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Working Paper No. 267

December 2008

Resonances from *Economic Development* for Current Economic Policymaking

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[⊕] The views expressed in this paper are my own. All the data used in Section 2 come from the ESRI databank. I am grateful to Thomas Conefrey for assistance with compiling the data series in Section 2, and for comments on early drafts of the paper. I am very grateful to John Fitz Gerald and Ken Whitaker for invaluable discussions during the course of writing this paper.

Resonances from *Economic Development* for Current Economic Policymaking

1. Introduction[1]

On November 25 1958, an article in the *Irish Times* stated that the publication of *Economic Development* was *a unique event, because for the first time, an Irish Government has revealed in full detail the view put to it on the whole range of economic policies by its principal adviser, the Secretary of the Department of Finance*. The (unnamed) journalist went on to note that in its *Programme for Economic Expansion*, published ahead of *Economic Development,* the Government had endorsed most of its content, and in particular, the suggestion of allocating more State investment to support productive enterprise. He further noted that the new productive investment would be superimposed on top of the existing socially-oriented programmes – in other words, there was no plan for a major reallocation of existing public resources. The article also recognised that the plan was not perfect but was optimistic that any criticisms it might attract would be aimed at making it a better plan. The journalist's tone is one that is empathetic to a country recognising its problems and planning to deal with them.

The publication of *Economic Development* came at a time when Ireland was suffering continuously high levels of emigration and unemployment – the twin signals of economic failure – while the rest of Europe was booming. Growth rates were very low or even negative. Balance of payments deficits were high and rising – reflecting in part the decline in Ireland's trade balance. Crucial messages running through the document were that policy needed to promote economic growth as the way to address unemployment and emigration, and that economic growth required structural change.

The process whereby economic policy changes direction is a complex one, and while there are moments, such as the publication of *Economic Development* where this change is clearly recognised, the reality is that the seeds of change long pre-dated that

[1] This Paper was written in early September 2008, when it was already recognised that the Irish economy was in recession. However, it was completed before Ireland entered a period of severe financial crisis (linked to the global crisis that began in the USA as the problems of the sub-prime mortgages developed) and an exceptionally rapid decline in tax revenues.

publication. Then, as now, policy change is about process rather than about the public document that discusses the need for change and what it will involve. What was exceptional in the mid-1950s was that a group of civil servants and carefully selected others put into the public domain their considered view of the real problems that faced the Irish economy and identified the changes they thought were required. Allowing the publication of a separate document reflected a new maturity on the part of the political system, indicating that politicians had confidence in the ability of the civil servants to produce an independent and competent analysis of the Irish economy. It also recognised that political decision making could not ignore economic realities.

While the basic analysis in Economic Development was sound, it had an inherently static approach (reflecting economic theory of the time), and consequently their conclusion that agriculture and food-based industries would be the route to faster growth turned out to be wide of the mark.[2] It is also not clear whether the implications of Keynesian economics for Irish macro policy were fully understood.3 Nonetheless, as we would all recognise today, there were three crucial elements in that analysis which were absolutely correct:

- An appreciation of the potential benefits of opening up the Irish economy to trade and foreign direct investment, and conversely the serious damage that would be done to the Irish economy by continuing the twenty-five year old policy of combining high levels of protection with a prohibition on foreign direct investment;

- Tentative evidence of the usefulness of Keynesian economics to inform the role of the State in smoothing economic cycles; and

[2] The basic logic of the economic understanding was that improvements in technology in agriculture would increase its output and hence its purchasing power. This would stimulate further demand for goods and services, leading to additional employment in industry and services but no increase in agricultural employment. In effect, employment generation would be in manufacturing and tourism. This led to the conclusion that: *In general, however, it would seem that attention should be concentrated primarily on raising the efficiency and volume of production in agriculture and in industries based on agriculture.* Chapter 2, Para 32.
[3] Several economists have visited this issue, including Patrick Honohan and Cormac Ó Gráda.

- A recognition of the significant challenge faced by the public service, with scarce resources, trying to plan and deliver policies that would support the restructuring necessary to generate higher levels of economic growth.

The French have a saying – *plus ça change, plus ça reste la même* – an expression which quickly comes to mind in looking at Ireland in 2008, some fifty years later. Now, as then, we are still dealing with these same three elements.[4]

- Openness is an issue today in terms of the challenges and potential generated by globalisation (a word that did not even exist in 1958). This openness means a continual restructuring of our economy into higher value-added products and services and constant pressures for innovation. It also means increasing internationalisation of domestic production, if we are to remain globally competitive.

- We are now faced again with managing economic cycles with limited independent monetary policy instruments, with a growing budget deficit, with current fiscal policy constrained both by EU rules, and by having adopted what has been described as an 'accounting' rather than 'economic' approach to handling large fiscal surpluses in recent years.[5]

- We are also faced with determining how best to allocate a tighter capital budget, under the National Development Programme, which is intended to enhance current and future growth rates. This requires now, as it did in the 1950s, a stronger culture of planning and evaluation than we have managed to achieve in many of the intervening fifty years.[6]

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[4] *Economic Development* states that we are at …*a critical and decisive point in our economic affairs* – 0an expression that would not go amiss in 2008.

[5] In effect the Keynesian counter-cyclical policy message has been forgotten over recent years, as policy has been pro-cyclical, driven by the idea that 'when you have it, spend it'.

[6] Whatever about the criticisms that can be made about Irish economic policy over the period, in terms of its general direction it has been positive overall, though weaker on the Keynesian dimension. The benefits of this are very apparent when one comes to compare the successes of economic and social policies with the failures of spatial policy.

This paper explores some potential resonances for policymaking in Ireland in 2008 by examining the links between the approach to economic policymaking in *Economic Development* and those underpinning the *National Development Plan 2007-2013: Transforming Ireland* and NESC Paper No 117: *The Irish Economy in the 21st Century.*

In Section 2 we look at three sets of economic indicators that highlight how we have progressed since the 1950s. These indicators help to place the current challenges in perspective. In Section 3 we look briefly at how the policy process has changed over the five decades since 1958, while in Section 4 we look at some of the possible lessons from *Economic Development* for the short to medium term.

2. What Has Changed in the Past Fifty Years?

In this section we look at three sets of economic variables and how they have changed over the half century, since *Economic Development* was published:

1. the state of the economy (in terms of the labour market, economic structure, per capita growth and foreign debt);
2. the state of the public finances (in terms of national debt and interest payments) and
3. the openness of the economy (in terms of what net trade contributes to growth).

