

**ECONOMIC POLICY AND PERFORMANCE: THE IRISH EXPERIENCE\***

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**PRESIDENTIAL ADDRESS**

This year we celebrate not just the 150th anniversary of the Statistical and Social Inquiry Society of Ireland (SSISI). The session 1997-98 also coincides with the 40th anniversary of the founding of the European Community, and the 25th anniversary of Ireland's accession to membership. As such, it is timely to take stock of the economic effects of the change in policy orientation signalled by the deepening commitment to integration both within Europe and between Europe and Ireland. In so doing, we shall also assess the challenges that the process of globalisation may pose for the Irish economy into the next century.

Some of this ground has already been covered in Professor Kieran Kennedy's comprehensive presidential address (Kennedy 1992). In that paper he discussed the degree to which the Irish economy had converged to European levels of productivity and living standards and he outlined the policies needed if Ireland was to benefit from European integration. But even within the short space of the past five years, new dimensions of integration have come to the fore, and the standing of the Irish economy relative to the European Union (EU) average has altered out of all recognition. Besides, it is becoming apparent that the European integration theme is only part of a much wider trend.

This address is discursive in nature and focuses on broad themes related to Ireland's economic development and Europe. It is divided into five sections. *First* the shift in thinking about economic policy over the past two decades is outlined. The new policy paradigm has been described by some as the Washington consensus, but its origins are only partly attributable to the international agencies in Washington DC and for this reason I call it the New Policy Consensus (NPC). The NPC has three pillars: *competition and the market system; macro-economic stability; and trade liberalisation and openness.*

*Second*, the response of Irish economic policy to the NPC is sketched. Particular attention is devoted to the openness pillar, where Ireland gained first-mover

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advantages. Openness is defined in a broad sense to include free international exchange of goods, services, capital and labour.

*Third*, the reasons for Ireland's adoption of the NPC are analysed. The sequencing of how the different pillars were introduced is an important aspect of this discussion.

*Fourth*, the effect of adopting the NPC on Ireland's economic performance is assessed. Policies of integration are directly linked to the explosive growth of Irish exports, the influx of multinationals, the liberalisation of foreign exchange markets, and the virtual disappearance of the balance of payments constraint and, for Ireland, the novel problem of inward migration.

Finally, the implications of Ireland's adoption of the new policy consensus are explored. An independent Irish government has voluntarily relinquished the use of trade protection and restrictions on foreign investment as an instrument of economic development, the Irish pound is being replaced by the euro, and fiscal independence has been eroded. Meanwhile steps towards even deeper European integration portend further centralisation. Ireland has to a large extent reverted to the small regional economy it was one hundred years ago, except that now Brussels has replaced London at the core of the system. What does this mean for Ireland's future economic growth?

## **1. THE NEW ECONOMIC POLICY CONSENSUS (NEP)<sup>1</sup>**

*A successful strategy for growth requires openness toward international trade, macroeconomic stability, and limited government intervention in the economy.*

(International Monetary Fund (IMF) 1997, p. 92)

The NEP involves policies which can be grouped under three headings: *competition and the market mechanism*, *macro-stability*, and *openness*.

*First*, there is increasing emphasis on *competition and the market mechanism* to achieve economic objectives. Drawing on the belief that markets perform efficiently only if there is competition, competition law is being strengthened in many countries. Its range of application has been extended to hitherto "protected" sectors in telecoms, transport, energy and postal services. Rights to establish, to provide services and to tender for public contracts (public procurement) have been greatly extended. Trade unions too have found their monopoly power challenged. There is emphasis on labour market flexibility as being the way to "solve" the unemployment problem. Capital markets have also been dramatically influenced by, as well as influencing, the evolution of policy. Financial markets, from stockbroking to building societies and banks, have been liberalised, and long-established distortions between different types of financial institutions are being removed.

Policy-makers have become more conscious than ever of the distortionary effects of the tax system on the behaviour of economic "agents" in their role as buyers and

sellers, savers and investors, employers and employees. Greater tax uniformity and tax “neutrality” between different types of economic activities has become an important fiscal objective in many countries. Enterprise is being subjected to fewer regulations and lower tax rates. High marginal tax rates have been cut, because they blunt economic incentives and generate unproductive service activities (tax avoidance). In general, the efficiency aspect of taxation is being given priority over equity aspects. The NPC has proved a marvellous decade for the rich; but advocates of NPC policies would immediately add that this does not imply that it has been a bad decade for the poor.

Lower taxes means “smaller” government. The share of government spending in national income in the EU is 49 per cent, compared with 37 per cent in the US and 33 per cent in Japan. Prior to the First World War, government spending was below 20 per cent in the UK, Germany, France and Italy. The need to reduce these figures led to the programmes of privatisation and deregulation which are now universally commonplace. Also the public sector is being subjected to market-type disciplines through tendering, charging for public services, out-contracting of services and the extension of managerial accountability to government departments. Market mechanisms are being used in preference to regulation as a way of achieving policy objectives.

*Second*, the objective of *macro-stability* has replaced fiscal activism as the primary focus of macroeconomic policy. Macro-stability refers to low inflation, sound government finances, and a stable exchange rate regime. A core feature of NEP is the identification of price stability as a central objective of policy, not just a desirable ‘extra’. Central banks have been given the responsibility for price stability, and legislation has been enacted, where necessary, to ensure that the monetary authorities have the degree of independence of political control needed to carry out their remit. The constitution of the European Central Bank, with its emphasis on price stability as the primary objective and the independence of the Bank’s Board, is a perfect example of the new thinking. Another example is the conferring of monetary policy independence on the Bank of England by Britain’s new Labour government in 1997. Exchange rate policy has also been subordinated to this objective. Many smaller countries have tied their currencies to larger low-inflation currencies as a way of maintaining price stability (e.g. Argentina to the dollar; Austria, Bosnia, Estonia, among others, to the Deutschmark).

Another key element in a macro-stability package is a commitment to low budget deficits. European fiscal policy in the 1990s has been dominated by the fiscal constraints of the Maastricht criteria. The emphasis on macro-stability has been motivated by pragmatic considerations. Vigorous use of counter-cyclical policies led to more deficits than surpluses and to rising public debt/GNP ratios. This involved higher debt servicing costs, which in turn led to higher taxation and related structural distortion. A high debt/GDP ratio also arouses fears that a government may be tempted to alleviate the burden of its fixed interest debt by “inflating” its way out of the debt problem. The financial markets demanded an increasingly high interest rate

premium to compensate for the risk. This risk premium had adverse implications for investment and long term growth.

In a presentation to President-elect Clinton in 1993, Professor Alan Blinder predicted that a deficit reduction programme would, by bringing about a reduction in interest rates and enhancing business confidence, result in a 1 per cent *increase* in the United States' standard of living after four-years<sup>2</sup>. As a country's debt ratio rises, the potential expansionary effect of fiscal expansion diminishes and the potential contractionary effect of stabilisation diminishes<sup>3</sup>.

