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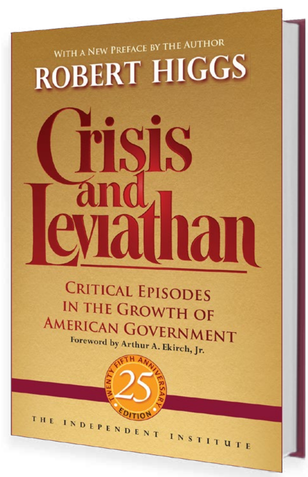

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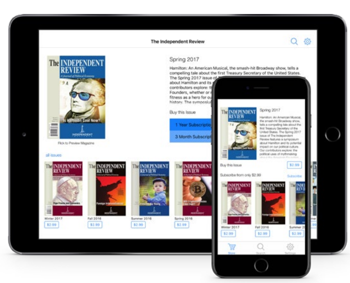

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Why Ireland Boomed

JAMES B. BURNHAM

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

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

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

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

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The Independent Review, v. VII, n.4, Spring 2003, ISSN 1086-1653, Copyright © 2003, pp. 537– 556.

Starting Points

The Republic of Ireland is a small, relatively new nation on the western edge of Europe. After emerging as the Irish Free State in 1922, following a long history of conflict with Great Britain, it promptly plunged into a civil war that lasted until 1923. At that time, the population included fewer than three million people and was dwindling. The new nation's desire to demonstrate economic "self-sufficiency" as well as political independence contributed to the adoption of inward-looking, protectionist policies: high tariffs, bans on majority foreign ownership in industry, and the establishment of state-owned enterprises in areas such as power generation, shipping, banking, and insurance (Foster 1988; MacSharry and White 2000). These policies were pursued well into the 1950s, with increasingly perverse results. The economy stagnated, emigration soared (more than four hundred thousand people left Ireland between 1951 and 1961), and foreign trade remained tied in large part to the United Kingdom (UK).

By the mid-1950s, the hopelessness of the situation, combined with the emergence of the Common Market (even though Ireland was not a member at the time) brought about the first significant change in government attitudes. Foreign investment, particularly in exporting industries, was made welcome. In 1956, new investors' export-derived profits were made tax free for a fifteen-year period. Restrictions on foreign ownership of industry were phased out, with full repeal in 1964. Recognizing the importance of low-cost imports for the exporting industries, tariff barriers began to be lowered. Still outside the Common Market, Ireland entered into a free-trade agreement with the UK in 1965.

The Industrial Development Authority (IDA), established in the 1950s, played an active role in soliciting foreign investment and provided substantial—and frequently controversial—subsidies for many firms in the form of nonrepayable capital grants, ready-made facilities, training, and research-and-development (R&D) grants. An industrial estate and free-trade zone, with full profits tax exemption, was established at Shannon. This city also hosted the major trans-Atlantic base for all commercial air traffic between North America and northern Europe until the advent of the Boeing 707 in the early 1960s.

All of these initiatives, however, were taken in the context of the prevailing view that the government, through its ownership of key sectors (for example, power and telecommunications) and a series of national development plans, had a major role to play in economic development. Although doctrinaire socialism has never been a prominent feature of Irish economic policy, as it was in England for a time, neither the political leaders nor their economic-policy advisers have made a Reaganesque or Thatcherite commitment to rely on the "magic of the marketplace."

The effort to entice foreign, in particular American, investment in Ireland began to show measurable results by the end of the 1960s. During that decade, 350 foreign companies were established and rapidly became leaders in the export sector. Tradi-

Table 1
Measures of Irish Economic Performance, 1961–80
(Average Annual % Change)

	1961–70	1971–80
Real GDP	4.2	4.7
Real GNP	4.2	3.9
Employment	0.0	0.9
Unemployment rate *(average level)*	4.8	6.8
Consumer Prices	4.8	13.6
Net Migration *(decade total)*	–165,000	96,000

Source: OECD 1991–2001 and data provided to author by the Irish Central Statistical Office.

tional industries, however, were slow to adopt new ideas or to increase their exports (Foster 1988, 579).