Labour Market – Unemployment and Emigration

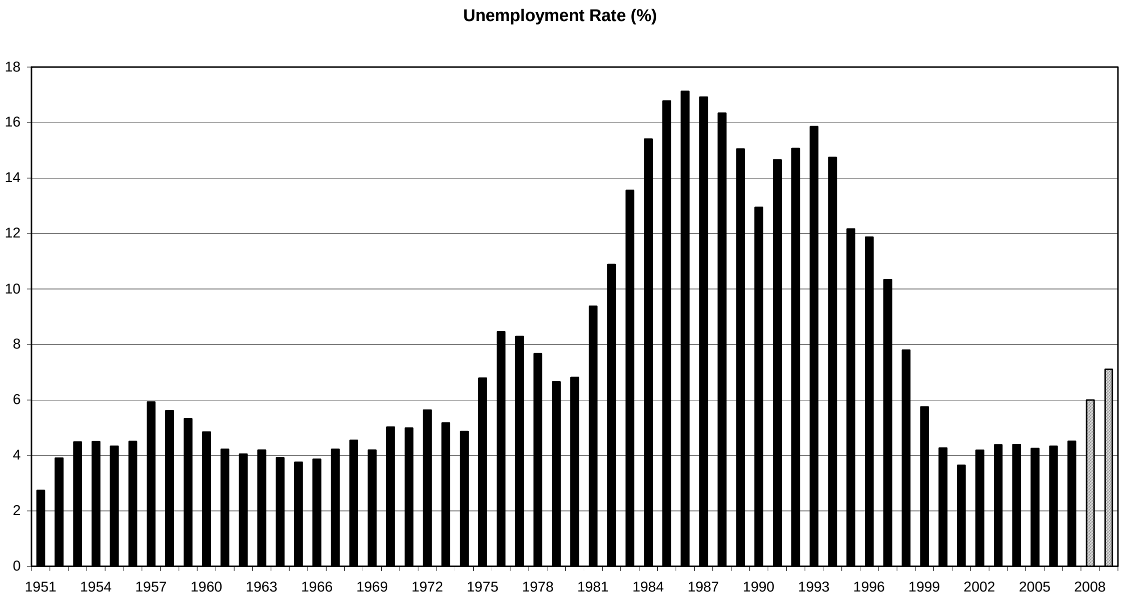
The scale of unemployment and emigration were the two most tangible indicators of economic failure in the 1950s. High levels of unemployment meant that many young people emigrated and emigration itself set a cap on the size of the unemployment rate. The unemployment rate in 1958 was just under 6 per cent and in that year net emigration was almost 60,000.[7] Leaving emigration aside, the unemployment rate

[7] Had those 60,000 not emigrated, the unemployment rate – making the conservative estimate that 50 per cent of them would have been in the labour force – would have been around 8 per cent.

understates the extent of the unemployment problem, as there was massive underemployment at the time in agriculture.[8]

Two features are striking in Figure 1. Firstly, the cyclical pattern of unemployment over the fifty years (low (high) during periods of relatively high (low) growth) is evident, particularly in the earlier years of this decade. Secondly, the upward trend in unemployment from the late 1970s through the 1980s and into the 1990s is very clear. The early 1990s was described at the time as having 'jobless growth' as the reduction in unemployment trailed the growth in output.[9] However, as Ireland regained international competitiveness, the results predicted by the early ESRI *Medium-Term Reviews* were found to hold – unemployment rates fell rapidly and increasing numbers entered the labour force.[10]

Figure 1: Unemployment Rates, 1951- 2009[11]



Given the openness of the Irish labour market, the unemployment figures have to be looked at in the context of net emigration, as shown in Figure 2. While unemployment fell in the years following the publication of *Economic Development*, net emigration

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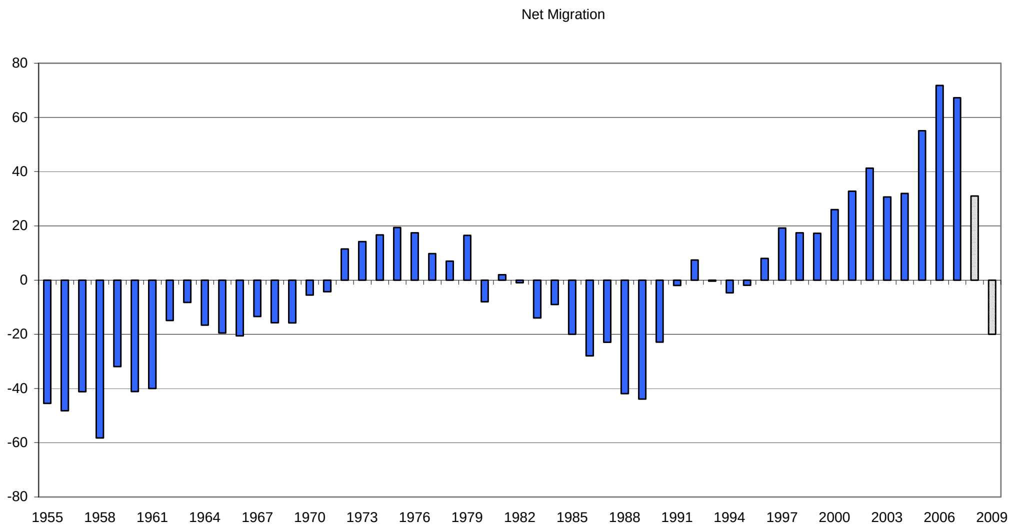
[8] The underemployment was implicitly recognised in *Economic Development,* which saw output growth potential in agriculture if it modernised, but no employment growth potential.
[9] See Guiomard (1994).
[10] The source of the addition to the labour force was increased female participation and returned migrants.
[11] The estimates for unemployment for 2008 and 2009 come from the ESRI *Quarterly Economic Commentary,* Summer 2008.

remained relatively high and it was 1972 before the switch occurred between net emigration and net immigration. Net immigration peaked at 20,000 in the mid-1970s, seeming to confirm Ireland's potential sustainability as an economic region in the face of increasingly open labour markets.[12] The sensitivity of migrant flows to conditions in the Irish and UK markets became apparent again in the mid-1980s as net emigration rose quickly, peaking at over 40,000 in 1989. Ireland experienced levels of net immigration in recent years that were not just unprecedented historically but, in terms of scale, were unprecedented internationally. The recent drop in immigration and the likely switch to net emigration in 2009 are clear evidence of both the mobility of labour to changing economic circumstances and the globalisation of labour.

Figure 2: Net Migration 1955-2009[13]



High (low) rates of unemployment and out(in)-migration indicate an economy where the labour market is not generating jobs. We now turn to look at jobs and their sectoral allocation over the period since 1961.

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[12] Most the immigrants were returning emigrants from the 1960s with their families.

