just starting to emerge from twenty five years of civil unrest and is only now experiencing a renewal of the social and economic normality that the South has already broadly enjoyed for over seventy years. Consequently, the implications of the recent Northern cease-fires are major items on the Northern economic policy agenda. A minimalist view would be that, in narrow and purely economic terms, the consequences could turn out to be more marginal for the South, however important we feel they may be in political terms. More optimistically, the Northern peace could provide a vital opportunity for a fundamental rethink about many aspects of our island economy, North and South, and a realistic opportunity to address and solve perennial problems.

As we begin to explore the economic implications for this island of *Frameworks for the Future*, we do so in the full knowledge that the preservation of peace is bound up intimately with the capability of politicians to put in place new acceptable political and political/economic institutions in Northern Ireland, with associated mechanisms to ensure harmonious relations among Britain and the two Irish regions. The design of these institutions will tax the abilities and skills of the political actors in the drama currently being played out.

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Does continuing political uncertainty matter as we try to foresee the economic benefits of the Northern peace for the island at large? Could it not be said that since Ireland and the United Kingdom are in the European Union, the benefits of the Single Market and moves towards EMU will facilitate international economic activity to such an extent that national frontiers will become irrelevant in purely economic terms? Even ignoring the acrimonious debate on EMU that is currently taking place in Britain during the run-up to the Inter-Governmental Conference in 1996, it would be naive to expect a resolution of the economic problems of this island to come about as an uncontroversial by-product of European unification. The principle of subsidiarity operates here, and we must seek local solutions of our own political economic problems.

From the tangled web of the Northern debate, two key issues can be isolated. First, the consolidation of the Northern peace is intimately bound up with the design of political institutions that are acceptable to the people of Northern Ireland, taking into account the responsibilities and duties of the British and Irish governments. Here, economic arguments, while not irrelevant, have limited persuasive power, and are almost completely absent from the Framework document<sup>1</sup>. Second, from among the range of feasible political/institutional frameworks that could possibly emerge as the Northern peace is consolidated, is there a preference or ranking in terms of potential economic benefits to this island and Britain? Here economists may have something to contribute, even if we fall short of being the "profession of hope"<sup>2</sup>.

In our paper, we will first set the scene for the post cease-fire economic possibilities by briefly examining what we refer to as the "lost" years since the start of open conflict in the North in 1969<sup>3</sup>. Although economists of nationalist and unionist hues are likely to interpret the historical North-South socio-economic record with differing degrees of emphasis, nevertheless the facts tend to speak for themselves in a relatively uncontroversial way and point generally to the desirability of more imaginative policy experimentation in both parts of Ireland<sup>4</sup>.

We then attempt to address more controversial matters and explore three interrelated possible post cease-fire scenarios of peace, that differ in their assumptions concerning North-South economic policy interactions and North-South institutions. The first is the case of peaceful but separate development, or the economic *status quo ante*. The second is the case of North-South co-ordinated development, where limited forms of political/economic co-operation are put in place. Finally, we attempt to conceptualise the case of a single island economy, borrowing and re-defining a term used in a more restricted context by Sir George Quigley in his address to the CII in 1992 (Quigley, 1992) and elsewhere (Quigley, 1993). For each scenario we try to explore the implications for a range of important issues, such as public finance/expenditure, transitional aid, investment and employment, and island synergies.

We conclude with a more speculative view on likely economic developments on this island. In reflecting on this material we had in mind the admonitions of Mr Haughey to economists in general, and to Sir Charles Carter and Professor Loudon Ryan, in particular after their presentations to the New Ireland Forum on September 21, 1983. Mr Haughey complained that economists "could not formulate for us in this Forum a prospect of an all-Ireland economic entity capable of developing its own inherent dynamic for progress provided the political structures are right". This was hardly surprising, since at that time - late 1983 - the economic health of the peaceful South was a troubling issue on peoples' minds for reasons entirely unrelated to the Northern conflict! Perhaps in these more peaceful and confident times the exploration can be more imaginative and free-ranging, the questions can be franker, and the answers need not be so pessimistic?

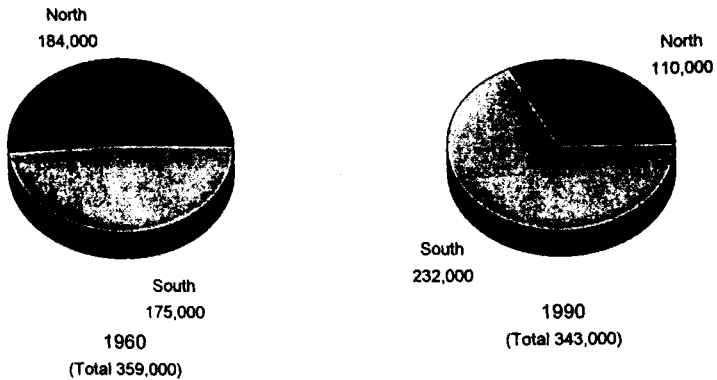
## **2. LOST YEARS: CONSEQUENCES OF NORTHERN CIVIL UNREST**

Politics and economics were interrelated at the foundation of Northern Ireland, since the spatial distribution of the two main communities on the island was mirrored by a similar spatial division in economic orientation and specialisation - a largely agricultural South and a more industrialised North. In planning the island's future, it is essential to understand the historical origins of the present-day economic problems of Northern Ireland, particularly the dramatic change that came about during the last three decades. Cutting through subtle detail, four inter-related issues stand out: the decline of Northern manufacturing; the massive expansion of the Northern public sector; structural unemployment problems and chronic regional trade deficits.