Economic performance in the 1960s at first glance appears to have been satisfactory. Average annual growth in real output exceeded 4 percent (table 1). However, net emigration persisted (at a somewhat lower rate than in the 1950s), total employment stagnated, and the number of unemployed persons rose as a rise in manufacturing and service jobs was offset by continued job declines in agriculture. In Ireland, as in most countries and regions, a higher gross national product (GNP) means little politically if people are still voting with their feet to find jobs abroad.

First Steps Forward

Ireland's long-anticipated entry into the Common Market in 1973 (along with the UK) set in motion important structural and psychological changes for the country at all levels. The Common Market provided an alternative to England and the United States as an outlet for Irish energies. At last, Ireland was positioned to reduce its historic dependency on the UK market, a long-sought if generally unremarked goal for many.

The immediate impact was a boom in agriculture as Irish exports gained free entry into a vastly expanded market at attractive prices. Between 1972 and 1978, real farm income rose more than 40 percent, and land prices soared (MacSharry and

White 2000, 152). Foreign investment continued to grow, although not without problems. In 1977, the largest foreign employer, a subsidiary of a Dutch multinational, closed, causing a loss of fourteen hundred jobs. Although poor management-labor relations apparently brought about the closure, the Irish Republican Army's kidnapping of the plant manager in 1975 might have contributed to the shutdown decision (258).

By some measures, the record of the 1970s constituted an improvement over that of the previous decade. As table 1 shows, real GNP growth again averaged close to 4 percent per year.[1] The net loss in migration was reversed, but inflation—fueled by loose fiscal and monetary policies—soared, the government's foreign borrowing skyrocketed, and unemployment rose. Although the oil price shock of 1973–74 was a factor, Irish economic performance, compared to that of other European countries, was well below average.

By the end of the 1970s, some Irish economists were calling for a repudiation of the national debt, labor strife was rampant, and political leadership was sorely lacking. Thanks to entry into the Common Market, the farmers enjoyed the ride, and foreign investment continued to create jobs, but there was little evidence of a decisive break with previous patterns of development, even if the net outflow of Irish citizens to other countries had been modestly reversed.

One important step forward was taken, however, in tax policy. The European Commission objected to the tax exemption on export-derived profits as excessively discriminatory. (The existing statutory rate on domestically traded output was 50 percent.) In 1978, the Irish government negotiated a very favorable "compromise" that enabled it to make a twenty-year commitment to a 10 percent rate on *all* manufacturing, while still honoring the zero-rate, twenty-five-year commitments made to earlier investors (MacSharry and White 2000, 249–50).

The 1980s: Touching Bottom

If analysts were gloomy at the end of the 1970s, they had even more cause to lack optimism throughout much of the 1980s. The government's budget deficit averaged 12 percent of gross domestic product (GDP) in the first half of the 1980s. Concerns about the country's creditworthiness began to spread to international investors. A start at bringing government spending under control helped to cool down the economy but sent the unemployment rate up to a high of 17 percent in 1986. Job growth through 1986 averaged –1.3 percent, and the net outflow of citizens resumed (see table 2). Out-migration peaked at forty-four thousand in 1989. With two important exceptions (both overlooked by most analysts), the government took no decisive action in restructuring the environment for business or in selling off

1. The difference between rate of GNP growth and the usually higher rate of GDP growth springs from the substantial earnings of foreign-owned firms, which are included in GDP, but not in GNP.

Table 2
Measures of Irish Economic Performance, 1981–2000
(Average Annual % Change)

	1981–86	1987–93	1994–2000	2000
Real GDP	2.1	4.8	9.0	10.2
Real GNP	0.1	4.1	8.4	9.8
Employment	–1.3	1.1	5.1	4.7
Unemployment rate *(average level)*	13.8	15.2	9.5	4.2
Consumer Prices	10.8	2.9	2.5	6.5
Net Migration *(period total)*	–70,000	–94,000	72,400	20,000

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

inefficient state enterprises, as the UK government was doing under Margaret Thatcher.