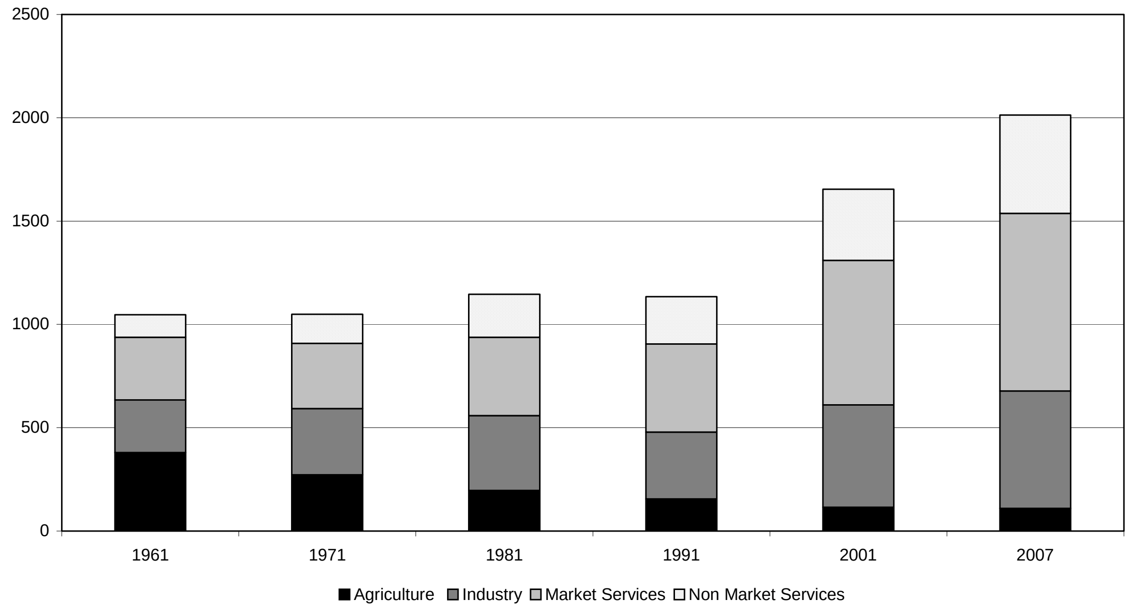
[13] The estimates for migration in 2008 and 2009 come from the ESRI *Quarterly Economic Commentary*, Summer 2008.

Changing Economic Structure and Growth

Figure 3 allows us to look at both employment change and the change in economic structure since 1961. We look at four broad sectors – agriculture, industry, market services and non-market services.[14] The hope expressed in *Economic Development* was that industrial employment would grow significantly, supported by the growth in agricultural output but not employment. Marketed services featured very modestly in *Economic Development*, with tourism being the only traded service meriting attention.

The most striking feature of Figure 3 is that employment has almost doubled since 1961, and that most of this change occurred since 1991.[15] Such an increase was unthinkable in 1991, let alone 1961, and suggests that inappropriate policies had stood in the way of economic and employment growth.[16]

Figure 3: Sectoral Growth and Composition of Employment, 1961-2007 (various years)



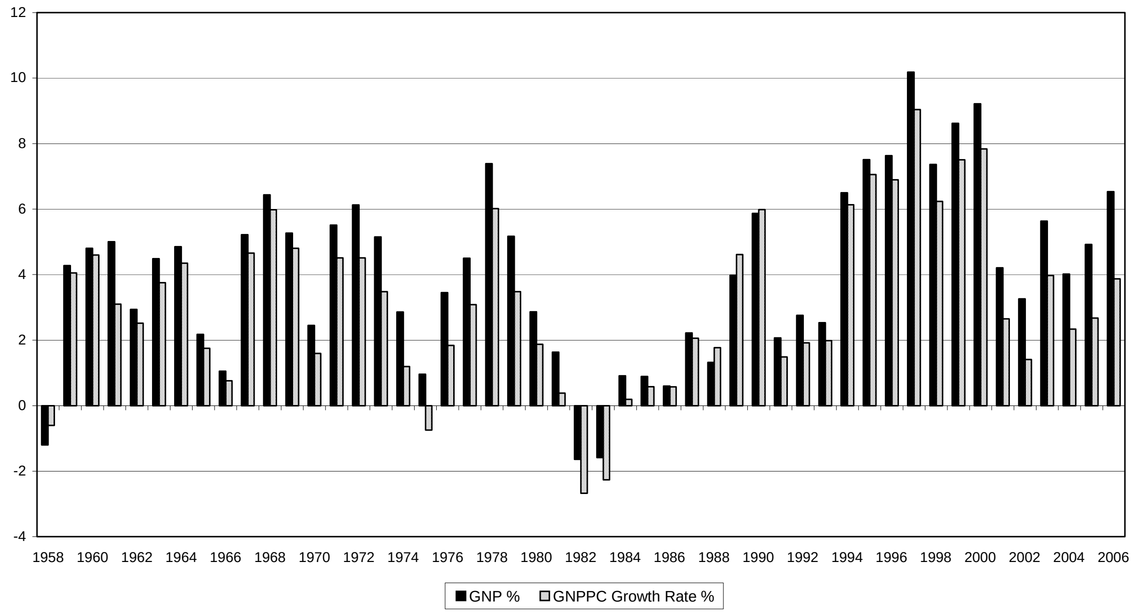
Linking back to the unemployment and migration data in Figures 1 and 2, we see that between 1961 and 1971 there was almost no change in employment numbers but

[14] Non-market services are primarily government services which are provided outside the market system.
[15] The population grew by 25 per cent in 1961-1991 and 20 per cent in 1991-2006.
[16] This issue has been a topic of much research in Ireland – see for example, Barry (1999) and Honohan and Walsh (2002).

considerable reallocation across sectors – in effect the numbers released from agriculture were just about being absorbed in the other three sectors, with the largest share moving into industry. In the 1971-81 decade, during which Ireland entered the EU, total employment grew by 9 per cent. Despite the huge boost to Irish agriculture under the Common Agricultural Policy, the share of agriculture in employment continued to decline, while the share of non-market services rose very considerably. In the decade 1981-1991, aggregate employment fell slightly, with non-market services holding their share while employment transferred out of both agriculture and industry into marketed services. The decade 1991-2001 saw total employment grow at a remarkable rate of just under 50 per cent – from 1.1 million to 1.6 million. Industrial employment grew in numbers but not in share while there was substantial growth in both types of services. In the period since 2001 the most striking change has been the increase in non-market services employment by almost 40 per cent (to 476,000). Employment in market services increased by 23 per cent to almost 860,000 as the combination of domestic growth for services and the international tradability of services led to a significant expansion in this sector.

Figure 4 shows the growth in GNP and in per capita GNP since 1958. Three features of this Figure merit comment. First, it is clear that we have had cyclical growth patterns over the past fifty years – if we learn anything from the past, we must surely learn that growth rates are not constant and we should expect variation across years. Second, we see that on either side of the disastrous 1980s, we had relatively high growth. The growth in the latter half of the 1990s was clearly 'off-scale', and in part reflected the growth that should have come earlier had we not incurred the economic mistakes of the late 1970s and early 1980s.