The high level of Northern industrialisation relative to the more agricultural South was both a visible sign of economic superiority and increased the likelihood of Northern self-sufficiency within the United Kingdom. As Figure 1 shows, there were more people employed in manufacturing in the North than in the larger South, even as late as 1960. During the 1970s and early 1980s this position changed dramatically, for a variety of reasons: the wider decline of older "sunset" industries in the United Kingdom and elsewhere (see Figure 2); wider economic troubles in the slow-growing UK economy, the consequences of which were exacerbated by the continuing very close links between the North and Britain; the restricted scope for regional fiscal and development policies compared with the more autonomous South; side effects of civil unrest, particularly the inability to win a sizeable share of US direct investment.

Figure 1

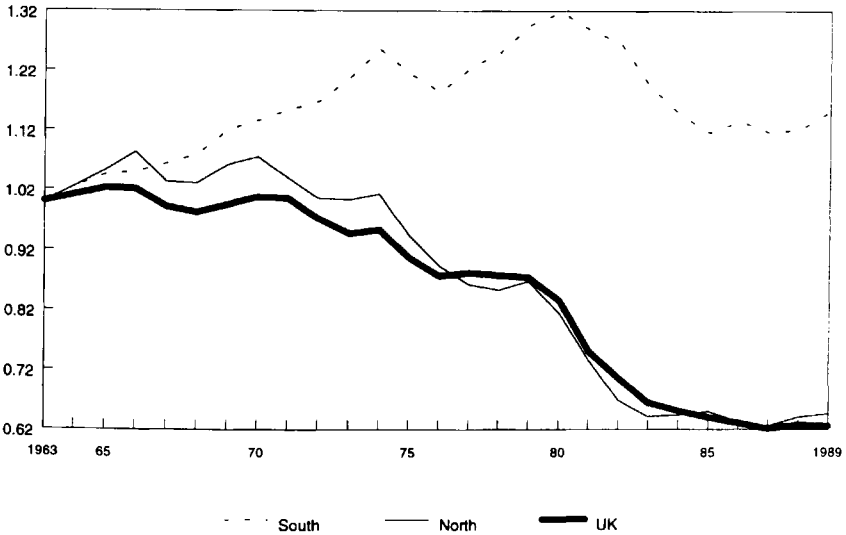
## Size of Manufacturing Sectors Employment, North and South



As the Northern manufacturing sector contracted, much of the slack was taken up by expansion of the public sector, with knock-on benefits for the market service sector and the smaller non-traded subset of manufacturing<sup>5</sup>. Combined with post-Stormont decisions to provide social and other public services to the North on the basis of "need" relative to British norms, and with escalating security expenditure, the pattern of previous decades of moderate regional public sector deficits was broken and Northern Ireland shifted to a situation of chronic structural deficits that amount today to some 25 per cent of Northern GDP (Figure 3)<sup>6</sup>. If Northern policy makers remain indifferent to the size of this deficit, and regard the subvention as an enduring aspect of their economy, then the Province risks becoming trapped in a Mezzogiorno-like problem of permanent dependency (CEC, 1993).

**Figure 2**

**Employment in Manufacturing**  
Index: Base 1963=1.0

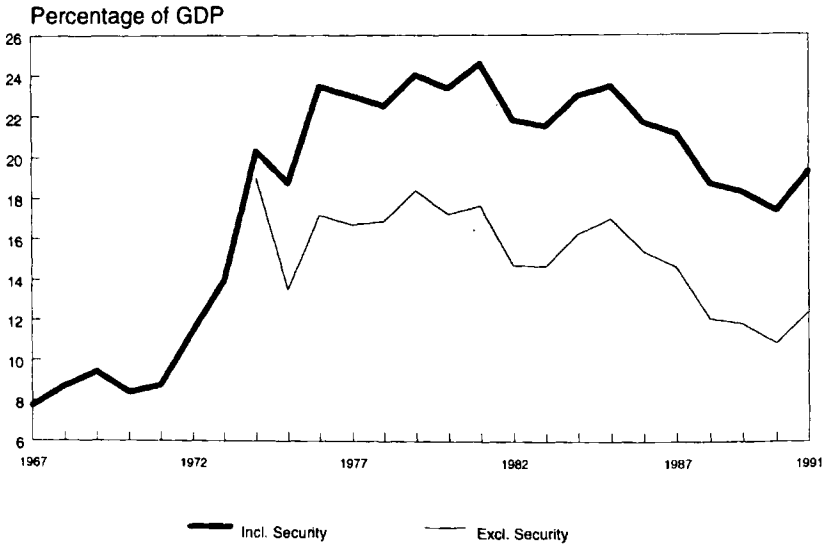


The deterioration of the Northern labour market in the late 1970s and during the 1980s was paralleled by a similar deterioration in the South, where employment over-shooting after the fiscal expansions of the late 1970s merely delayed the inevitable retribution. In both regions a serious problem of structural long-term unemployment has emerged (Figure 4). Economic studies in the South indicate that unemployment rose initially as a result of world recession, raised taxes and population growth pressures (Kennedy, 1994). Sociological studies show that a key characteristic of long-term unemployment is low skill levels, and that working class marginalization arises from the rapid and uneven nature of class transformation in Ireland and changing patterns of emigration (Breen et al, 1990; Whelan, 1995).

These factors clearly operated in the North as well, but were overlaid by "community" and "location" factors in unemployment experience whose interpretation has been an area of great controversy in Northern socio-economic research (Whyte, 1990; Murphy and Armstrong, 1994; McCrudden, 1995). The fact that a Catholic male is almost 2.5 times more likely to be unemployed in the North is not necessarily associated with past or present discrimination, but certainly does direct attention to a serious Northern socio-economic problem of complex origins that has been at the heart of the Northern civil unrest.