IDA policies came under attack from a variety of critics. A government report in 1982 found that policy was "overly generous towards multinationals—relative to what was needed to attract them—and providing the wrong kind of incentives." IDA policies historically tended to favor capital-intensive investment, such as those of chemical and pharmaceutical companies, provided few penalties for firms that did not live up to their original employment projections, and did little outsourcing with Irish firms (O'Grada 1997, 118). Shortly thereafter, IDA programs and marketing began to concentrate more on the service sector, in particular software and data processing. By 1985, IBM, Lotus, and Microsoft had established development centers in Ireland.

Foreign investment inflows slackened significantly in the second half of the 1980s, in part because of the country's own problems, but probably also because of a general slackening in investor confidence in European Community institutions in general (Organization for Economic Cooperation and Development [OECD] 2000, 52). In addition, three high-profile U.S. companies—AT&T, Black and Decker, and Hyster—closed their Irish operations (MacSharry and White 2000, 262–65). As a picker of winners, IDA clearly had a mixed record.

In the late 1980s, however, the necessary underpinnings for the extraordinary expansion of the 1990s were gradually being put into place. One highly visible initiative was a drastic change in fiscal policy in the face of extraordinarily high unemployment rates and growing concerns about the country's finances. In 1987, a new (minority) government took office. Much to almost everyone's surprise, it engineered substantial cuts in planned spending and abolished some cherished government agencies. The shocked included civil servants, whose planned pay raise was canceled, and voters, who had not heard of these initiatives during the electoral campaign (MacSharry and White 2000, 66–74).

A noteworthy element in the new government's program was an amnesty offer for delinquent taxpayers. Prompted by a top marginal rate of 58 percent for individuals and 50 percent for corporations, tax evasion had been rampant. The government gave delinquents six months to settle their accounts (without interest or penalty charges). The result was a IR£500 million windfall (approximately U.S.$750 million) against a forecast of IR£30 million and an effective broadening of the tax base (MacSharry and White 2000, 87–91).

Another element in the government's program was the negotiation of a multiyear "Program for National Recovery" among government, unions, employers, and farmers—resuming a tradition of centralized wage bargaining begun in the 1970s. The essence of the program was a negotiation with key labor unions on a ceiling for pay increases, a modest amount of tax relief, and a promise to hold constant the real value of government-funded benefits. Although the direct economic impact of such arrangements has been questioned, in this case the ensuing absence of labor strife helped give this form of "incomes policy" a favorable image in Ireland.

The effective implementation of the government's budget was an important step in bringing its precarious financial affairs under control, shoring up the country's reputation among foreign investors, and setting the stage for reductions in marginal tax rates for both individuals and corporations in the 1990s.

Getting It Right: Telecommunications

At the same time that fiscal policy was finally moving in a constructive direction, efforts to tackle the country's most-pressing infrastructure problem began to bear fruit.[2] In 1980, Ireland's telecommunications system was perhaps the worst in western Europe. Operated as a government department, it was vastly overstaffed, its equipment was antiquated, its service was erratic, and its charges for both domestic and international calls were among the highest in Europe. It was the subject of regular questions in the Dail (Parliament) from members representing small towns that

2. This section draws on Hall 1993, the record of parliamentary (Dail) debates of the period, and An Board Telecom and Telecom Eireann annual reports.

had been seeking community pay phones for a year or more (residential installations typically took even longer). Customers were required to prepay a year's fixed charges.

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

One route to reform would have been to throw the telecommunications market open to the private sector. This was the path Finland had followed much earlier, thereby gaining the most competitive and innovative communications infrastructure in Europe. (The Finnish approach played an important part in the transformation of Nokia into a global electronics giant.)