Figure 4: Growth in GNP and GNP Per Capita



Third, the differences in the GNP growth rate and the GNP growth rate per capita are quite striking – the latter is what really matters from a welfare/quality of life point of view. Except for the period known for 'jobless growth', GNP rose faster than GNP per capita.[17] The growing gap between the two reflects the growth in population over the recent period and is also consistent with more slowly rising productivity. Clearly the growth rates for 2008 and 2009 will represent a significant change on what we have experienced in the period up to 2008.

Foreign Debt

A recurrent theme throughout *Economic Development* was the level of foreign government debt and the extent to which it was a drain on domestic resources. Figure 5 shows Government Foreign Debt Interest Payments as a percentage of Tax Revenue and of GDP. While debt service was an expressed concern in *Economic Development*, looking at the period since 1960, we see that debt service costs relative to GDP were quite low at that time and remained so until the mid-1970s. The ratio rose rapidly after that period, reflecting the scale of borrowing, the high rates of interest and low rates of GDP growth. The effect of rising GDP and access to low interest rates in relation to monetary union saw the ratio fall dramatically from 1995, so that it now accounts for

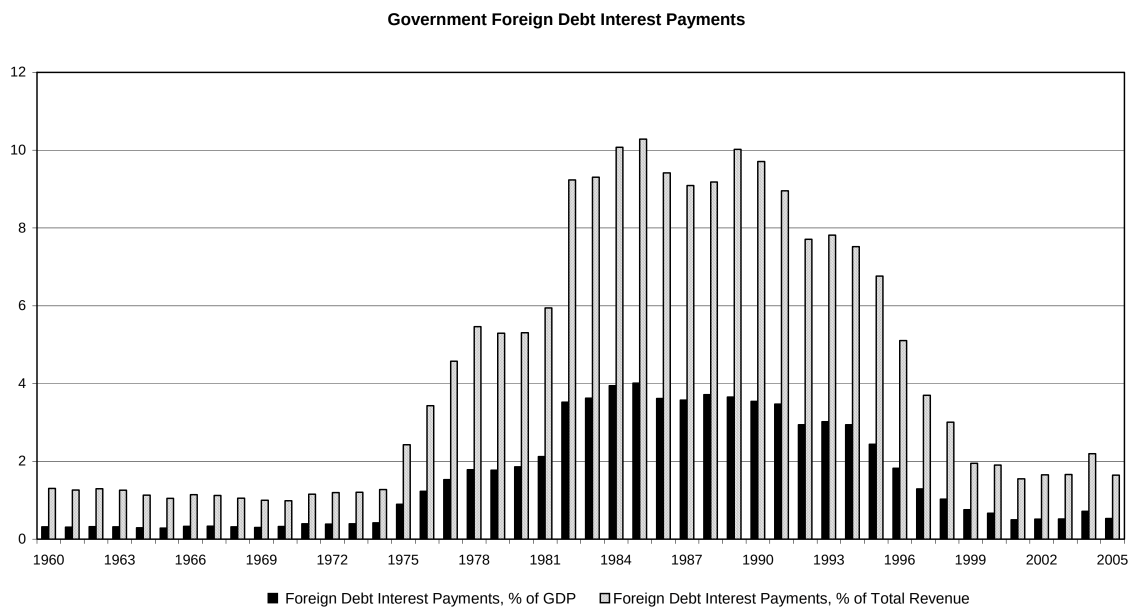
[17] See Guiomard (1995).

little more than half of 1 per cent of GDP.[18] However, this indicator is no longer important since we entered the Euro Area.

From a government perspective, what matters is its capacity to pay the interest and so we look at the foreign interest payments relative to tax revenue. We can see that in the period from 1982 to 1995 foreign interest payments were over 6 per cent of tax revenue and as high at 10 per cent in three of those years. Today's ratio is rising very rapidly but is still far less than those high rates. What is worth noting, however, is how quickly the ratio rose in the 1970s and fell in the 1990s. The latter fall was driven strongly by the strength of exchequer associated with rapid economic growth. This change is reflected in Figure 6, which covers the period since 1975 only.

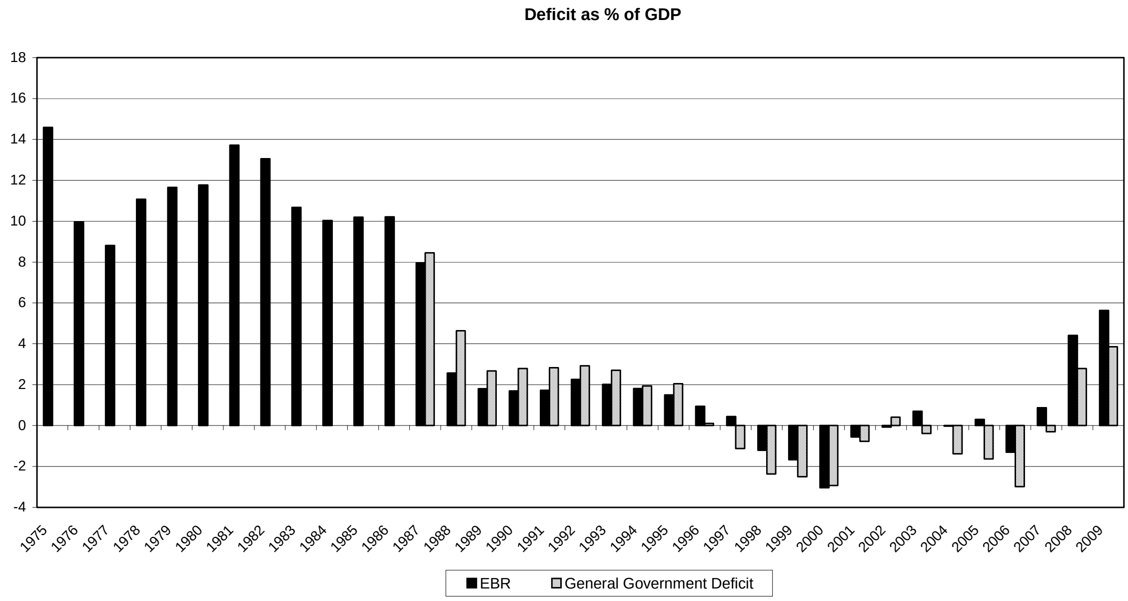
While interest payments continued to increase right throughout the 1980s, the Exchequer Borrowing Requirement was in fact falling, and it, together with the General Government Deficit were actually negative for many years in the past decade. This pattern set its own challenges for government in that, with large-scale infrastructural and other deficits, it was under severe pressure to relax the budgetary and efficiency constraints that a tighter fiscal environment would have created.

Figure 5: Government Foreign Debt Interest Payment to Tax Revenue and GDP, 1960-2005



[18] It should be noted, however, that private debt has risen dramatically in the past decade.