The accumulation of public debt and the growing sophistication of markets have made demand management policy more problematic and less effective. The rise of government spending, once so effective in easing the unemployment problem, ended up by accentuating it. This is a fact of life. It is not necessarily a "good" development for the world economy. The belief that counter-cyclical policy did work, and could be applied, kept business confidence and investment high for many decades. "Thinking made it so" - the belief that the economy would never be allowed to slide into depression - ensured that depressions were avoided. Witness the sustained growth of the post-war economy and the reduced amplitude of business fluctuations during this period.

*Third*, national policies have become *more outward-looking*, as evidenced by the completion of the Uruguay Round, the increasing membership of the World Trade Organisation (WTO), the relaxation of controls on capital mobility and the more benign stance towards foreign investment. Since the 1980s, a virtual revolution in trade policy has taken place, as one country after another replaced import substitution policies by trade liberalisation and export orientation. Over 120 countries signed the Uruguay Round agreement in 1994.

Significantly, poorer countries are now leading the movement towards a more liberal world trading system. Mexico pushed as hard to achieve the North American free trade agreement (NAFTA) as the US (though its GNP per person was ten times higher), and several other South American countries are anxious to join. Likewise the eastern and central European countries have concluded free trade agreements with the European Union and Turkey's low income per head did not deter it from participating in a customs union with the European Union.

Several features of the policy revolution described above merit attention. First, the NPC has been adopted not because the principles of economics have changed but because, over time, we have learned more about the correct policy inferences to draw from them.

Second, the global reach of the NPC is remarkable. In Europe and North America, the key turning points were the policy reforms of Mrs Thatcher and Mr Reagan in the first half of the 1980s. New Zealand and Australia adopted even more radical pro-market policies. In South America, Chile took dramatic policy initiatives during

the 1980s, and Chile's example was to be followed by Mexico, Columbia, Argentina, and Brazil. In Asia, the much publicised success of the four 'Tigers' (Hong Kong, Singapore, South Korea, Taiwan) goaded India into embracing a reform package in the early 1990s involving use of market incentives in domestic labour and product markets, openness to trade and foreign investment, and fiscal stability<sup>4</sup>. China too has become more conscious of the need to use market mechanisms.

Third, the three pillars of the NPC are closely interdependent. A well functioning market system requires prices that can act as reliable signals. But the signalling function of prices requires low inflation and tight control of government finances i.e. macro-stability. Also competition, especially in small economies, will flourish only if there is a high degree of openness. And openness will deliver benefits only in the context of stable domestic prices, exchange rate convertibility and realistic exchange rates.

## **2. IRISH ECONOMIC POLICY AND THE NPC**

Ireland has been affected as much as other countries by the new consensus. However, the sequencing of its adoption of the NPC is distinct from other countries. Irish policy makers were quick to see the merits of openness, slower to appreciate the importance of macro-stability, and patently sluggish in recognising the importance of competition and the market system.

### *a) Openness*

Irish policy makers were early converts to openness. The conversion process began in the fifties following the publication of Whitaker's *Economic Development* (1958). The history behind this change from protection to free trade is well known and need not detain us here. The sequencing of liberalisation, as between goods, services and factors of production, however, is a comparatively neglected topic.

Openness was first applied to trade in goods. Foreign investment was initially seen as a means of attracting industry to Irish regions where indigenous industry had shown no inclination to invest. Only gradually did the policy of attracting foreign investment extend into a fully-fledged national policy.

Portfolio capital movements were not liberalised until the late 1980s and then only under EC pressure. There was concern about the implications of the export of capital from Ireland. Such capital, it was argued, had it not been exported would have been invested in Irish business. Little attention was given to the possibility that liberalisation might encourage capital inflows as well as capital outflow. This is strange because, as Philip Lane has shown, capital markets tend to view open economies as a better credit risk than closed economies. A more open Irish economy therefore would in theory have been able to borrow more easily and cheaply than as a closed economy (Lane 1997). This superior access to foreign capital raises the

investment/GNP ratio and leads to higher growth - the “credit channel” gain. However, this potential was unlikely to be realised in the absence of macro-stability. Given the Irish government’s precarious financial position and the alarming balance of payments deficit through much of the 1970s and 1980s, some caution towards the benefits of free capital mobility may have been justified.

Liberalisation of services trade scarcely appeared on the agenda during the “openness” debate. Such liberalisation as took place happened mostly because of external forces, notably the European Commission and the Uruguay Round. The tendency was to regard the opening of the domestic market for services to foreign competition with considerable misgiving. Yet, in retrospect, liberalisation of the services sector under the 1992 Single Market Programme was to have a major positive impact on our economic performance.

The last component of openness, labour mobility, evoked a rather unbalanced response. Irish policy stridently demanded for free access of Irish labour to the markets of the UK and the US, but at the same time demonstrated a tendency to shed crocodile tears about emigration and its alleged adverse effects on the domestic economy. That Ireland would one day become a host country for inward movements of internationally mobile labour would have been considered a very outre idea until a few years ago.

#### *b) Macro-stability*

Up to the 1970s, the openness strategy was accompanied by macro-stability. Indeed one was seen as essential to the success of the other, in so far as fiscal restraint would help to maintain equilibrium in the current balance of payments. Unfortunately, once that policy was changed in the mid-1970s (following the oil crisis, and not without some economic justification), it proved difficult to put the genie back in the bottle. Fiscal policy became a source of serious destabilisation of the Irish economy for 15 years afterwards. The budget deficit, inflation and the balance of payments deficit moved into two digits<sup>5</sup>. The public debt/GNP ratio reached a peak of 130 per cent in 1987. By that time, every canon of macro-stability had been spectacularly breached and the Irish economy had come close to financial disaster. It is difficult now, only ten years later, to realise just how serious the problem had become.

The fiscal reforms implemented over the past ten years are by now familiar. Budget balance was restored. The debt ratio was stabilised and then reduced. The process of adjustment relied primarily, but not exclusively, on curbs on government expenditure, a key ingredient in the success of the new policies. The fall in oil prices during the 1980s and stable prices in Ireland’s major trading partners assisted the reduction in inflation to single figures. By the end of the adjustment period, Ireland had been transformed from a conspicuous delinquent in fiscal terms to a model of macro-stability.

### *c) Competition and the market system*

Ireland was a latecomer in policies relating to competition and the market system. One distinctive feature of the Irish approach to policy reform was its reliance on a consensus approach to economic policy and industrial relations. In the case of the labour market, for instance, this meant resistance to many of the staple features of a flexible labour market. By definition, the determination of pay through national agreements means that some important market-clearing forces are ruled out. Given the small number of players involved and the interdependence between their decisions, a consensus approach may well have provided a superior outcome in economic terms that which would have emerged from free-for-all bargaining. But the consensus approach probably inhibited efforts to deal decisively with unemployment and poverty traps. It also embedded a certain suspicion of competition and a bias towards increasing government spending than on reducing taxes and in this way affected the time path and the composition of the adjustment process.