The Irish government, however, chose to rock the boat as little as possible. In 1979, it committed itself to a major capital-spending program designed to achieve "state-of-the-art" service. Equally important, in 1980 responsibility for telecommunications services was removed from the Post Office Department and from the civil service and given to an independent entity, An Bord Telecom, which in 1984 was transformed into a self-financing state enterprise, Telecom Eireann.[3] A leading businessman, Michael Smurfit, was appointed to control the new organization, and he immediately secured the services of the senior IBM manager in Ireland as CEO. Together, they set clear, aggressive goals for service levels, debt reduction, and profitability that drove the organization throughout the 1980s.

In doing so, they had to be sensitive to the fact that they were starting with a staff of more than eighteen thousand, which made them the largest employer in Ireland. Upgrading service and bringing costs under control by installing new equipment inevitably would reduce jobs substantially, however. Furthermore, in contrast to many countries' traditional use of high international charges to cross-subsidize domestic service, Telecom Eireann strove to offer highly competitive rates for most international services. Doing so was relatively easy for new or specialized services (telex, data lines, and packet switching), but a significant reduction in charges for traditional international voice services would have had major revenue implications and was deferred until 1988, the first year of profitable operations. By 1987, Telecom Eireann had achieved its first major goal, completion of digital switching throughout the country, and the company began an aggressive program of laying optical-fiber lines.

By 1988, the government could tell the members of the Dail that international service "had been improved to such a degree that it is now a major contributing factor to present day successes in wooing foreign firms to our shores" (*Dail Parlia-*

3. That the new enterprise took IR£1 billion in debt off the government's books was probably an added attraction for the Department of Finance.

mentary Debates 373: 2385 [May 24, 1988]). By the end of the decade, Telecom Eireann had established itself as a recognized leader among European telecommunications entities, especially with respect to international services and charges, although the company remained a state-owned monopoly that guarded its privileges jealously.

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

Discovering the Magic of the Market

The initial transformation of the Irish telecommunications sector did not result from an ideological revolution among government policymakers or from a vision of the telecommunications revolution to come. Rather, it sprang from a belated recognition that the sector had become a serious impediment to Irish economic growth and job creation. What was needed, besides a substantial investment program, was a drastic change in organization, management, and culture. No one initially proposed to surrender Telecom Eireann's monopoly powers, except with regard to equipment inside the customer's premises (Hall 1993, 197).

A quite different approach, with spectacular economic results, followed from the one significant step toward deregulation that Ireland took in the 1980s: the breaking of Aer Lingus's near monopoly on cross-channel flights to England.[4]

In 1984, the government proposed legislation to restrict the discounting of air fares in order to protect the state-owned airline, Aer Lingus, from increased competition. Aer Lingus was a classic state enterprise; it suffered from low productivity and high costs, and it always lost money. Instead of enhancing protection, however, the government decided at the end of 1985 to take precisely the opposite approach with respect to Ireland–UK routes: it adopted full decontrol of both fares and flight frequencies. Precisely why the government experienced this change of heart is shrouded in the mists of Irish politics, although public and business dissatisfaction with the high cost of the heavily traveled Dublin-London trip had been evident. Equally important must have been the willingness of a fledging Irish airline, Ryanair, to make its case.

4. This section draws heavily from Barrett 1997.

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

The broader economic impact of deregulation was impressive. An Irish government paper estimated that over the period 1987 to 1993, deregulation generated a 60 percent increase in visitors, additional tourist earnings of £560 million, and an additional twenty-five thousand jobs (cited in Barrett 1997, 71). English tourists and Irish immigrants in the UK alike responded to the lowered costs of transportation to Ireland; businessmen at both ends found that the cost of developing markets across the Irish Sea had been reduced suddenly and drastically.

The full implications of forcing Aer Lingus to face competition, however, were ignored. The government continued to control entry on trans-Atlantic routes, to protect Aer Lingus, and to require that foreign carriers stop at Shannon to boost economic activity in that region. In the context of the somewhat statist mentality that traditionally had characterized government policy, the Ryanair decision was an exception, not the forerunner to a clear pro-market strategy.