Figure 6: Exchequer Borrowing Requirement and General Government Deficit



Trade and Growth

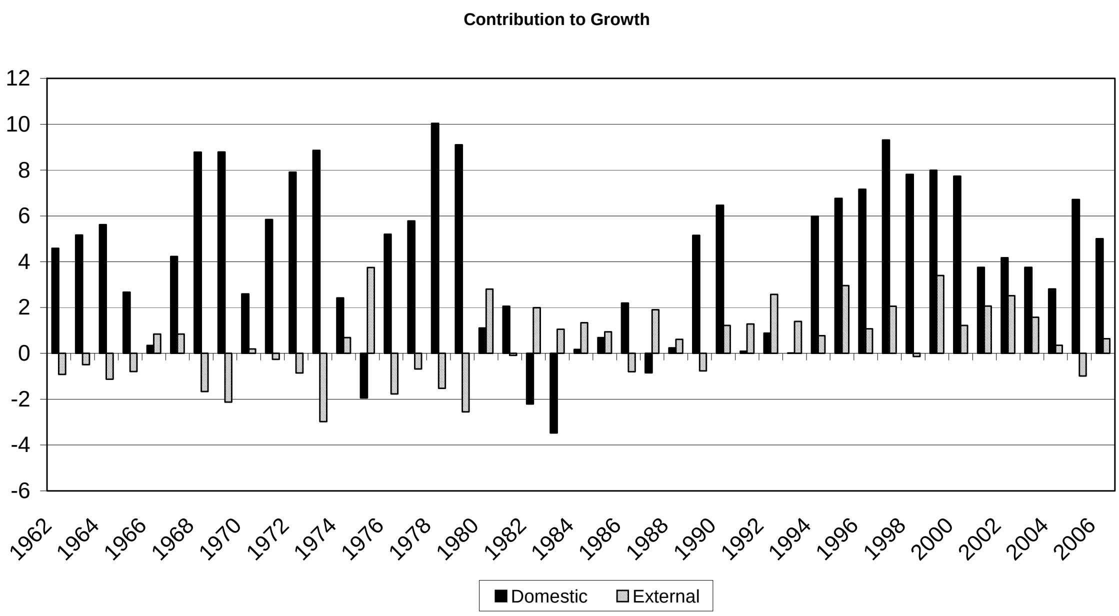
It is well known that Ireland now has one of the most open economies in the world, as measured in terms of its ratio of traded goods/services to GDP/GNP.[19] The openness is a product of our pro-trade policy (going back to the 1960s and advocated strongly in *Economic Development*), the scale of our domestic market (whose relatively small size does not allow economies of scale in production without sales into international markets), and the large share of Irish business that is foreign-owned. In effect, our engagement with international markets has contributed very positively to recent economic growth, and as a country, Ireland has benefits very significantly from the further integration of Europe brought about by the addition of new members states and the reduction in cross-border barriers to economic activity under the Single Market Programme.

Figure 7 decomposes growth into domestic and external sources. The pattern shows that if we ignore foreign markets and the need to be competitive, we do so at our peril. We now see that the growth driven by internal factors only cannot be sustained and for us to grow at our (supply-driven) potential over the coming decade, we need to

[19] Ireland ranked first place in terms of the AT Kearney Globalisation Index for several years since 2000.

ensure that the contribution to growth from external factors remains positive.[20] A further message from this figure is that external trade growth is highly volatile – an unavoidable consequence of being engaged in the global economy. This consequence was recognised with stunning bluntness in *Economic Development.*[21]

Figure 7: Internal/External Sources Contributing to Growth, 1962-2006



These seven charts show that while we have made extraordinary progress since 1958, the path of development has been very uneven. While external factors contributed strongly to the unevenness, the way in which we have exercised policy has also contributed to the uneven growth pattern. To illustrate the cost of adopting pro- rather than counter-cyclical policies, just think how different Ireland would look if it had grown at the average rate of the whole period.[22] Might it have been possible with a better policy process to have avoided the infrastructure and fiscal crises, the mismanagement of the health system, the unstructured growth of higher education and the very costly labour market disruptions?

[20] This is a recurrent message in the ESRI's *Medium-Term Reviews*.

[21] *Economic Development* states this very succinctly*: Our imports and exports can fluctuate in an embarrassing way*. Chapter 4, Para 19.

[22] This is a very useful thought experiment for any economy, and particularly Ireland, given the striking contrasts between the 1980s and 1990s.

3. Policy Process

In this section we explore some elements of the policy process from *Economic Development* and relate them to the current process of economic policymaking in Ireland.

As noted above, the separation of the government's programme from the analysis of the economy by civil servants and other specialists was a major event for Ireland. In a sense the publication of *Economic Development* recognised, perhaps for the first time in Ireland, the technical requirements for sound economic management. It would appear that prior to 1958 economic policy had been driven strongly by political ideology, involving little input from economics expertise *per se*, and the civil service role was simply to administer the policies associated with that ideology.[23] Discussion of the reason for the change at that time is beyond the scope of this paper. However, it is important to recognise that the publication of civil service documents of this type and scale was not the norm in Ireland or elsewhere at the time.[24] In effect, while the government's perspective and policies were reflected in its *Programme for Economic Expansion*, it was prepared to put into the public domain the independent analysis of Ireland's problems and opportunities by a group of what some might call 'technocrats'. This might be seen as an early example of transparency in national policymaking anywhere.

As a document, *Economic Development* subscribed to the principle of being as evidence-based[25] as possible and acknowledged some outside influences.[26] Subsequent history would suggest that the strong support by T.K. Whitaker and his department for the establishment of the Economic and Social Research Institute (ESRI) reflected an acknowledgement that the amount of evidence available to inform

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[23] The ideology was characterised by a protectionist trade policy and policies to conserve the positions of key vested interest groups, with no real appreciation of the damage these policies were doing to the country's economy.

[24] While there were expert documents produced on specific issues – such as emigration and banking – there were no expert documents produced on the system as a whole. The importance of the systemic approach to policy is that is demonstrates publicly the need for trade-offs in policy choices.

[25] Chapter 1 states that: *The mind needs the support of facts and figures*, an approach supported by the Chair of the Group and by the inclusion of the Head of the Central Statistics Office as a member.

[26] Frank Barry discusses this issue in his paper to this conference. The full influences are not acknowledged in the document – the Introduction mentioned just two individuals – Sir Alec Cairncross and Bishop Philbin of Raphoe. This is in stark contrast with NESC Paper 117, which includes several pages of academic references and agency reports.

policymaking was limited.[27] In essence there were three elements to *Economic Development*:

1. The first element was a thorough analysis of the Irish economy, at an aggregate and a sectoral level, in terms of deficiencies and the principles that needed to be invoked to correct them.

2. The second element was the focus on Ireland's potential: What exactly could be achieved if the right policies were in place? By how much could growth increase so that we would catch up with our European neighbours? What is perhaps not fully appreciated is that the importance of competitiveness as an essential prerequisite for realising this potential was recognised in 1958.[28]

3. The third element was the use of a ten-year perspective in framing policy, combined with the identification of the national capital programme as the key policy instrument. In context we must recognise that this was a long timeframe for a country that was then less than forty years old. We should note that it was closer to a perspective rather than a rigid plan, reflecting an awareness of the large external influences over which Ireland would have no control.[29] Again this provided evidence of Ireland's growing maturity and the imminent shedding of protectionist policies.