**Figure 3**

**Northern Ireland Subvention**

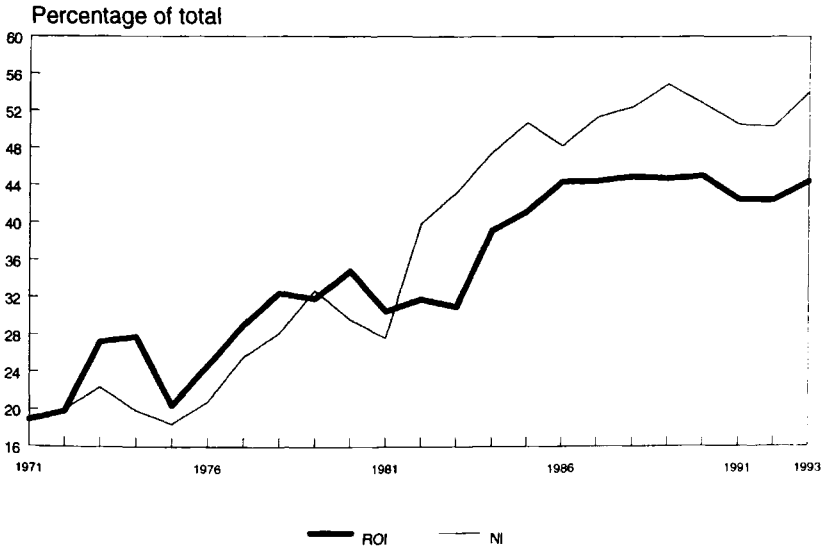


The Northern regional public sector deficit, as manifested in the need for ever larger subventions, served to sustain a high level of public and private consumption, public investment and imports. A corollary was the emergence of a chronic trade deficit that became difficult to quantify after 1974 when the publication of Northern trade statistics was discontinued (Figure 5). However, the trade deficit is believed to amount to between 20 and 25 per cent of regional GDP (Bradley and Wright, 1993)<sup>7</sup>. The South had embarked on a similar expansion of public expenditure in the late 1970s and early 1980s, but without the benefit of free external finance. The subsequent economic costs of restructuring were massive, but were eased in the latter part of the 1980s by a boom in the world economy (Bradley, Whelan and Wright, 1993).

Given the massive injection provided by the subvention, the financing of the trade deficit was not a problem for the North. However, the existence of the trade deficit may also be linked to a more underlying problem in regional competitiveness, that is associated with such factors as the sectoral coverage of Northern manufacturing, the continued concentration on the British market, and close links between British and Northern wages and costs (Borooah and Lee, 1991). The experience of the South in emerging from a similar case of twin deficits during the 1980s may hold interesting lessons for future Northern recovery.

Figure 4

Long-term Unemployment (> 1 year)



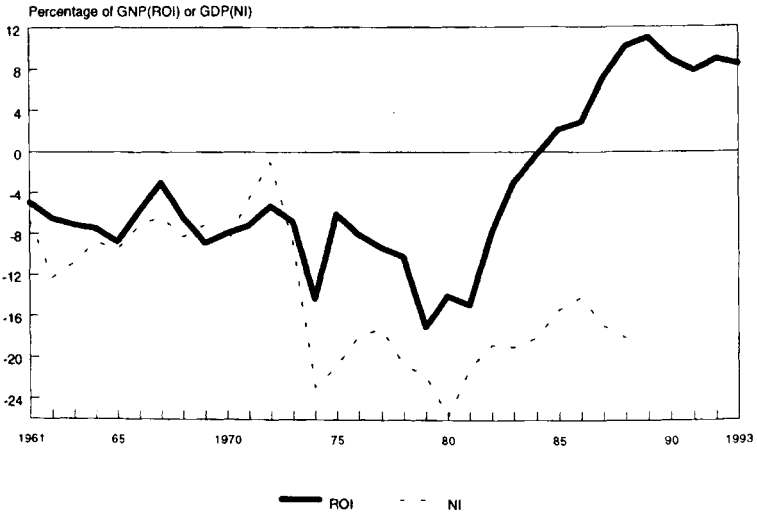
To summarise the historical situation, the picture of the Northern economy that emerges is one where much of the economic prosperity that the Province undoubtedly enjoys is underwritten to a large degree by the British tax-payer. The size of the public sector and the role played by transfers to persons and companies would appear to have engendered a culture of dependence that goes considerably further than its Southern counterpart (NIEC, 1990). Northern attitudes to this dependence take different forms. For Nationalists, such dependence effectively requires that their political aspirations must be worked out in the short to medium term within the context of the United Kingdom. Unionists go further. Dependence for them is both a birth-right from their UK citizenship and a bulwark against any possibility of a "united Ireland", given the inability and/or unwillingness of the Southern tax-payer to take over the subvention and thus sustain the higher Northern standard of living (Cadogan Group, 1992).

History is full of fascinating "what ifs". If Northern Ireland had continued to function under the financial constraints that applied under Stormont, prior to the imposition of direct rule, it is quite likely that the standard of living in both regions of Ireland would have converged during the 1970s and 1980s, to a level below that of Britain and a fortiori below that of the main EU members. We can only guess at the nature of the pressures that might have emerged in Northern Ireland either for

greater policy autonomy along Southern lines or for a negotiated form of full integration into the United Kingdom. We call these "lost years", because the postponed problems are only now being addressed.

**Figure 5**

**Net Trade Balances of Irish Regions**



ESRI-NIERC data bases

### **3. ECONOMIC PROSPECTS: ALTERNATIVE PEACEFUL SCENARIOS**

The present policy context for Northern public expenditure is both different from the South and something of a paradox. The very forces of violence that worked to repress manufacturing employment, inward flows of foreign direct investment and export growth in the North after 1969 were also instrumental in creating the situation of massive inward financial flows from the British exchequer. This financial aid served to improve the level of public infrastructure as well as supporting the wider Northern standard of living. Unlike the domestic and foreign borrowing of the South, the subvention does not generate regional debt obligations within Northern Ireland over and above a notional Northern share of the total UK national debt. Unlike CSF aid to the South from Brussels, it does not even require any explicit level of regional co-finance.