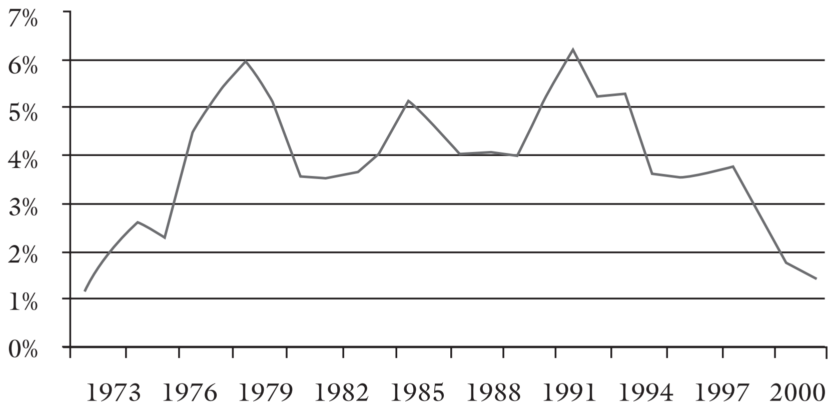
Impact of European Union Transfers

When Ireland joined the EU, it was one of the poorer members, and much has been made of the country's access to the EU's various financial transfer programs. How large a role did these transfers play in the extraordinary economic performance of the 1990s? As figure 1 shows, such transfers were relatively most important in the 1980s and the early 1990s, but their importance has declined sharply since then. As a share of GDP, they peaked at 6.2 percent in 1991, with a sharp decline thereafter, falling below 2 percent beginning in 1999. The absolute magnitude of net transfers averaged approximately IR£700 million in the 1980s and IR£1.6 billion in the 1990s. Compared to other EU countries, Ireland has been perhaps the most-favored recipient on a per capita basis (Braunerhjelm et al. 2000, 70).

The most important direct beneficiary of EU assistance has been the farm-related sector, particularly in the form of direct payments to farmers. Approximately 65 percent of EU transfers are farm related (OECD 1999, 44). Inasmuch as the Irish farm sector continues to contract, it is difficult to argue that such payments have been an important factor in Ireland's recent overall economic growth.

Visible evidence of other forms of EU largess is easy to find: a "ring" highway around Dublin, numerous "heritage centers" scattered throughout the country, air-

Figure 1
Net Receipts from European Union, 1973–2000, As Percent of GDP



Source: Data provided to author by Department of Finance (Ireland) (for net receipts); IMF, Department of Finance, n.d. (for GDP).

port improvements, and the like. However, a recent study of the overall impact of "structural" EU transfers in the 1990s concluded that their contribution to income growth was "very low," on the order of one-half of one percentage point a year, or 3 to 4 percent cumulatively (Barry, Bradley, and Hannan 1999, 114).

Some of the uses to which transfers were put in Ireland, particularly in the educational sector (discussed later), dovetailed well with other initiatives. Such meshing was particularly the case with programs to strengthen the technical colleges. (Little went to the major 1980s investment program for the telecomm sector.) It also should be noted that other relatively poor regions in the EU have received substantial funding (southern Italy, for example) but have shown decidedly poor results.[5]

Education

One other important change was taking place gradually during the 1980s: the expansion and reorientation of state-funded higher education. Additional funds went to expand the Regional Technical Colleges (RTCs) as well as to construct two new universities. IDA was a powerful force in persuading the RTCs to emphasize programs in electrical engineering and information technology when it realized at the beginning of the 1980s that it would be unable to deliver on the promises being made to foreign computer firms, such as Apple and Wang (MacSharry and White 2000, 283). By 1993, the share of science and technical graduates in the twenty-five

5. Braunerhjelm et al. (2000, 88–89) discuss the reasons for different outcomes in Ireland and in the Mezzogiorno.

to thirty-four age group of the labor force in Ireland was the highest of the twenty-five OECD countries (OECD 1999, 139 fn. 26). Modern languages also were stressed, with the goal of having all secondary graduates proficient in two foreign languages.