If we were to look today at a parallel for the policy process implicit in the preparation of *Economic Development*, we would find the three elements in different places:

1. Increasingly the current view of the economy, how it works and in particular the link between the economy and society, is now encapsulated in documents produced by the National Economic and Social Council (NESC). Its most

[27] T.K. Whitaker played an exceptionally active role in persuading the Ford Foundation to provide the initial funding for the ESRI, while RC Geary played a pivotal role in attracting leading international researchers to come to the Institute since there was a dearth of empirical economists in Ireland at the time.

[28] For example, *Economic Development* states: *If we do not expand production on a competitive basis, we shall fail to provide the basis necessary for the economic independence and material progress of the community*.

[29] It also recognised an ambiguity towards economic planning at the time, as Eastern European communism was seen as being 'plan-centric' in its approach.

recent document, NESC Paper No 117: *The Irish Economy in the 21st Century* is informed by a range of influences, and some or all of these are duly acknowledged in the bibliography. This represents a big change compared with 1958. The 'technocratic view' in *Economic Development* has been replaced by a 'consensual view' agreed by the social partners, informed by the NESC Secretariat drawing on a range of policy documents produced by and for government departments and agencies. The link between NESC, Social Partnership and the Department of An Taoiseach also means that the role of the Department of Finance in this context seems to be quite different to what it was in 1958. It is not evident how significant a role the Department of An Taoiseach, *qua* Department, played in the production of *Economic Development.*

2. In terms of looking at Ireland's potential, the ESRI's *Medium-Term Review (MTR),* based on a two/three year cycle, is the main instrument for exploring, within a global context, what is possible if we manage the economy well and continue to be competitive. The global context is now more complex and the modelling is much more complex, but the overlap between the issues explored in key chapters of *Economic Development* and in a typical *MTR* is very striking, e.g., competitiveness, growing productivity, public sector efficiency, control of public sector pay.

3. In terms of the ten-year perspective, this is now much more developed than it was and has been implemented through our sequence of *National Development Plans* since 1989. These plans are produced in a more 'bottom up' way than the Whitaker plan in 1958, with Departments providing inputs and other institutions and agencies, including the ESRI, assisting the Department of Finance in drawing a coherent plan together.[30] Furthermore, today's plans have substantial resources attached to them, in contrast with the 1958 plan, which relied totally on the funds available in annual budgets for

[30] An interesting issue for economic historians is how we came to abandon the approach adopted in the *First, Second and Third Programmes for Economic Expansion* in the early 1970s, only returning to such planning type documents under the requirements of the EU structural funds in the late 1980s.

implementation. They also incorporate a more structured multi-annual approach.

By international standards, it could be said that Irish economic policymaking is exceptionally mature in the extent to which it takes a long-term view – something that can be linked back to *Economic Development.* In effect, long-term economic development issues, and even the policies put in place, tend to run above politics in Ireland. Indeed taking politics out of serious economic crises was central to the *Irish Inc* approach adopted in solving the disastrous problems of the mid-late 1980s.[31] Arguably we are currently back in such a position today.

The preparation of large-scale planning documents means that the annual budget is less important to the direction of policy now than it was in the 1980s. Indeed, arguably its main role is to manage economic cycles, which (from a Keynesian perspective) means reducing public expenditure during a boom period and *vice verse* during a recession. The importance of planning in the Irish policy process means that we take it for granted that the current NDP should be rationally-based and should run beyond the life of the present government, lest these longer-term policy perspectives be eroded by the 'political business cycle'.[32] That said, there would be widespread agreement that the scale though not the general direction of the current plan was not independent of the political cycle. In a rational economic framework, the scale of the plan should match both the absorption capacity of the economy itself[33] and its ability to deliver that without undermining the structure of the economy. It should also take account of the capacity of the public sector system to deliver the projects and programmes at the standards of evaluation and monitoring to which it has committed, while the precise roll-out of the plan would reflect the demand management context.[34]

[31] In effect the Tallaght Strategy allowed Ireland to re-engage in rational policymaking, without which the prosperity of the 1990s would not have occurred.
[32] This is required to avoid the 'damaging inconsistencies and conflicts' noted in *Economic Development.*
[33] For example, the ability of the higher education system to expand its research output without reducing the quality of the undergraduate education system it offers, or the construction industry to provide infrastructure at cost levels that allow a real return on capital for the State.
[34] The commitment of the Department of Finance to high quality evaluation and monitoring is set out in presentations by David Doyle (2004) and Jim O'Brien (2007) to annual conferences of the Irish Evaluation Network.

A distinct difference between *Economic Development* and the current *NESC* and *NDP* documents is the dominant focus on sectors in *Economic Development* compared with a more 'market-focused' approach, in terms of both products and factor markets, in the *NESC* and *NDP* documents. In fact, the focus on joined-up thinking at this level has moved well beyond where it started in 1958, and there is now a greater appreciation that sectors contain heterogeneous enterprises that interact differently with the market, and that markets respond to relative price changes. Furthermore, while it may well not have been the case, reading *Economic Development* one has a sense of its authors not quite believing in markets, in terms of their resource allocation potential. Implicitly direct government intervention was seen as the driver of change. Indeed one of the great changes in Ireland in the past couple of decades is a slowly growing awareness of the way markets operate – whether it is the market for university places (through the points system), for air-travel or for housing. The sectoral focus in the current documents is on internationally-traded services and on high-tech manufacturing, and the ways in which these connect with the markets for skilled labour and technology. By contrast the sectoral discussion in *Economic Development* was dominated by agriculture,[35] where policy interventions were described at an extraordinary level of detail, while there was virtually no detail available on the manufacturing or service sectors.[36] There are lengthy discussions on capital availability in *Economic Development*, a focus that is almost entirely absent from recent documents, reflecting no doubt the integration of Ireland into global capital markets.

A striking similarity between *Economic Development* and the *NESC/NDP* documents is the importance all attach to competitiveness and the dangers of ignoring it. This is ultimately about recognising long-term economy-wide interests and setting these above short-term vested interests. To some it might appear that Ireland only

[35] The dominance of agriculture derives from the conclusion that: *In general, however it would seem that attention should be concentrated primarily on raising the efficiency and volume of production in agriculture and in industries based on agriculture.* The only real mention of services is in relation to tourism about which there is quite some discussion because of its perceived importance as a foreign exchange earner.