The Irish NPC was also influenced by the weight of state ownership in public utilities. The introduction of competition into these markets involved difficult political decisions. Domestic political forces were, with few exceptions, hostile to competition in key services areas. Generally it was felt that competition would hamper state companies from exploiting economies of scale by diminishing the size of their market and inhibit their ability to help lower income consumers or disadvantaged areas of society.

For all that, Irish policy on competition has changed radically in recent years. There has been extensive deregulation in the energy sector, the financial system, transport, and telecom. Competition law has been strengthened and a new Competition Authority was appointed in 1997. One feels nevertheless that many pro-competitive measures were taken less out of conviction as to the merits of the market than as a response to European Commission directives. Ireland is a late and a reluctant convert to the third pillar of the NPC.

### **3. WHY POLICY CHANGED**

Economic policy does not change in a vacuum. It usually changes in response to the perceived failure of past policies. The 1980s was described as “a lost decade” for many economies such as Ireland which were wedded to the interventionist policy regime, “lost” because zero or even negative growth per person was achieved in that period. Up to the 1970s, activist government policies were (rightly, in my view) thought to have been instrumental in setting many industrial countries on a more stable and rapid growth path than ever before. That perception changed after the oil price increases and the resultant slowdown in growth. A major reason for the change in policy in Ireland was what Cathal Guiomard described as “the whiff of economic and civic bankruptcy” (Guiomard 1995, p. 37). Indeed it took the crisis of the 1980s,

with a real fear of a collapse of our fiscal integrity and economic independence, to force a change in policy orientation.

Another crucial factor in the turnaround was the European Community. The Commission was a vocal critic of Ireland's macroeconomic mismanagement, and these criticisms were reinforced at various meetings of Ministers and officials in Brussels. All this was a source of embarrassment. To be hauled over the coals by outsiders is hurtful to national pride. Added to this, the single market programme unleashed a huge agenda of pro-competition measures which were only dimly appreciated when the EC White Paper on the Single Market was published in 1985. The 1992 programme was to have a dramatic impact on the Irish market. The importance of the Structural Funds also has to be underlined. These came with strings attached: monitoring of investment appraisal and adherence to EU market rules of the game.

A policy demonstration effect was also in evidence. Changes in economic policy in the UK and the US had a powerful influence on Irish thinking. I give Mrs Thatcher much credit for Ireland's change in policy orientation. She won the war against the trade unions after a long and expensive battle. Ireland benefited from the resultant shift in attitudes without having to incur any of the costs. By lowering income tax rates, the Conservatives placed pressure on Ireland to do likewise. Britain led the way in the privatisation debate; as a follower Ireland learned some useful lessons, again at zero cost. In this instance, the latecomer, Ireland, gained by "free riding" on the mistakes of first movers.

At a global level, Ireland was influenced by the loss of credibility of the socialist model as an alternative paradigm. The poor record of achievement of the socialist countries gradually became apparent. Even benign versions of socialism, such as the justly admired social market economy of Scandinavia, began to be re-evaluated. All this eventually impacted on Irish opinion, albeit at a much more slower pace than elsewhere. For example, unthinking anti-US sentiment and a naive championing of the socialist regimes in Latin America were the hallmark of church and left-wing organisations in Ireland right into the late 1980s.

Developments in the theory of "government failure" added weight to experience of that failure on the ground. It showed how government intervention considerations could create distortions in the system that were more damaging than the market failure they were designed to correct. Added to this, the potential benefits of fiscal consolidation on growth were also found to be greater than once expected.

This combination of practical experience and theoretical developments induced governments to undertake a radical review of their economic policies. Out of this review, which took place over the most of two decades, came the transformation of Ireland's economic policy regime.



#### 4. EFFECTS OF ADOPTING NPC

Ireland in 1997 is an economy of high-flown growth rhetoric, with more than a tinge of “irrational exuberance”. Concepts such as “jobless growth”, peripheralisation, centripetal tendencies, “dependency”, once were seen as very *ad rem* in an Irish context, have become unfashionable, even embarrassing. The suddenness of this change suggests that a note of caution is in order. Booms do not last indefinitely and the Irish economy still lacks strength in depth. Yet an unprecedented convergence towards European levels of prosperity has indeed taken place. And it has coincided with the new policy regime. An intriguing question is whether adoption of the NPC has caused this change in economic performance.

Finding statistically robust links between policy regime change in a country and its economic performance is difficult. Yet an impressionistic review of the evidence to-date suggests several conclusions.

First, the simple theoretical intuition that increased integration with the world economy is good for small, lower-income countries seems to explain Irish experience better than the more esoteric predictions of new trade theory (Ó Gráda and O’Rourke 1995, pp 223-4). There is virtually unanimous agreement that the early move to trade liberalisation and the open-door to foreign investment was the right policy option.

Second, macroeconomic instability seriously damaged the economy during the 1970s and the 1980s and, by extension, the restoration of stability since then has improved economic performance. A leitmotif of White Papers and official pronouncements on EMU was that Ireland’s self-interest was to restore order to the public debt and budget deficits, irrespective of the need to satisfy the Maastricht criteria.

Third, lack of competition in the services sector damaged the growth prospects of Ireland’s traded and the nontraded sectors, with consequent loss of employment growth. The classical example of this is the effects of deregulating air fares between Dublin and London. Barrett shows that this was associated with a fall in price to one-quarter its original level and a fourfold increase in volume (Barrett 1997). Even allowing for other intervening factors, this is impressive. Thus tourism gained from air fare deregulation, not just the airline business. A series of papers to this Society adds weight to other studies which show the potential gains still to be reaped from greater competition (see O’Rourke (1994), Massey and O’Hare (1996) and Fingleton (1997) among others).

Hence there is, in my opinion, a *prima facie* connection between the adoption of the NPC and the recent upsurge in economic performance. Belief in the importance of the new policy package makes one slightly more circumspect about the argument that attributes Ireland’s economic recovery to the plentiful supply of well-educated young people. Not because the high quality of Irish young people is in doubt, but

because we had a plentiful supply of bright well-educated people in the 1980s, but there were no jobs for them in Ireland. Why were there so few job opportunities in the 1980s as compared with the late 1990s? The most likely answer is that the economic policy environment made it profitable to employ them in the 1990s, whereas in the hostile environment of the 1980s it was not.

The change in policy regime has major implications for the economy. For firms, it will mean widening opportunities, but less safety, as the domestic market becomes more exposed to competition. For employees, it will mean higher productivity and higher salaries for those able to adjust to the new system. But alongside this, there may be less job security and for many longer working hours. Governments will be smaller, and safety-nets less all-encompassing and less readily provided. There may well be some widening gap between rich and poor individuals (though household income is a different matter), such as is already evident in market economies most advanced in the reform league such as Britain, New Zealand and the United States. Against this, the new policy regime will make the labour market more flexible and, in the process, removing some of the major causes of unemployment and perhaps also increasing upward mobility.

## 5. IMPLICATIONS FOR THE FUTURE

### *Policy Dependence in the EU*

The NPC has been accompanied by a radical re-appraisal of the role of government and the meaning of economic autonomy in a globalised world. Is there a sense in which Ireland has reverted to its position at the turn of the century? But, instead of policy being determined in London, it will now be determined in Brussels and Frankfurt. The prevailing justification for this state of affairs, then as now, that what was good for the centre was also good for Ireland.