Nevertheless, it is probably the desire of most Northern people that their economy should return to its earlier dynamic self sufficiency and that the subvention will



prove to be a transitional aid to help them through difficult times rather than a permanent feature. If the "troubles" were, indeed, a key negative factor influencing the economy of the North since 1970 then the prospects for a rapid acceleration of growth in the aftermath of peace could indeed be very great as the benefits of the improved infrastructure and human resources, previously unrealised, are exploited by the private sector. This must be a cause of great optimism as political talks work slowly towards defining the political and institutional arrangements that will oversee that recovery. Few regions in history have emerged from civil strife with better infrastructure than they started with!

By contrast, the Southern policy context is still dominated by the positive effects of opening the economy to foreign direct investment, initiated in 1958 by the First Programme for Economic Expansion. This facilitated a process of export-led growth that permitted a greatly increased level of public capital expenditure. Subsequent fiscal policy errors of the late 1970s and early 1980s interrupted this process, had long-tailed negative effects due to the need to reduce the accumulated public debt burden, but did not permanently destroy it. Present public expenditure on Southern infrastructure operates mainly within the context of the EU Community Support Framework, with fiscal policy tightly constrained by the Maastricht criteria. The implied loss of national sovereignty is accepted pragmatically by the majority of people as a trade-off for the benefits of EU and EMS membership.

In order to explore possible implications of a permanent peace in a more concrete way, it will be necessary to hypothesise a range of North-South economic policy and institutional configurations. Such configurations carry with them profound, if implicit, political implications, the treatment of which goes far beyond our brief. Understandably, such detail is absent from Frameworks for the Future. Nevertheless, it is difficult to see how one can seek to identify the principles and key strategies that should inform economic policy responses to the peace process without carrying out such *ex ante* thought experiments, however provocative they may appear to be prior to resolution of more political difficulties.

We identify three broad alternatives for the future economic evolution of the two regions of Ireland in a period of permanent peace<sup>8</sup>.

- (a) Separate development
- (b) Co-ordinated development
- (c) A single island economy

If these alternatives could be specified sufficiently precisely, we could analyse their likely consequences making use of formal economic models of the South and the

North, of the kind developed by the ESRI during over the past two years (Bradley and Wright, 1992a and 1992b). Use of such models would represent an advance over previous simpler "back-of-the-envelope" methods, the conclusions of which can be misleading. For example, most estimates of the implications of a single island economy have greatly understated likely interactions between future peace-time growth of the Northern private sector and the reduction of the subvention, as in the appendix on the economic consequences of a unification of Ireland contained in Cadogan Group, 1992. However, for the moment we must eschew formal quantification in favour of informed qualitative exploration. Quantification is needed, but must come later.

### *Separate development*

Separate development is essentially the institutional situation which prevailed before the cease-fires, with only modest North-South economic interaction and no formal policy co-ordination. It represents the economic *status quo ante* and is the conceptual background for many previous studies of the costs of the Northern civil unrest to the two Irish regions and to Britain (DKM, 1994) and for economic forecasts prepared before the cease-fires (Cantillon, Curtis and Fitz Gerald, 1994; Gudgin and O'Shea, 1993).

Two different costs associated with the civil unrest can be considered under this heading, with their mirror images of potential benefits of peace as these costs are reduced or vanish altogether. First, there are the obvious costs of the violence, in terms of extra security expenditure, together with human injury and material damage, business disruption, etc. Second, there are more hidden costs in terms of previous growth potential not realised: failure to attract enough high technology foreign direct investment; stunted tourism growth; inability to secure cross border sharing-related energy cost reductions, etc. The former costs are not negligible, and were estimated at about £365 per capita annually (in 1989 prices) in the North and £225 per capita in the South (DKM, 1994). However, they are probably overshadowed by the second type of costs, which represent a more direct loss to the island rather than a diversion of public expenditure away from productive activities<sup>9</sup>.

Under the separate development alternative, it is important to correct some misunderstandings about the costs of civil unrest, and the consequential benefits of peace. It is not at all clear how much of the accelerated decline of Northern manufacturing during the 1970s was due to the civil unrest. The composition of Northern manufacturing was such that a serious shake-out was inevitable, and in Figure 2 above we showed that Northern Ireland was merely tracking a UK-wide process of deindustrialisation. However, the inability of the North to substitute "sun-rise" for "sun-set" industries is probably largely attributable to the civil unrest. A comparison with Scotland shows how another deindustrialising region of the

UK, subject to the same macroeconomic policies of the UK government, managed to attract considerable high-technology industry, and created a "Silicon Glen" electronics agglomeration similar to the Irish case (NIÉC, 1992). In this area, success breeds success, and Northern Ireland is a late starter.

Nor can the rise in the Northern subvention be regarded as a "cost" of violence, in this case one to be borne by the British tax-payer. Even if Stormont had survived to the present day, it is difficult to see how a massive rise in net transfers from the other British regions to the North could have been avoided in the absence of a Northern economic boom, with a consequential growth in the Province's tax base. Since the rise of the subvention was partly associated with the onset of the "troubles" and partly with the imposition of direct rule, an important aspect of the UK government's policy as it faces into the negotiations on Frameworks for the Future must be to send clear signals concerning their attitude towards the continuation of these financial transfers into the medium term. In his speech to the Institute of Directors in Belfast on October 21st last year, Prime Minister John Major stated that:

*"We have long recognised the particular needs of Northern Ireland. We have set public expenditure at a level above the UK average, and provided a subvention of over £3 billion last year to finance this. The people of Northern Ireland will get our continued support in the future. We understand that they face exceptional economic and social difficulties. Some will result, indeed, from the transition to peace - such as the consequences for employment of an end to terrorism. I can assure you that the government will take full account of Northern Ireland's special needs in setting future levels of public expenditure for the province."*

What this means is that any savings in expenditure on security are likely to be recycled to other areas, presumably on condition that it can be demonstrated that such reallocation will work towards boosting activity in the private sector in addition to augmenting other areas of the already large public sector. Nevertheless, it may appear desirable to reduce the role played by the subvention and encourage growth of private sector activity. If this is not done, there is a risk that the massive support provided by the size of the subvention will lock the province into a semi-permanent dependency that however comfortable in the short term, can hardly be healthy in the longer term.