[36] The absence of discussion on manufacturing, which in the subsequent three decades was to become the major engine of economic growth, was in part due to the absence of hard or soft data on the sector. The latter was to be rectified to some degree by the development of CSO data and the reports produced by the Committees for Industrial Organisation (CIOs) that were set up in the 1960s to explore how the industrial sector needed to prepare for free trade.

discovered competitiveness as an issue in the 1990s – as symbolised in the establishment of the National Competitiveness Council. However, this is not true as *Economic Development* is full of statements pointing to its importance in 1958, starting with the statement: *Our level of real incomes depends on our competitive efficiency*[37] in Chapter 1 and later stating: *If we do not expand production on a competitive basis, we shall fail to provide the basis necessary for the economic independence and material progress of the community.* And, in a statement that is as relevant today was it was in 1958, we find in *Economic Development*: *Economic Expansion could be seriously hindered both by restrictive practices on the part of trade unions and by insistence on frequent and indiscriminate increases in wages and salaries exceeding any benefit from increases in productivity and causing a general rise in production costs.*[38]

4. Lessons for the Short to Medium Term

Before looking at potential lessons from 1958 for today, let us focus briefly on the ways in which the economy is different from what it was in 1958.

Openness: While *Economic Development* stressed the importance of greater openness, the extent of openness today is much greater. This means that we get greater upswings from international growth but we also get correspondingly greater downswings.[39] Furthermore, the economy today is much more globally diversified – where in 1958 most trade and factor mobility was between Ireland and the UK, today our international relationships are much stronger with mainland Europe and with the USA. Clearly the extent of integration between Ireland and other EU countries is completely different now from what it was in 1958. Furthermore, the extent of integration of the two countries on the island of Ireland is obviously much greater now.

[37] See Chapter 1, Page 2.
[38] See Chapter 3, Para 14.
[39] We are extremely conscious of the latter today, having enjoyed the benefits of many years of upswing in the past two decades.

Growth Engine: Whereas in 1958 the economy did not have a growth engine, we potentially have one today, centred on high-tech internationally-traded manufacturing and services.[40] However, the growth engine is mainly found in foreign-owned enterprises, and, despite recent reports, we are still a considerable distance away from having large numbers of strong internationally-trading indigenous businesses. We ignore at our peril our dependence on these foreign-owned enterprises, and the need to provide a competitive environment in which they can prosper. Of particular concern here, and similar to 1958, is the poor productivity performance in many parts of indigenous manufacturing, even in those enterprises that are exporting.[41]

Human Capital: Ireland's level of human capital in the 1950s was very low and increasing slowly. This contrasted with the rest of Europe, where secondary education was the norm, and where larger proportions of the population were continuing on to post-secondary education. Today our participation levels are much higher at senior secondary and at tertiary levels but lag way behind our OECD comparator countries at the fourth (PhD/research) levels – a level not even envisaged in *Economic Development*.

Role of the Market: Whereas in 1958 there was no confidence in the role of markets to reorient development, there is, as noted above, much more recognition today that markets do work. Consumer and business people now see that: if airlines[42] and inter-city buses are de-regulated, better service and lower prices result; if prices are uncompetitive, producers lose market share; if wage costs are too high, employment falls; if charges are levied on plastic bags, shoppers move to alternatives. That having been said, the lack of confidence in markets remains a weakness in Ireland, with a tendency to presume that government must intervene in some areas where the market can do the job much better. Furthermore, we need to address the failure of certain

[40] To the extent that there was a growth engine in the 1950s, it was in the agricultural sector.
[41] Recent research on indigenous manufacturing shows a productivity performance that does not indicate potential for rapid output growth or for large increases in pay. See Gleeson and Ruane (2008).
[42] For example, while tourism was the only service sector that received attention in *Economic Development*, there was no mention of the cost of getting onto the island which remained high until Ryanair entered the market in the late 1980s.

publicly provided services, such as urban buses, to provide a good service to Irish consumers.[43]

Public-Sector Efficiency: While there is some recognition in *Economic Development* of the need for increasing public sector efficiency, there is greater recognition of that need today and very slowly growing recognition that in a knowledge society more specialised skills are needed within the civil and public service. While there is the commitment to increased efficiency in the public service, evidence of real reform remains to be seen.[44] There is considerable cost, in terms of economic growth, of having a public sector that is relatively costly and not properly resourced to deliver services efficiently. A further source of risk is the dependence on consultants for technical and specialist knowledge.

Growth Potential: Whereas in 1958, there was little confidence that we could achieve a better equilibrium, with lower unemployment and no involuntary emigration, today we know that it is possible – and this should provide the confidence needed for taking the tough decisions necessary to deal with our current difficulties.

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Reflecting on *Economic Development*, reviewing recent government publications on the economy, and bearing in mind the challenges faced by policymakers in the present fiscal climate, several observations come to mind.

Competitiveness Matters: Ireland's success in turning the economy around in the past came from growth through international trade and internationally mobile investment. The lesson, which *Economic Development* recognised in 1958 but that is periodically forgotten, is clear – Ireland cannot succeed if it is not globally competitive. No one, neither government, nor employers, nor trade-unions, nor consumers can simply 'wish away' that economic reality – if they try to do this, history shows that the country loses. For example, *Economic Development* suggests that if the competitiveness level is lower than Europe, then living standards must be lower. It goes on to recognise that

[43] This continues despite publications like *Better Regulation* and the advice of the OECD to the Irish government.
[44] See OECD (2008)

lower living standards are only acceptable as part of a programme of national regeneration. This conclusion is as relevant in 2008 as it was in 1958 and in 1987. Anticipating the type of situation we currently face, Chapter 3 Para 14 notes that: *The success of any policy of economic development will depend on the effective and continuous cooperation of the trade unions in promoting increased productivity and in avoiding increases in wages and salaries which would injure export prospects.* So the message for today is clear – Ireland must win back its competitiveness and that means starting with a pay policy that does not raise public sector costs or does not reduce private sector employment. In today's climate, this may mean a review of the current levels of public sector pay and whether they impede economic recovery and longer term prosperity.

Economic Cycles Happen: Economic cycles are a fact of life – they happen again and again and we must continuously plan with this in mind. Our experience, from time to time, of long periods of sustained growth in our major markets, such as in the 1990s, should not cause us to forget this. Government needs to operate counter-cyclical policies and thus be ready for a downturn – it should not be taken by surprise when the inevitable happens. Strong global competitiveness means that the impact of a downturn can be moderated, but this is not the situation Irish business faces in 2008, where the economy has lost international competitiveness in recent years, and recent policies have been pro-cyclical.

Thus in today's difficult climate, flexibility is needed on both sides of the table in the business sector – employers and senior managers must recognise that ability-to-pay constraints apply just as much, and arguably much more, to their salaries and bonuses as they do to those of their lower paid employees. If financial viability is to be assured, flexibility in the face of a recession should cover all dimensions of a company's operations: numbers of employees at all levels up to the highest management levels, remuneration rates for employers/ employees, work practices at all levels, returns to the owners of the companies, etc. Inevitably this means greater efforts in monitoring resources and managing staff than in a boom period. The greater the flexibility, the more likely a private sector company and its employees are to weather the recession and recover when it is over.