From the Act of Union in 1801 to Independence in 1922, economic policy was uniform across the British Isles. Although the scope of economic policy was vastly more limited at that time, the absence of policy autonomy provoked critical reaction from the nationalist community. Without such autonomy, it was argued, Ireland would never be able to enjoy a prosperous industrial sector. “*A neglected and mismanaged portion of a great estate...*” is how one former President of the Society, and frequent contributor, Joseph Todhunter Pim described our predicament in 1899 (Pim 1899), while another luminary of this Society, Charles Oldham (1924-26) complained in 1900 that “*for many a long year, Irish men have felt themselves like a sleeping partner in a business which was being run at a loss by the other partner, which had only an indirect interest in the business*”. Another grievance was that British tax law meant that Ireland was unfairly taxed. Taxation of tea, tobacco, and whisky impacted disproportionately on the Irish consumer relative to the wealthier British consumer. To many economists and politicians, Ireland’s participation in the United Kingdom and in the greater British Empire was seen as detrimental. Hence

the question: is it conceivable that Brussels might one day be viewed in the same way as London was in the past?

Ireland of the 1990s bears some resemblance to Ireland of the 1890s. We embrace the same principles of free trade and free enterprise. As Ireland's commitment to the EU grows, its capacity to exercise independent policy discretion lessens. The EU pervades every facet of economic policy. The scope for independent action in agriculture, foreign trade, tax and competition policy, environment management and countless other policy areas has been eroded. EMU heralds not alone the end of independent monetary policy (a country whose population is about the size of a European capital is unlikely to carry much weight in a future European Central Bank), but also severe constraints on future fiscal policy. The Stability and Growth Pact places limits on the size of budget deficits for countries adhering to the monetary union. In a celebrated statement, a former President of the European Commission, Jacques Delors, once remarked that on completion of the single market over 80 per cent of economic decisions affecting a member state would be made in Brussels.

*The scope for independent policy action*

But not all independence of action will be abandoned after EMU. Scope for domestic policy initiatives will continue to exist: national wage agreements, science and technology policy, education, health and social welfare will remain substantially national in character.

Take for example the three factors identified by the OECD *Economic Survey of Ireland* as key to the current strength of the Irish economy:

- sound fiscal and monetary management;
- an excellent incomes policy guaranteeing continuing wage moderation;
- existence of positive supply side factors such as a substantial inflow of direct investment, a favourable tax regime, and the existence of a highly qualified but relatively "low cost" labour force (OECD 1997, p. 16).

Included in its prescriptions for maintaining future growth are measures such as tax reductions to improve work effort, a revamp of unemployment benefit, rationalisation of public spending on labour market programmes, broadening the second-level curriculum, curbing school dropouts and decentralising control of hospital budgets.

What is striking is that a large proportion of these measures recommended by the OECD will remain under the control of the Irish authorities - apart from the obvious exception of monetary policy and the over-arching constraints on fiscal policy. Moreover, the EU interacts with the domestic policy formulation. Ireland participates in Europe's decision-making process and in certain areas can exercise its

veto. Also, the subsidiarity principle requires that decisions should be taken at the point where it is most efficient to do so, whether at a local, national or European level. Under this principle, the Commission legislates only where action is most effectively taken at a European level. Arguably, the existence of the subsidiarity principle is one of the defining differences between the Ireland of the late nineteenth century as part of the United Kingdom, and the Ireland of today, as a voluntary member of the EU.

## 6. CONCLUSIONS

The Irish economy has attracted intense international interest over the past decade. Given the small size of the economy, this may at first appear surprising. Yet it is precisely because of its small size that the Irish case is so interesting. Irish experience brings us to fundamental questions about the ultimate constraints on growth in a context where, because of EU membership, there is an unlimited supply of capital, elastic supplies of labour from home and abroad, and unimpeded access to the world's richest market. One might ask what could hold growth back in such a world, rather than what could make it happen?

This paper argues that Ireland's economic success owes much to the adoption of the new economic consensus. Irish economists and policy-makers have bought into this consensus, at first tentatively and then with enthusiasm. The Irish government was an early convert to the free trade and foreign investment component of the new consensus. The IDA was rolling out the red carpet to foreign investors in the 1950s at a time when most other countries were rolling out the red tape; we have been enjoying "first mover" advantages ever since. Acceptance of the importance of the second pillar of the consensus, macroeconomic stability, had a rockier journey, at first accepted, then abandoned, and then restored. Standard economic models did not help matters by showing, wrongly as it turned out, that reductions in the budget deficit would lead to reduced output and higher unemployment. The decisive turn in policy came in the late 1980s<sup>6</sup>. Finally, Ireland proved a definite latecomer to the third pillar, competition and the market system. Not only a late convert, but a reluctant one too. Yet, paradoxically, it is in the market services sector that most jobs are being generated. The opening of these service markets to competition has led to employment expansion, not employment contraction as was feared.

The Irish economy is now top-of-the-pops in the European growth league and journalists and scholars are streaming in to find out the secrets of our success. We are right to enjoy our celebrity while it lasts! While upturns are lasting longer than they used to, it is an unfortunate historical fact that booms tend eventually to be followed by downturns. History does not tell us when the downturn will come or how severe it will be. There is no lack of clouds on the horizon: ranging from a collapse in the US stock market and a weakening UK economy (with the accompanying threat of sterling competitiveness) to escalating property costs, rising public sector pay bills and labour scarcity. The advent of the year 2000 could itself be a source of problems, compounding the economic slowdown in Asia and the

transition costs of adopting the euro. A reasonable objective would be to aim for a soft landing to a lower, more sustainable long-term growth. Achieving this will require skilful economic management - further reductions in tax rates, elimination of poverty traps and unemployment traps, and development of a top-class physical and human infrastructure - and also a certain amount of luck. Come what may, there is no doubt however that the new policy regime adopted during the past decade has left Ireland in stronger position than ever before to confront the challenges of the new millennium.

## Footnotes

1. This section draws heavily on chapter 1 of McAleese (1997).
2. Blinder was joined in this exercise by another well-known academic economist, Laurence Summers. See Woodward (1994, pp 83-86).
3. Macro-stability does not imply that fiscal policy has no role to play in stabilising the economy. A balanced budget is not a sign of good economic management in all circumstances. Fiscal activism is needed in case of a threat of severe downturns or upturns. But, as Lindbeck (1994) argues persuasively, instead of “fine-tuning” aggregate demand, fiscal policy may have to settle for the more modest objective of “coarse-tuning”, that is, responding only to prospective major deviations from potential output.
4. The East Asian success story has been tarnished by the crisis of 1997. But this was a financial crisis and its happening does not negate the tremendous benefits yielded to these economies by the new consensus policies.
5. Dr Garret FitzGerald claims that his Coalition government in 1981 faced an incipient deficit of over 20 per cent of GNP (FitzGerald 1997).
6. My views on the reasons for Ireland’s economic recovery are outlined in McAleese (1990 and 1992).