More broadly, the percentage of high school ("upper secondary") graduates increased substantially. In 1996, 66 percent of those in the twenty-five to thirty-four age group were graduates, in contrast to only 30 percent of those in the fifty-five to sixty-four age group. This change represented an improvement well in excess of that experienced by the average OECD member (OECD 1999, 42). The growing percentage of university graduates has shown a similar pattern.

It is important, however, to view changes in the state-run educational system as *enabling* factors in the acceleration of economic growth in the 1990s, not as causal factors. A long-standing complaint in Ireland had been that although the country invested in its young graduates, the brightest and most energetic immediately went abroad—as indeed they frequently did until the early 1990s. Not until all the critical enabling factors came together in the early 1990s could the country take full advantage of its educational reforms.

A final factor to note was the extension to additional activities of the 10 percent corporate tax rate. In 1987, the government established in Dublin an International Financial Services Center(IFSC), in which eligible companies would receive a tax incentive. Although originally intended to apply only to foreign or Irish firms that located in a twenty-seven-acre redevelopment site in the Custom House Dock area near downtown Dublin, it was extended to firms outside the immediate area on a "transition" basis, apparently an indefinite extension.

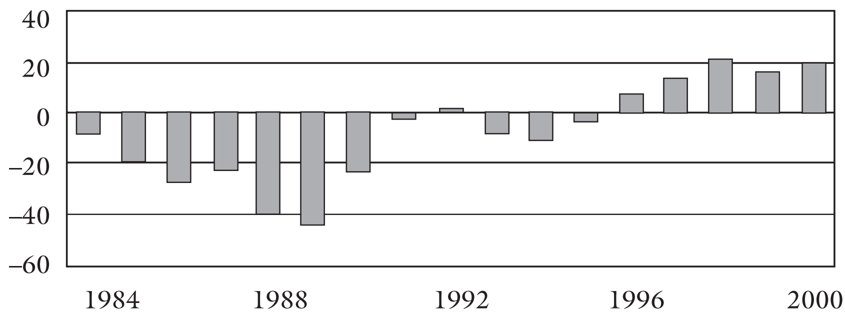
The 1990s: The Celtic Tiger Emerges

For many observers (and politicians), the single best measure of economic performance for a region or country is the number of young people voting with their feet against local prospects. For Ireland, yearly estimates of net migration provide a graphic picture of the 1990s (see figure 2).

The first half of the 1990s saw a halt to the substantial outflows of the late 1980s. Then, in the second half of the 1990s, for the first time since the early 1970s, a sustained inflow occurred as job opportunities in Ireland became abundant. This change is reflected clearly in the pattern of employment growth. A comparison of Irish growth and the EU average highlights Ireland's exceptional and sustained performance in job creation (figure 3).

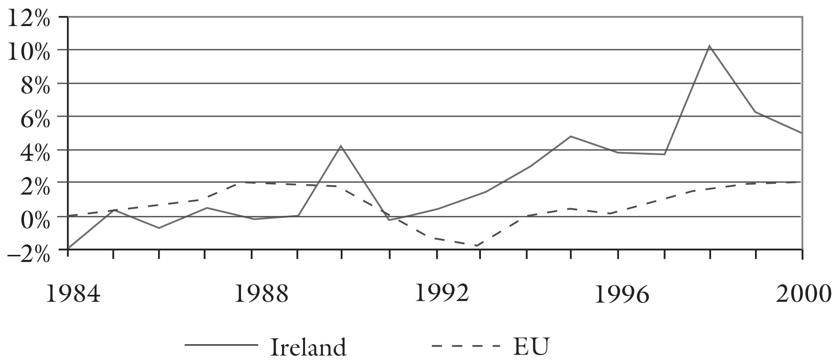
Frank Barry, J. Hannan, and E. Strobt (1999) have made a detailed examination of where employment gains took place between 1987 and 1997. Table 3 presents some of their data in a format that emphasizes the striking gains made in "market services" (which exclude government, health, and education employment). This sector accounted for 165,100 jobs, or two-thirds of the total gain over the period. Agri-