The situation in the public sector is somewhat similar to that section of the private sector that is protected from market competition.[45] There is no market threat to generate pressure for flexibility. So if revenues are down in the public sector, what happens? Historically if wages continue to increase rather than stay constant or fall and if work practices are slow to change, the only flexibility that government has as an employer is to reduce output, i.e., reduce the scale of programmes it supports or reduce the quality of services it provides directly to the public, with the latter linked to not replacing those who leave (retire from) the sector. This is clearly a much lower degree of flexibility than found in the globally-trading private sector, and it calls us to question the ability of public sector to be able to manage a strong econo0mic downturn such as we have in 2008/9. It raises the question of whether it is possible to continue with a situation where some individuals (i.e., those in the public sector and the private sector that face no global competition) suffer much less than those in sectors facing global competition when the international economy is in recession. In the absence of downward pay adjustments in the public sector and the protected private sector, the potential recipients/consumers of the services of these sectors will suffer.

Finally, it is worth noting that while we have benefited very considerably from being part of the Euro Area, one consequence of this is that it restricts our use of monetary instruments.[46] It points to the importance of getting fiscal and incomes policies right, and of using such monetary controls as we have effectively. Indeed *Economic Development* provides some very pertinent advice in this regard – concluding a discussion on banking it notes: …*the exercise of financial responsibility may require unpopular measures of restriction as often as it admits of liberality and expansion.*[47]

So the message for today is that we would do well to recognise the power of economic cycles, and act accordingly. This means recognising the cost of operating pro-cyclical policies in recent years and planning our way out of this present situation in a long-term systematic way – revising decisions and re-prioritising as needed. In essence, the development plans we have in place set out a general direction and if this

[45] The protection may be through past or current regulation or through the absence of an active competition policy in the past.
[46] This is nothing new historically and rather similar to the situation in 1958 when we were parity-linked to £-sterling.
[47] See Chapter 3 Para 18.

direction is correct, the cycle does not change the direction but merely the pace of development. However, if the plans contain elements that do not stand up to scrutiny on closer inspection, then the present downturn provides an opportunity to revisit these elements with a more critical mindset.

Adaptability is Essential. The ability of people to adapt quickly to changing situations is vital to competitiveness and ultimately to economic prosperity. Indeed the first paragraph of *Economic Development* says all that is needed: *Readiness to adapt to changing conditions is a sine qua non* for economic success. The extent of the change envisaged in *Economic Development* was great – but it was not expected to be as unrelenting as the changes we experience today.

While talk of change is easy, the reality is much more difficult, especially in large complex organisations, whether in the public or the private sector. Today, we have to accept that we are in a world that is ever changing from an economic perspective, fuelled by the globalisation process, by technology change, by environmental concerns, etc. Organisations that have no market driver for adaptability face particular challenges in handling change. For example, what does it mean to 'be ready to adapt' in the public sector, and how is the commitment to adaptability achieved?

In the private sector, if the market generates large profits in a boom and losses in a recession, the government needs to recognise that it should not try to protect enterprises in difficulty unless there are specific reasons to do this that go beyond the enterprise itself.[48] In the Irish context this means that, very regrettably for some employees, it is unwise for the government to intervene if some construction and property development companies are forced to close. If small companies in the private sector do not adapt to change in a recession, they simply fail and they fail quickly. If large companies do not adapt, they lose market share and profitability, and may ultimately fail. This has implications for employers and employees in any company – in a dynamic world they have a shared interest in that nothing is certain except that to survive they must be competitive and innovative.[49] Putting it bluntly, the restrictive

[48] The interventions of many governments across the world in the current banking crisis come to mind.
[49] The paper by Sir Alex Cairncross quoted in Chapter 1 of *Economic Development*, states that *the nerve centre of the whole forward movement may lie, not in finance, but in entrepreneurial capacity*.

practices of employers and employees are rapidly self-defeating in a dynamic open economy environment – whereas in a closed market, the speed of decline is much slower and those practices are less immediately costly.

So the message for today in those parts of the economy where there are no market pressures on individuals for change is that there are huge pressures on managers to deliver on that change. In the public sector, the modest proposals in the recent OECD (2008) report should be seen as a starting point and nothing more. This discussion links to the final issue to be addressed.

<u>Leadership:</u> There is much talk today of the need for leadership in Ireland to deal with the present challenges. Following years of Celtic-Tiger hype, there is a need now to counteract the rapid shift to despondency. Such despondency was rampant in the 1950s though at that time the situation was much worse with many families living at bare subsistence levels. This contrasts with the situation today where we have just come through almost two decades where we enjoyed a virtuous circle of growth reinforced by increased labour supply (through increased numbers of school leavers, women re-entering the workforce and immigrants). This has generated a larger domestic market, creating incentives for entrepreneurs to invest and in consequence generate increased employment and living standards. While there are still issues related to equality, we have clear evidence to show that deprivation and absolute poverty have declined very substantially since the mid-1990s.[50]

Central to good and sustained leadership is realism – a time to face up to issues squarely, in contrast to recent years when the benefits of exceptionally high growth rates allowed us to take easier routes.[51] The following are some possible actions where benefits could be realised, with any significant increase in public spending:

This was really quite different from the thinking of the time in Ireland, namely, that capital constraints were the greatest problem but more akin to what we recognise today in terms of the need for entrepreneurship and innovation.

[50] This is set out in some detail in *The Best of Times? The Social Impact of the Celtic Tiger,* edited by ESRI researchers and published by the IPA in 2007.

[51] The availability of extraordinary levels of growth in tax revenues was a real problem when the country at large seem to have adopted an operational philosophy of ‘buying its way’ out of every tough problem.

- facing down the inefficiencies in public sector monopolies and the powers of vested interests (including the professional groups),
- narrowing the gap between the rhetoric about the quality of our education system at every level and its reality,
- operationalising the commitment to efficiency in the delivery of public sector programmes and projects,
- facing up to the challenges of implementing regulatory regimes that will better serve national interests,
- dealing with the implications of potentially large increases in population and the cultural diversity that will accompany them.

Leadership in the present situation is about ultimately dealing with some major challenges that have lain in the shadows for too long. The loss in competitiveness is to the fore, as is public sector reform. Reform is a slow process and, to keep the public finances on target, it may be time to question what has previously been seen as unquestionable, namely, that public sector salaries should be adjusted to take account of the government's 'inability to pay', so that the pain of adjustment to the present global and national problems should be shared across the economy. This would foster social partnership and contribute to Ireland's regaining economic competitiveness.[52]

We are, in the words of *Economic Development* at *…a critical and decisive point in our economic affairs*, and then, as now, as in 1987, both the private and public sectors need to take the longer view and make those decisions which will leave us in good stead as international markets pick up. The advantage of taking the large overview is that inconsistencies are avoided – but to do this tradeoffs need to be recognised, something which is not ever easy in a political context.

[52] Concerns that such wage adjustments would be to the benefit of profits does not arise in the case of the public sector.

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