Given that changes in demographics come about very slowly, any sustained short to medium-term improvement in the Northern economy could work automatically towards a reduction in the subvention mainly through such mechanisms as higher tax revenue arising from greater activity in the province and a fall in numbers unemployed. However, economic reconstruction and recovery is unlikely to be triggered by reductions in the subvention in isolation from other policy changes.

One would hope that the process of restructuring could take place during a period of strong UK and world growth, similar to the fiscal restructuring that was forced on the South during 1987-90.

Any restructuring of the subvention and its consequences would be of as much interest and concern to the economy of the South as it would be to the North. At present the Northern economy is dominated by its trade, investment and other links with Britain. The Southern economy, on the other hand, has diversified away from a similar dominance during the last three decades and is now more internationally oriented. However, the Southern trade surplus with the North, at about £400 million, is an important by-product of the subvention and sustains Southern jobs.

The crucial issue for the future is whether the previous pattern of separate economic development will continue to be thought to be the best choice for the future, or whether the present modest "arms length" North-South links can be developed to become an additional driving force for mutually reinforcing and beneficial growth in the island economy. Given the complexities, uncertainties and sensitivities involved, there can be no firm answers at this early stage. But enhanced policy co-operation and a vibrant Northern manufacturing sector with strong inter and intra-firm links with its Southern counterpart may be exactly what will be needed to push the economy of this island towards faster sustained growth and prosperity.

#### *Co-ordinated development*

Co-ordinated development assumes an increased level of co-operation in areas such as tourism, cross-border infrastructure and industrial policy designed to attract foreign direct investment and encourage the growth of indigenous industry and services<sup>10</sup>. Such arrangements are envisaged in the *Framework*, albeit introduced somewhat tentatively<sup>11</sup>. However, the fiscal and monetary arrangements in the North will be assumed to continue to be set within the United Kingdom, and thus the process stops short of the notion of island EMU. The *Framework* is silent on these latter matters, presumably because they touch on issues of great political sensitivity, both between these two islands and for Britain's wider relationship with the EU.

To illustrate this assumption, consider how the South manages its economy in a process of co-ordinated development within the European Union. For example, the Southern Public Capital Programme is dominated by the Community Support Framework (CSF), a six-year public investment and aid programme drawn up in co-operation with the Commission and whose performance is monitored by the Commission in association with the Southern public authorities<sup>12</sup>. Southern budgets are drawn up in the context of the Maastricht criteria, and few in the South would complain about the loss of sovereignty involved. Irish ministers, civil servants, business representatives and trades unionists sit very visibly around Brussels tables

where European policy issues are trashed out, and our small size tends to be compensated for by the formation of natural alliances on issues of common concern. Our exercise of national sovereignty reflects a realistic assessment of our lack of economic autonomy, but maximises our cultural diversity.

The principle of subsidiarity would indicate that future North-South policy co-ordination would deal with matters that are best resolved at a local level. Examples include matters that intrinsically concern the island as a unit, such as tourism promotion, planning of physical infrastructure, promoting mutually beneficial business linkages, etc. However, it is more difficult to see such co-operation extending easily to potentially competitive areas such as attracting foreign industry to locate North or South, or to encouraging harmonisation of the wide range of social and educational policies on the island. Finally, the absence of fiscal and monetary harmonisation introduces a potentially serious North-South complication, particularly if the United Kingdom deviates from evolving European consensus on economic and social harmonisation.

Just as the Single European Market and EMU contains an internal logic of further integration, so too a process of North-South co-ordinated development is likely to lead inexorably to suggestions for further harmonisation and policy convergence<sup>13</sup>. Even within the United Kingdom, strains have already emerged due to the higher level of grants offered by the North to attract foreign industry where other British firms feel threatened<sup>14</sup>. It is doubtful if a process of North-South co-ordination could succeed unless all the policy cards were on the table, at least in the longer term.

Under a process of "co-ordinated development", there is no reason to believe that the existing subvention financing of the North would be called into question. Indeed, this option would appear so attractive as a means of copper-fastening the peace that a wide range of direct and indirect benefits could flow to the North, with beneficial spill-overs to the South: US and EU direct aid<sup>15</sup>; island-wide initiatives in the area of industrial promotion; cross-border initiatives to bring the border counties into the economic mainstream; a re-think of island regional policy; the evolution of an enlarged and more demanding domestic market to encourage greater innovation by indigenous industry. There can be few limits to where co-operation might lead, and ultimately the economic fragmentation of this island, however logical it may have appeared in the 1920s, might be reversed, as a single island economy evolves under whatever political structures are freely chosen.

### *A single island economy*

In our concept of a single island economy, we envisage a situation where increased co-operation, over an appropriate time-scale, leads to a virtually complete harmonisation of economic and social policies and institutions where it is found

that lack of such harmonisation imposes costs on the island. No exact analogue to this scenario exists elsewhere, although useful insights can be obtained from the Benelux experience, suitably modified for the Irish situation. Clearly, our notion of a "single island economy" goes far beyond that raised by Sir George Quigley in his CII address. We are driven to deepen the concept because of the critique of Anderson, 1994, who doubts that the more restricted concept could come about without the kind of political movement whose logic would require and facilitate an ever increasing level of economic policy harmonisation<sup>16</sup>.