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## DISCUSSION

**Padraig McGowan:** Mr President, distinguished visitors and members of the Society, I am honoured and delighted to have the opportunity to propose the Vote of Thanks to our President on the occasion of his Presidential Address in the year that this Society celebrates its 150th Anniversary. Your distinguished President, Professor Dermot McAleese, the incumbent Whately Professor of Political Economy at Trinity College Dublin, provides this Society with a lineal connection, stretching back to the time of the Great Famine, to its first President, Archbishop Whately who founded the first Chair of Political Economy in Ireland in 1832.

In view of this antecedent, it is fitting that our President chose to review the major developments in Irish economic policy in recent decades. He is particularly well placed to do this in view of his early researches into import protection, his subsequent Chairmanships of various committees concerned with national policy matters, the latest being pensions, and his insights into monetary stability arising from being one of the longest serving Directors of the Central Bank. Economic policy is a vitally important matter frequently debated in this Society and a most appropriate subject to mark its 150th Anniversary and reflect its tradition as being a lobby for the public interest.

Mr President you have presented us this evening with a masterly overview of three interwoven themes. Firstly, you have critically reviewed why the different strands of economic policy need to be continuously assessed and reoriented from time to time. Secondly, you have evaluated the benefits to the Irish economy of the changes in economic policy since the 1970s; and thirdly you have wisely advised us about the desirable direction of economic policy in the years ahead as the Irish economy becomes fully integrated into the European economy.

There are many themes in your Address Mr President but I will confine my remarks to two policy areas, namely, putting balance into fiscal policy and the coming of age of monetary policy. But first I will say a few words about the increased emphasis in recent decades on the markets and economic liberalism as distinct from state involvement.

### *Tempering Competition with Intervention*

The balance between promoting the market system and the degree to which there is public sector intervention has never been a settled issue once and for all as a glimpse at the 150 years since the founding of this Society demonstrates. For example, economic liberalism is a term that can be applied validly to the period 1850 to 1914 when free trade, stable prices, labour market flexibility, capital mobility, low taxation and minimum intervention by the State prevailed at a time of major advances in communications. This policy stance gradually gave way to a lack of confidence in the efficacy of market forces in subsequent decades especially from the 1930s to the 1960s. This led to large-scale state intervention, nationalisation of

economic activities, rising taxation and public expenditure, tariff barriers, trade quotas, price controls and eventually exchange controls.

As Professor McAleese has pointed out, the pendulum has been swinging back again since the late 1950s, with, in Ireland, the gradual abolition of import substitution policies, the early adoption of openness in relation to external trade, the increasing emphasis on privatisation since the 1980s, the abolition of price controls from the early 1980s, onwards, the suspension of credit ceilings in the depressed mid-1980s, the enhancement of the role of the Competition Authority in the 1990s, the pressure since the advent of the Single European Market in 1985 from the Commission in Brussels to gradually reorientate the Common Agricultural Policy and to reduce state support for industry and services, and finally the phasing out of exchange controls over the period 1988 to end-1992. We are honoured to have with us this evening Dr T K Whitaker, the architect of the shift in economic policy from insularism to openness and a former President of this Society.

While we have undoubtedly benefited substantially from the policy shifts since 1958 that have given greater scope to market forces, we did not fully embrace the free market system. For example, we provided state support for the direct encouragement of exports, and, in relation to the capital market, we have relied upon a variety of tax incentives, shelters and grants to attract external corporate investment, to promote investment by local enterprises and to encourage urban renewal.

There are two main economic reasons for state intervention in the market system. One is that there are imperfections in how the market system operates, e.g. the existence of external economies, i.e. social benefits and costs that differ from purely private benefits and costs, deficiencies and asymmetries in the availability of information, non-tariff barriers to the adoption of market solutions, dominant firm influences and limitations on entry, myopia in relation to the longer term plus market over reaction in the short term. Some of these examples of areas of market failure can be minimised by state intervention. The other economic reason for state involvement is that temporary initial support may lead to a permanent addition to competitive capacity. This is the old infant industry argument which comes to the fore from time to time and which is often advocated to support the creation of comparative advantage or to overcome diseconomies of scale through public investment in infrastructure, research and training and in the promotion of growth centres concentrating on specific activities. It has to be acknowledged, however, that the infant industry argument may not always be as compelling as some of its advocates maintain.

Continuous change with some activities expanding and others contracting is the very nature of economic progress. In this environment society needs to strike an optimum balance over time between effective state intervention and the operation of free market forces without negative side effects. The evidence suggests that by far the greater weight should be given to the operation of market forces and that the case for state intervention ought to be clearly demonstrated. One is often struck that in

seeking a solution to one set of problems a new set of problems can be created as human behaviour adjusts to familiarity with its constraints. This is the unsettled and ever-changing economic environment, nowadays favouring and giving substantial scope to market forces, that forms the background against which fiscal and monetary policies are formulated and implemented as we enter the 21st century.

#### *Putting Balance into Fiscal Policy*

As Professor McAleese has pointed out we have witnessed fundamental changes in the formulation and implementation of fiscal policy. There were two main reasons for this. Firstly, they arose at the international level because of changes in how economists think about how economies function and behave in response to fiscal policy initiatives. The second reason for changes was the domestic reassessment of fiscal policy that was required because of the need to resolve the serious problems of imbalance in the public finances that had arisen from fiscal mismanagement between the early 1970s and the late 1980s.

At the theoretical level the Keynesian tradition that peaked in the early 1960s had to be fundamentally reassessed. The promotion of higher levels of demand or spending in the economy through active public expenditure failed to lower unemployment while creating major unsustainable budget deficits which, in turn, led to other problems. The trade off that seemed to exist between achieving a lower level of unemployment with some limited higher level of inflation gradually disappeared as inflation was ratcheted up and became more predictable from the late 1960s onwards to become an international menace in developed economies. At the international level this led to a serious questioning by economists of the functioning and management of an economy resulting in a number of schools of analysis within the economics profession which in varying ways contributed to the reshaping of macroeconomic management and to the initiatives summarised in the President's New Policy Consensus.

I recall here what I consider to be the more important developments in macroeconomic analysis that had a bearing on the reshaping of Irish economic policy. The economic problems that orthodox Keynesian policy seemed unable to deal with resulted in a revival of interest in the classical approach to economic analysis. This re-focused attention on the longer-run limitations to productive capacity arising from shortage of manpower with appropriate skills, inadequate growth in capital, limited technological applications, and scarcity of other resources. As a result it was gradually appreciated, though perhaps not fully accepted, that Keynesian demand management had to be conducted in a manner consistent with the potential capacity to support additional output.

Another major change in economic analysis that influenced Irish economic policy formulation was the handling of economic expectations. Before the 1970s, economic theory treated expectations as either being determined from outside the economic system or from within it according to some imposed formulae. During the late 1960s

and early 1970s academic economists developed economic models of expectations. While these theoretical developments and associated empirical researches have not yielded robust practical results, they have helped to change the focus of fiscal policy from being less concerned with short-run stabilisation of the economy to providing a more stable medium-term fiscal framework. This has given the private sector a long-range focus conducive to formulating medium-range strategies and making longer-term investment decisions with greater confidence.

With these and other developments in economics we hear less nowadays about the multiplier effects of public sector investment, the expansionary influence of the balanced budget or about the fine tuning of the budget so that it remains in balance over the cycle. Instead we hear of deficit reduction, fiscal consolidation, the squeezing of the private sector and sometimes the suggested equivalence over time of tax and debt financed public expenditure. We also hear that markets operate more efficiently given the medium-term focus of fiscal policy. Leaving aside these theoretical developments in economic analysis that indirectly influence the formulation of fiscal policy I now turn to some of the serious fiscal difficulties we experienced in practice and which we eventually addressed at the brink of disaster in the late 1980s.

From the early 1970s, and even up to recently a traditionally described “golden rule” of fiscal management - left intact by the reworkings of macroeconomics - whereby the current beneficiaries of public services should pay for them and not burden future generations, was abandoned in Ireland. This rule does not call for the entire budget to be tax financed. It just requires that current outlays be paid for currently and that productive capital outlays be debt financed and amortised as the putative benefits from these projects accrue to society. Furthermore, it does not rule out the financing of capital expenditure by taxation or the repayment of public debt from excess tax receipts in circumstances of rapid growth such as we are currently experiencing.

Today’s society bears the burden, in the form of higher taxes and transfers abroad, of the excessive level of public sector indebtedness incurred in the 1970s and 1980s which, as it was accumulating, was accompanied by periodic crises in the Exchequer Bond market. This indebtedness is with us to this day as the absolute level of debt never contracted and indeed was increased in the 1990s by the continuation until recently of current budget deficits. However, because of the current high growth rates in the economy, arising partly from the reoriented economic policies analysed by our President, the relative burden of the public sector indebtedness has fallen quite rapidly from a peak of 116 per cent of GDP in 1987 to around 68 per cent in 1997. Relatively speaking this is a substantial improvement but absolutely speaking the level of the public debt and its service costs and associated additional taxation remain large thereby reducing the scope for lower taxes.

Another major problem that arose in implementing fiscal policy in Ireland was the upward drift in the ratio of public expenditure to GDP which peaked at around 50

per cent in 1985 but has since declined, though more slowly than one would have expected given recent record growth rates, to around 37 per cent. The increasing burden on society of the expanding public sector up to the late 1970s and early 1980s was accompanied, as you have recalled Mr President, by inflation and interest rates of 20 per cent together with balance of payments and budgetary deficits of similar orders of magnitude relative to GNP in an environment of virtual economic stagnation - a situation that is nowadays even hard for those of us with direct experience to fully appreciate. It is appropriate to remember that this led to the threatening tax marches of the early 1980s. These in turn resulted in the establishment of a Commission on Taxation which in the second half of the 1980s influenced tax and public expenditure reforms.

Having unwound the share of the public sector by about one quarter we are now more concerned in the context of the emphasis on efficient markets with the incentives and disincentives arising from taxation and public expenditure and their distorting micro-level effects. More attention may also need to be given in the future to the incidence of once off items and off-balance sheet liabilities such as future pensions in managing the public finances. These micro-oriented considerations must also remain at the core of fiscal policy in the years ahead at the same time as the macro fiscal framework is set by the disciplines of the Maastricht Treaty and the Stability and Growth Pact. One of the comforting aspects of participating in EMU will be that it will act as a bulwark against relapsing into the fiscal macro excesses that we pursued in earlier decades. Once EMU is launched, tax reform at the EU level will probably be the next major economic initiative with a view to facilitating further the integration of the Single European Market.

In reorienting fiscal policy to correct excessive imbalances and dead weight burdens and indirectly extending the scope of the markets one must be careful not to throw out the baby with the bath water. In restructuring tax breaks and subsidies and moving to a generalised lower rate of corporate taxation to promote investment in the manufacturing, services and agricultural areas, we need to move carefully. We also need to maximise the contribution made by the effective use of the Structural and Cohesion Funds from the EU. One senses that in giving further scope to the markets the economy might be quite fragile in some areas with a more limited range of incentives such as grants, structural funds, public sector support for education, retraining grants, etc than is currently available.

Despite the popular slogan that small government is good government we need to acknowledge that, apart from the stabilising function of fiscal policy, there is an important role for the public sector as the provision of public goods and services must be kept in perspective as well as the objective of achieving what society regards as a fair distribution of income and wealth. Downsizing in itself is not the ultimate object. The objective is to encourage a high level of economic performance through an ever-changing partnership between the market system and the public sector. Since parts of the market system do not work satisfactorily the public sector needs to remain potent enough to correct for serious market failures. The fiscal

functions of government must serve the overall goals of an economy that aspires towards the provision of adequate public goods, functioning efficiently and equitably and at the same time fully utilising its growing capacity.

#### *Monetary Policy - Coming of Age*

Now I will turn to the role of monetary policy and the contribution that it makes to economic growth. The establishment of a decisive role for monetary policy owes much to the developments in monetary analysis since the 1950s which in turn was part of the overall reassessment of macroeconomic analysis that I referred to earlier. As a result numerous lessons have been learned about monetary policy since the 1950s resulting in its coming of age so to speak over the past two decades. Prior to the mid-1960s little distinction was made between monetary and fiscal policy and it was well into the 1970s before the capacity of budget deficits to compromise monetary policy was generally accepted. Now there is a broad professional consensus on the benefits of price stability and how to achieve it. But much needs to be done to broaden public interest and support for monetary policy which will be a major challenge for the European System of Central Banks.

Keynesian analysis, partly because it was conceived during the depressed 1930s and partly because inflation was not a problem in those years, gave little recognition to the role of monetary policy, though limited short-run influences of a contra cyclical nature were not ruled out. Also the classical tradition, with its emphasis on the long term, regards money as a veil rather than a factor that has real effects. This suggested that central banks could not affect real magnitudes such as output, employment, wages and, indeed real interest rates. Central banks could only determine nominal magnitudes and prices but these were not regarded as important as long as inflation did not inhibit economic growth and lower real standards of living.

Up to the early 1960s most countries did not even compile official money supply series or present analytical statements showing the monetary impact of the operations of the Central Bank. Despite the overwhelming impact of Keynesianism in the early post World War II decades, the monetarist tradition in economic analysis persisted in studying the impact of monetary phenomena, especially the causes and effects of hyper inflations arising directly from the impact of major wars. It also concentrated on the effects of the operations of the central banks on the economic cycle with particular reference to the great depression of the 1930s. This prepared the ground for a penetrating analysis of the causes and effects of the inflation that arose in the industrialised nations from the mid-1960s onwards and which culminated in a combination of rapidly increasing prices, little real economic growth and rising unemployment in the 1970s.