In light of the present acrimonious debate on European integration that is taking place in the UK, it is doubtful if the above logic of Irish policy integration will find complete favour. But it is not difficult to show that the present Northern policy integration within the UK is not without its problems for the Northern economy. A considerable part of Northern industrial policy is aimed at off-setting the comparative advantage of the South, arising mainly from the ability to set a low rate of corporation tax, and compensating for the greater Northern peripherality within the United Kingdom, with subsidies that are often higher than their British counterparts<sup>17</sup>. Research has shown that blanket subsidy-based Northern industrial aid policies are subject to high dead-weight (Roper, 1993; Gudgin and O'Shea, 1993).

The major factor that could prevent such island policy harmonisation is the large size of the present subvention. Hence, it is legitimate to ask what would be a reasonable period over which, given favourable world economic developments and appropriate transitional aid, the subvention could be reduced to the level, say, of the Southern exchequer borrowing requirement?

An earlier Cadogan Group analysis purports to show that the subvention is a permanent feature of the Northern economy (Cadogan Group, 1992). It isolates four main flows of income into the North, shown in Table 1 for the year 1990.

**Table 1: Main Flows of Income into Northern Ireland, 1990**

Category	£ million	Per cent
Exports of Goods	4125	59
Exports of Tourism and Other Services	450	6
Private Inward Investment	400	6
Subvention	2018	29

The Cadogan analysis assumes a form of "unification" that would imply a complete subvention cut-off of about £2000 million in 1990, and suggests that off-setting increases could arise in the total of the other three inflows of about £500 million. Two scenarios are considered: a "worst case", where higher Southern taxes must be used to finance the balance of £1500 million per annum (in 1990 terms) and a "best case", where the UK phases out the subvention over an extended period. Both are dismissed: the former as economically impossible for the South; the latter as politically impossible, because of "strains within the new united Ireland".

If the Cadogan analysis is typical of the level of economic advice available to Unionist politicians, then it is easy to see why even modest proposals for movement towards all-island co-ordination, to say nothing about a "single island economy", are so vehemently rejected. Indeed, the implicit Cadogan assumption that the North is never likely to return to balance between regional expenditure and taxation is either a damning vote of no confidence in the future of the Northern economy, or a political attempt to deflect attention away from real economic issues and potentials of North-South co-operation.

#### **4. THE NEXT DECADES: ISLAND PROBLEMS AND WIDER ISSUES**

The opportunity of five to ten years of peaceful growth will lead to a complete transformation of the Northern economy, in ways that we should not pre-judge, and which are likely to have entirely beneficial spill-over effects for the South. Any attempt to quantify this process is premature and bound to lack conviction - as does the Cadogan analysis, so we conclude with a heuristic discussion of the possible potentials. There will be peace dividends under all three of the above alternative strategies. Unfortunately, prior attitudes to all three, be they those of Unionists or Nationalists, are likely to become self-fulfilling. Thus, we must expect that the emergence of an economically optimal level of North-South economic policy co-ordination will be highly constrained by existing political and cultural attitudes.

Under all three alternatives, the peace dividend is likely to have four main elements, that are interrelated in a way that will require later detailed and sophisticated analysis. First, the inevitable restructuring of the balance between the public and private sectors in the North, not all of which is security related, is likely to be at worst a zero-sum game, if budgetary savings are recycled as promised by the British Prime Minister. Second, tourism growth seems poised to take off, as the synergies between the two previously isolated parts of the island are about to be realised. Third, a recovery in high technology inward direct investment in the North is very likely, and could be accelerated and mutually beneficial if the South is proactively generous in making its successful experience and contacts available to the North. Finally, the recent dramatic surge in North-South business contacts, and the deepening IBEC/CBI(NI) initiatives, holds out the prospects for developments

and strengthening in the indigenous industrial and service sectors that have eluded us over the past thirty years.

Even negative aspects of the island economy may come to be looked at with more hope. It cannot have escaped attention that since the scale and characteristics of Northern and Southern unemployment have much in common, then perhaps the underlying causes and eventual solutions have much in common as well. In the North, the unemployment has a regional dimension that coincides partially with the community divide. Policy in the South appears to have been more successful in addressing regional imbalances, in particular the dispersal of foreign plants throughout the country. Similar policies were operated in the North, but there are differing views about their efficacy (Wilson, 1989).

The crucial issue for the future is whether the present modest "arms length" North-South links can be developed to become an additional driving force for mutually reinforcing and beneficial growth in our island economy. Given the complexities, uncertainties and sensitivities involved, there can be only modest optimism at this stage. But why do we have to await the final outcome of the political talks before specific North-South initiatives are launched?

Where, for example, are the official reactions by the Northern and Southern public authorities to the imaginative IBEC/CBI(NI) East Coast Corridor initiative? Why has there been a long delay in implementing the new INTERREG programme? Has the geographical border become a border of the mind that is preventing the explosive growth of information interchange along the electronic highway? Why has it proved so difficult for Irish community and local initiatives to diffuse North-South tensions and bring to bear the wealth of experience and initiatives that were so impressive in the Opsahl Report and in the recent presentations to the Forum for Peace and Reconciliation?

If progress at the highest political level is so difficult to make, why are our decision-making structures so hostile to a measured devolution of power and responsibility down to the local and community level, where those who most suffered and paid the costs of the violence and political posturing of the last three decades seem to paradoxically be the most willing to move on to new co-operative agendas. Just what do we have to do to start the process of practical co-operation and re-generation now?



## Footnotes

1. However, the British exchequer will not be indifferent to any Northern political institutional arrangement, so public finance issues will be important.
2. In their presentations to the New Ireland Forum, Sir Charles Carter and Professor Loudon Ryan avoided passing judgements on the relationship between political institutions and economic performance, other than to assert that "policies that are appropriate for the North are those which are appropriate for the South" (New Ireland Forum, 1983, page 41)..
3. A more detailed examination of the "lost" years can be found in an earlier paper read to the Society (Bradley and Wright, 1993). The present material is a somewhat blunt summary.
4. For a balanced and persuasive statement of the Unionist interpretation of Irish economic and other issues, in particular a critique of the New Ireland Forum approach, see Wilson, 1989.
5. The good performance of the SME sub-sector of manufacturing in Northern Ireland during the late 1980s, as documented in Hart et al, 1993, may be due in large part to the injection of external finance from Britain, with its role in underpinning Northern living standards. The southern SME sector had no such lucky break and suffered badly during the fiscal restructuring of the late 1980s.
6. Northern Ireland, from its foundation in 1920 until Stormont was prorogued in 1972, was a largely self-governing region of the UK and was both expected to finance its own regional public expenditure and make an additional contribution to the national exchequer. In practice this level of financial independence proved impossible to sustain and a series of special arrangements were made that gradually permitted Northern expenditure to exceed local revenues.
7. The South currently enjoys a trade surplus with the North of some £400 million, a case of beneficial spill-over from the Northern subvention.
8. If the Northern civil unrest were to resume, the first alternative, "separate development", would very likely be the only feasible option, continuing the previous historical pattern of North-South minimalist interaction.
9. In a Keynesian world of spare capacity and sticky prices, even "unproductive" public expenditure can provide wider economic stimulus through the regional

multiplier. Econometric research indicates that the Northern fiscal multiplier is higher than the Southern (Bradley and Wright, 1992b).

10. Although not defined by him in a precise way, the use of the term "single island economy" by Quigley, 1992, would probably be better thought of as a case of "co-ordinated development" in our terms. The economic logic of "co-ordinated development" is increasingly seen by the business community, North and South, as a logical and efficient way of exploiting the strengths of the island's human and physical resources.
11. "Again, by way of illustration, the Governments would make proposals at the harmonising level for a broader range of functions, clearly defined in scope .....", *Frameworks for the Future*, paragraph 32.
12. It should be stressed that direct aid under the CSF, at about £1 billion per annum, is less than one third the size of the annual Northern subvention.
13. The relationships between the federal and regional levels of government in a country like Belgium shows that a limited degree of heterogeneity can persist in areas such as education, cultural affairs, industrial promotion, etc.
14. The recent controversy over a Taiwanese textiles plant is a case where the debate has actually led to British textile manufacturers challenging the level of aid through the European Court system.
15. The existing annual Northern subvention is considerably larger than any envisaged specific "peace" aid packages from the EU and the USA. It will be important to maintain balance in the analysis of the impact of external aid to both regions and not permit such analysis to be dominated by the specific marginal additions to aid that will accompany the peace process, however useful this additional aid will be.
16. "... there is no possibility of 'purely economic' integration; and there was indeed an explicit political dimension in Dr Quigley's suggestion that the EC and the British and Irish Governments jointly administer an EC fund for the whole of Ireland", Anderson, 1994, page 65.

"Without significant political and institutional changes, there will be two separate economies and only limited scope for co-operation: 'making a reality of the island economy', contrary to Dr Quigley's 'non-political' posture, is precisely dependent on there being 'political agendas', Anderson, 1994, page 69.

17. During his presentation to the Forum for Peace and Reconciliation on December 16, 1994, the Chairman of the CBI(NI), Mr Doug Riley, drew particular attention to the difficulties created for the North by the South's 10% corporate tax rate.

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## DISCUSSION

**Louis Smith:** In this most useful exercise of charting the effects of peace in Northern Ireland there is one large vacancy - the agricultural and food sector.

When I gave a paper to this Society comparing the condition of agriculture in the Six Counties and the Twenty Six in 1949 a very wide divergence had developed. Even among the Ulster counties, which had been similar before 1922, the North had become more intensive than the Republic. The intensive, small farm, agriculture generating twice as many jobs in food processing as in farming, was vastly more prosperous in the North than in the South.

The peculiarities of the CAP and the Monetary Compensation Amounts reversed price advantage. Some 200,000 cattle a year were smuggled to factories in the Republic; about 10 per cent of the pigs slaughtered in the Republic came from the North.

With 30,000 employed, farming and processing is of major importance to the future economy. It is dependent on Government regulation. Do you postulate integration? With open frontiers and variable exchange rates it could again provide a smugglers' bonanza with random impact on food processing.

Taxation is lighter in the UK by a very significant amount (up to 30 per cent difference in take-home pay for some). This should relocate labour intensive industry and services.

The Border cut across areas served by cities and market towns. North Donegal was served by Derry; Monaghan by Belfast rather than Dublin. Will these links be reformed?

There are special cases. The building trades have been busy with the reconstruction of bomb damage. Housing is very modern. Major building projects will be served by large firms. How severely will small builders suffer? Policemen's sons expect to follow their fathers' footsteps. If the force is reduced, say by 50 per cent, through redundancy on peace and the Nationalists claim 40 per cent representation in the ranks, what tensions are expected?

**Bob Curran:** I am puzzled by what appears to be differing attitudes in the discussion to the subvention. On the one hand, it is argued that if the subvention was cut, the Northern Ireland economy would be damaged, and that this would have adverse effects on the Republic also. However, on the other hand it seems to be implied that the subvention, because it allows for a lower level of taxation, both direct and indirect, and a higher level of certain services in the North than in the Republic, gives the North a competitive advantage over the Republic in, for

example, the question of wage levels. Viewed from the viewpoint of the Republic, and of Ireland as a whole, is the subvention a good or a bad thing?

### **The economic value of the subvention**

The notion that the subvention makes possible a lower level of taxation in Northern Ireland than in the Republic, and therefore gives it a competitive advantage in certain respects over the Republic is incorrect, given the existing and likely future institutional arrangements between Northern Ireland and the United Kingdom. The lower tax rates in Northern Ireland are not a result of the subvention, but are a reflection of the fact that as part of the United Kingdom Northern Ireland has the same tax regime as does Great Britain. This situation seems likely to continue indefinitely. If the subvention is cut, tax rates in Northern Ireland seem unlikely to have to increase in order to make up for the shortfall.