The monetarists demonstrated that inflation once started tended to accelerate rather than remain steady, that in the longer run the rate of unemployment in an inflationary environment was determined independently of the rate of inflation, and

that the lack of a clear distinction between real and nominal magnitudes in macro economic analysis leads to confusion in the core of such analysis. Arising from these experiences and developments, the power of money in the inflationary process was generally recognised, while the potential of monetary policy in large economies to have short-run stabilising effects on the real economy was accepted. This led to a reawakening of respect for and the promotion of the independence of monetary policy and, in turn, to less emphasis on fiscal policy.

Nowadays, monetary policy is assigned a specific role in achieving and maintaining price stability as reflected in Monetary Policy Statements released annually by the Central Bank. Inflation is regarded as a monetary phenomenon that cannot persist unless ultimately accommodated by monetary expansion. This consensus does not extend to all aspects of monetary policy such as the gains and costs of pursuing absolute price stability as opposed to aiming for a low rate of inflation; whether or not inflation is being measured reasonably accurately, the relative merits of inflation targets compared with intermediate monetary targets or exchange rate objectives, the appropriate balance between policy independence, operational transparency and historical accountability for a central bank, and whether in the current environment of strong market forces the appropriate combination of monetary policy instruments should include mechanisms such as reserve ratio requirements.

There will be lively debates on all of these issues throughout Europe as the European Central Bank and its associated National Central Banks formulate and implement monetary policy for the whole Euro area with the longer-term horizon to the fore but informed by short-term market developments. The principles underlying European monetary policy will be that one cannot sustainably increase the potential growth of the economy directly by additional monetary stimulus and that monetary policy, by aiming for price stability over time, will provide a stable background to facilitate savings, investment, efficient resource allocation and in turn economic development. This is the route through which monetary policy contributes, though indirectly, to increasing the growth of the economy and higher employment.

The evolution of monetary policy in Ireland since the 1950s broadly followed the international trends suitably adapted for small countries. Little distinction was made in Ireland between fiscal and monetary policy before the 1970s. This partly reflected the prevailing international orthodoxy of those early post-World War II decades. More importantly, it was a reflection that the country had chosen, back in the late 1920s, a fixed rate of exchange for its currency that was directly linked to sterling. While this sterling target or anchor delivered a high degree of price stability until the late 1960s it was not automatically achieved. Firstly, it depended on the British achieving price stability and having a firm exchange rate for sterling itself. On occasions, steps had to be taken in Ireland to defend the Irish pound's fixed exchange rate link with sterling. Thus, in the mid-1950s fiscal measures and trade restrictions were introduced to correct an external current account deficit - a situation that was aggravated by not implementing a timely increase in interest rates in line with international developments. Again in 1965, when our external trading

conditions became difficult, partly as a result of the manner in which sterling was being defended by UK policies and partly because of rising domestic costs, fiscal policy was tightened somewhat and credit ceilings were introduced to conserve the external assets of the banks and protect the exchange rate. These ceilings were relied upon until the depressed mid-1980s to contain domestic credit creation and minimise downward pressure on the exchange rate.

With hindsight we may appear to have been slow to abandon the sterling link from the late 1960s onwards as inflation in the UK increased rapidly and sterling depreciated significantly especially in the period 1973 to 1976. But it is not obvious what other feasible exchange rate arrangement was available at that juncture that would have given us more stable prices. This was because fiscal policy was resulting in growing budget deficits and increasing external current deficits. A domestic economic environment was created that was not conducive to a radical change in the exchange rate arrangements. However, when the opportunity to join the EMS arose during the second half of 1978 and early 1979 we bravely broke the link with sterling in highly unfavourable domestic economic conditions. This decision was taken at a time when there were major imbalances in the economy and little sign that appropriate economic policies would be pursued to defend the currency in the ERM.

As a result, in the first half of the 1980s we failed to achieve greater price stability which membership of the EMS held out for us. The first eight years in the EMS were very difficult and the Irish pound continued to depreciate by about 4 per cent a year on average against the DM, the anchor currency of the EMS. Over the 20 years from the mid-1960s to the mid-1980s like most small countries, the exception being Switzerland, we failed to avoid participating in the greatest international wave of inflation experienced by industrialised countries in peaceful conditions. We did however avoid a crunch similar to that experienced, for example, in Scandinavia in the early 1990s and, more recently by Mexico in 1994 and in 1997 by a number of the smaller Asian economies with emerging capital markets.

Over the past decade the evolution of prices in Ireland has been in line with that elsewhere in Europe which was the prime monetary reason for joining the EMS. This is reflected in the nominal effective exchange rate index which is at much the same level now as it was in 1987. This has not been achieved without significant unpredictable swings in the rate against individual currencies depending on the timing of movements in sterling, the DM and even the US dollar, movements which, over time, cancelled out against one another. International exchange rate fluctuations are making it much more difficult to successfully manage small currencies in a manner that supports both price and economic stability. This is the basic economic reason why Ireland is preparing to embrace the Euro - a currency that offers the prospects of price stability through an arrangement in which we will have much greater influence by comparison with the one that existed under the sterling link.

It may appear that after three quarters of a century of independence in formulating and implementing economic policy, we are reverting to a position, economically



speaking, similar to that which prevailed during the first half of the life of this Society. However, the current situation is quite different in two respects. Firstly, in the European economy a number of small countries, including Ireland have an opportunity and perhaps incentive, to be supportive of each other in advocating and formulating policies to deal with their common problems. Each member of the EU has much more influence in formulating and implementing European-wide policies that are in its interest than had the member countries of the British Empire in shaping policies in their own interest. Secondly, in relation to economic policy in general smaller members of the EU should fully support the role of the Commission in Brussels and, in respect of monetary policy, the Governing Council of the European Central Bank in Frankfurt as this institution will have responsibility for formulating and implementing the European-wide monetary policy which will embrace the whole Euro area rather than individual member States. Furthermore, it will continue to be in the country's interest to present comprehensive analyses and policy proposals to these European institutions so that they are kept fully informed about our national needs and interests and how they fit into the European-wide market. Such opportunities were not available to those concerned with Irish economic policy before the 1920s and indeed up until we joined the EU some 25 years ago.

#### *Conclusion*

Mr President, you have done us a great service by succinctly and comprehensively reviewing most of the major changes in economic policy that we have pursued in recent decades. You have reminded us, of a very uncomfortable period, embracing the 1970s and much of the 1980s, during which the management of the economy left much to be desired. More importantly, you have highlighted a number of the more important features of the welcomed reorientation of national economic policy particularly over the past decade and placed them in an international context informed by the evolution of macro economic analyses and useful experiences of other countries. In the best traditions of this Society, you have outlined a number of appropriate economic policy prescriptions that we should consider seriously with a view to maintaining our currently rising prosperity well into the next century. Ladies and Gentlemen, it is a great pleasure for me, in this historic location and in this important year in the life of the Society, to propose on your behalf the Vote of Thanks to the President.