The role of local government in Northern Ireland seems to be less than in the Republic. Therefore, if the subvention is cut, there is no obvious mechanism or reason why local taxation in Northern Ireland should have to increase to make up for the shortfall. There may however be increased user charges for some services where such charges are in place.

The likely effect of a cut in the subvention would be a reduction in the range or quality of public services. That might make the competitive position of the North weaker vis-a-vis the Republic. But to the extent that Northern demand for Republic exports fell as a result of a cut in the subvention this competitive benefit would be offset.

The subvention gives Northern Ireland resources which it would otherwise not have. It is hard to see why that access is a "bad thing", in the short run at least. The remark passed in the discussion that the European Structural Funds would have been better used in the Republic to reduce the National Debt instead of undertaking public expenditure programmes does not contradict the fact that those funds are an economic benefit. It simply questions the best economic use that can be made of them.

The question of whether the subvention is a "good" or a "bad" thing may be too simplistic, and the answer may depend on the time horizon one takes, and on the response of economic actors in the North to its reduction. But overall it would seem hard to regard it as a "bad" thing.

None of this addresses the question of the indirect effects of the subvention on the pattern of economic activity in Northern Ireland or of the effects thereon which its reduction would induce. It might be that the subvention has induced an unhealthy level of reliance on State support on the part of economic actors and, that if it were



reduced economic activity might, in some sense, be more “healthy”. But it is not clear that this would be the case. One could be sceptical on a proposition that a deterioration in the quality of public services, or of infrastructure, or an increase in the price of public services would strengthen the “animal spirits” of entrepreneurs in Northern Ireland. Some who now find employment, or profit, in the public sector might be induced to find it elsewhere. But such pressure need not necessarily mean that they would find it. If there are natural, or other strong limits on private sector economic development possibilities, reducing the scale of the public sector will not remove them, particularly if tax rates stay unchanged. It is also debatable whether a deterioration of the kind mentioned would lead to a change in the process of wage determination favourable to economic growth.

### **The feasibility of a United Ireland**

Professor Barooah said that the scale of the subvention makes a United Ireland an unreal prospect. The question is, of course, of theoretical interest, since the framework document does not envisage a United Ireland.

However, it is debatable whether a United Ireland need necessarily be regarded as an unreal prospect in the long run. Professor Barooah’s scenarios under which living standards in a United Ireland would have to be set virtually immediately and indefinitely at either the UK level, or the level of the Republic, or at differential levels, excludes the possibility that over time there could be convergence in living standards. The question of what level convergence would be towards arises. As mentioned later, the difference between the North and the Republic does not now seem to be great. Convergence between Irish and UK standards could come about as a result of a differential in economic growth rates. A “soft landing” over a long period in the UK subvention could facilitate that convergence.

Experience of the unification of Germany comes to mind. There, economic unification was brought about virtually at a stroke. One could debate whether a longer period to enable East Germany to adjust to the economic system imported into it from the Federal Republic would have improved the economic performance of East Germany. However, in that process of unification it was not the case that standards in the East were set at those in the West, nor did the reverse apply, nor was a system of differential living standards introduced for an indefinite period. There are still marked differences in living standards and in unemployment rates between East Germany and the West. How long it will take for them, fully to converge, if ever, is not clear. But convergence would seem to be the policy aim, at least implicitly.

There is one important difference between the unification process in Germany and what would happen in Ireland if there were unification. In the German case the larger, richer area, the West merged with the East, which had much lower living

example, the question of wage levels. Viewed from the viewpoint of the Republic, and of Ireland as a whole, is the subvention a good or a bad thing?

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There is one important difference between the unification process in Germany and what would happen in Ireland if there were unification. In the German case the larger, richer area, the West merged with the East, which had much lower living

standards and a much worse industrial structure and infrastructure. Tax payers in the West are having to bear a heavier tax burden in order to pay for the costs of unification. However, in the Irish case, if the subvention were rapidly reduced or eliminated, and if tax payers in the Republic were to be called upon to bear a heavier tax burden in order to make up for it, the position might be that the lower income area would subvent the higher income area. [The difference in per capita income levels between the North and the South seems to be slight (as measured by GDP per capita, and perhaps GNP per capita, although there are no published GNP figures for the North). But the Northern data presumably reflect the impact of the subvention.] If the same tax system applied throughout the entire Island the Republic would possibly not subvent the North, to any marked degree if income levels in the North were near those in the South. So, as between North and South, the cost burden consideration might not be decisive. But it could be significant as between Britain and Ireland ie the costs of unification would be borne in Ireland; the poorer area would bear those costs.

The German experience is also interesting in that the differences in economic structures, legal and Government systems, economic and market regulation, and patterns of foreign trade, were much greater before German unification than those which now exist between the Republic and the North. Furthermore, the exchange rate dimension was far more difficult. The exchange rate of 2 Ostmark per Dmark used at the time of unification did not reflect the market value of the Ostmark and effectively meant a very substantial overvaluation of the Ostmark. While this conferred purchasing power on East German consumers it made East German industry even less competitive than it already was. In any unification of Ireland such a currency "shock" to either part is unlikely to materialise unless the rate between the Punt and Sterling were to change radically.

It does seem that Germany is managing to cope with these differences, although this is not easy. If the Germans can deal with major difficulties of this kind, one might be hopeful that Ireland too could deal with lesser difficulties of this nature, particularly if there were an extended transitional period, and a "soft landing" on the subvention.

All of this is, of course hypothetical, since, as mentioned above, fast (or for that matter slow) unification on the German model is not in prospect in Ireland.