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**Finola Kennedy:** President of the Royal Irish Academy, President of the Statistical Society, Distinguished Visitors, Members of the Society, as Dr McGowan has said in his thoughtful and instructive Vote of Thanks it is fitting that the Presidential Address on this historic 150<sup>th</sup> anniversary of the founding of the Dublin Statistical Society was delivered by the Whately Professor of Economics in Trinity College, Dermot McAleese. In seconding the Vote of Thanks on your behalf to Professor McAleese for his splendid Address, I believe that it is appropriate to include just a

few remarks about Richard Whately. Many of Whately's concerns one hundred and fifty years ago remain central concerns today. These include economic development, unemployment, education and poverty.

The Report of the *Address on the Conclusion of the 1<sup>st</sup> Session of the Dublin Statistical Society* delivered by Dr Whately, ends with his vision of what this Society is - an institution

*for instructing not a few recluse students, but the people at large, in the knowledge of that science which all must practice, whether they practice it well or ill.*

It is then noted "His Grace resumed his seat amid loud cheering" - just indeed as Professor McAleese has done.

Before his appointment as Archbishop of Dublin in 1831, Whately had been Drummond Professor of Political Economy at Oxford, succeeding Nassau Senior. His first lecture began with an attack on the name "political economy", as sounding too concerned with pecuniary gain, suggesting instead "catallactics", or the "science of exchanges" as more suitable. A Benthamite, he once famously observed, "It is not that pearls fetch a high price *because* men have dived for them, but on the contrary men dive for them because they fetch a high price" (Whately, 1831, quoted in Black, 1945).

When, in 1832 he founded a professorship of political economy funded out of his episcopal income,

*.....the fellows of Trinity College were deeply disturbed by this generosity, for they saw it as a Trojan horse: the subject was associated with Whigs and radicals (Akenson, pp.104/105).*

Eventually the Chair was assimilated into the University and named after Whately following his death. Its distinguished holders include, as well as Dermot McAleese, Loudon Ryan, George Duncan, John Elliot Cairnes and Isaac Butt.

Whately's greatest influence on Irish life resulted from his activities with the Education Board of which he was a member from 1831-53. He saw education as a means of economic and social improvement, a theme developed a century later by Professor Patrick Lynch and his *Investment in Education* team in one of the most comprehensive and influential studies ever undertaken in this country. Whately chaired the monumental Royal Commission on the conditions of the Irish Poor 1833-36. Material was collected from every conceivable source and by the mid 1830s Whately knew more than anyone about the nature of poverty in Ireland. In their recommendations, Whately's Commission abandoned classical economics urging assisted emigration and a massive system of public works to relieve unemployment and stimulate development. In recent years poverty has again been

the focus of intensive research, notably by Professors Nolan and Callan and their colleagues in the ESRI.

I would now like to make a few observations regarding Irish experience in the three key areas identified by Professor McAleese: (i) openness, (ii) macro-stability and (iii) competitiveness. I would also like to remind you that the remarkable developments which have occurred in the Irish economy since 1987 were first adverted to in the World Bank paper of Dermot McAleese and Desmond McCarthy, subsequently expanded in Dermot McAleese's *Banking Review* article in 1990.

*(i) Openness*

Professor McAleese refers to concern about the implications of the export of capital from Ireland in the context of liberalisation under EC rules since the 1980s. Concern about capital outflow has a long pedigree. In a paper read to the Statistical Society in 1875/76, entitled "Complaints Against Bankers in Ireland", Neilson Hancock worried about the savings of Irish farmers ending up in British gilt-edged securities. The Society records include debates on the role and function of our "external assets", as well as a seminal paper on the topic by Dr. T. K. Whitaker (1948/49). An unusual aspect of the Irish experience is that at certain critical periods Ireland has been an exporter of *both* labour and capital.

The *uses* of capital are as vital as access to capital. In the latter half of the nineteenth century, domestic savings grew, but much indeed did flow into British gilts. In the mid-1980s capital was available, but it was spent on current budget deficits. If information technology had been as advanced in the 1980s as in the 1990s and there had been as much American technological investment in Ireland in the 1980s as in the 1990s, there might have been more demand than for young educated people.

Who controls the capital is also important. Since the mid-1980s the share of private investment and especially foreign direct investment has grown. The share of public investment fell between 1985 and 1990, then increased until 1994, falling again in 1995. Writing in 1970, when the Public Capital Programme was substantial and Foreign Direct Investment small, by today's standards, James Meenan said,

*The sign of a true development in the economy will be a growth in private investment, in an increasing number of people putting their money, or what money they can raise from the public, into their projects (Meenan 1970, p.379).*

In a prescient observation regarding "crowding out", Meenan continued, "The time may come when there will be a serious clash between public and private investment" (*ibid.*).

*(ii) Macro-stability*

Professor McAleese praises the British Tories, by implication, Margaret Thatcher. Credit must also go to Ray MacSharry, Charles Haughey, and to Alan Dukes for upholding the “Tallaght Strategy”. Did the lack of influence by the Labour Party during a few key years help to carry through the needed fiscal adjustment? Possibly. Dermot McAleese’s remarks about the loss of credibility of the socialist model would appear to bear this out. However it must be said that in the last couple of years, 1994-96, a Labour Minister for Finance, Ruairi Quinn, carried forward the new consensus with ability and commitment. Irish trade unionists deserve recognition for helping to deliver industrial peace and wage agreements which have contributed to the attractiveness of Ireland as an investment location. Looking back, it may be recalled that it was not just wanton fiscal looseness by politicians in the 1970s; many economists were urging greater public expenditure to offset the impact of the oil crises.

*(iii) Competitiveness*

Professor McAleese suggests that greater tax uniformity and tax “neutrality” between different types of economic activities has become an important fiscal objective. Perhaps Professor McAleese might have placed a little more stress on the role of the *structure* of taxation and of fiscal privilege. Of particular significance in the Irish case has been the pattern of tax breaks and capital allowances for investment, including the designation of certain areas for specially favourable treatment. The impact of these changes is comparable to the impact of export tax relief in the 1950s. High corporation tax may not “distort” choice between one investment and another, but a BES scheme which favours, for example, “pay-as-you-play” golf clubs over ordinary members’ clubs will have a clear impact on investment decisions. Such tax breaks represent, incidentally, a major intervention by the state in the market. It may well be, however, that the next major item on the European agenda after the Euro will concern tax harmonisation.

In relation to competitiveness I would like to raise a question not raised this evening. What was the significance of the currency devaluations in 1986 and 1993 - the last of which coincided with the golden jubilee of the Central Bank? Who were the gainers? Who were the losers? Are there any implications for joining a single currency?

Finally, as a student of the dismal science, a modicum of gloom is required. At the 200<sup>th</sup> anniversary of the Society in 2047, will some future Oldham, who may even be present here tonight, observe that Ireland in the 21<sup>st</sup> century was run by Brussels and the European Central Bank when the Celtic Tiger found itself in a cage? This, indeed, would *not* be a fitting note on which to end. Rather let us reflect on the engaging faith of Archbishop Whately who stated that “Next to sound religion, sound Political Economy was most essential to the well-being of society”. Tonight Professor McAleese has spelt out his policy imperatives for such sound Political

Economy. It is my privilege and very great pleasure to propose that he deserves the best thanks of the Society for doing so.

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