Figure 2
Ireland: Net Migration, 1984–2000 (in Thousands)



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

Figure 3
Employment Growth, 1984–2000 (% Change over Prior Year)



Source: OECD 2000.

culture continued to shrink, in effect providing labor for the expanding service sector, which had a 37 percent increase in employment. The strongest subsector was "insurance, finance, and business services," in which much of the growth—perhaps 75 percent—was internationally related.[6] An important part of this activity is the "back office" work for major international banks, which determined that Ireland has the necessary human resources, communications infrastructure, and tax regime to provide an excellent location for pan-European operations. These elements also led the New York Futures Exchange to establish its European trading floor for currency con-

6. Barry, Hannan, and Strobt (1999) cite data from Forfás, the government's industrial and technology development agency, which estimates that approximately twenty thousand jobs in this sector were internationally related, fourteen thousand of them in foreign-owned firms.

Table 3
Selected Employment Patterns

	1989	1997	Job Gain	% change
Agriculture	163,200	134,200	–29,000	–18
Building and construction	70,300	96,700	26,400	26
Manufacturing	215,400	271,300	55,900	26
Market services, including	442,000	607,100	165,100	37
Distribution	169,700	202,500	32,800	19
Insurance, finance, and business services	52,100	78,200	26,100	50
Transport and communication	65,700	83,800	18,100	28
Other, including professional services	54,500	242,600	88,100	57
All Other	199,000	229,100	30,100	8
Total Employment	1,089,900	1,338,400	248,500	23

Source: Barry, Hannan, and Strobt 1999, 20–21.

tracts in Dublin's IFSC early in the 1990s. (An additional consideration was the Irish authorities' willingness, in effect, to turn over regulation of the trading floor to the U.S. Commodity Futures Trading Corporation in order to provide traders with a seamless, extended trading day.)

Foreign-owned firms continued to account for the bulk of new job formation in the 1990s, although indigenous firms, particularly in the software sector, also recorded substantial job gains. Surveys by the government business development agency Forfás suggest that nearly 70 percent of employment gains in the 1990s took place in foreign-owned companies (Forfás 1999). Fifty-one percent of the job gains took place in internationally traded and financial services.[7] Clearly, Ireland benefited to a disproportionate extent from the U.S. and global investment boom in the computer, software, and telecommunications industries.

What were the relative roles of Irish and foreign investors in this extraordinary expansion? Extended financial time series are not available for such a breakdown, but the magnitude of net foreign direct investment in Ireland is suggested by the fact that

7. Calculated from the Forfás *Annual Employment Survey* (1999, 6–7).

in the period 1998–2000 such flows averaged 55 percent of gross domestic fixed capital formation, or more than U.S.$13 billion a year. The employment data suggest that the relative importance of foreign investors has not declined in recent years because the share of workers in foreign-owned firms has risen steadily, from 45 percent in 1991 to 52 percent in 2000. However, the emergence of numerous Irish-owned and Irish-managed startups in the software and Internet sectors beginning in the mid-1990s indicates the advent of more dynamic domestic investment activity.

It is important to appreciate the role of low-cost, reliable telecommunications services in enabling the rapid growth of the service sector. Telecom Eireann was perhaps one of the first carriers actively to pursue foreign companies to locate operations in its home country, setting up a marketing office in Stamford, Connecticut, in 1991 (Telecom Eireann 1991) and adopting an aggressive pricing policy for services, such as toll-free international in-bound calling. Between 1985 and 1991, Ireland reduced its international call charges by 28 percent, compared to an OECD average decline of only 3 percent. By 1994, leased-line charges for business were roughly half the OECD average; only the UK had lower rates (Burnham 1997, 15).

The pattern of overall employment growth has remained roughly comparable since 1997, with one important exception. The construction sector added almost 30 percent more jobs in the past two years, as lower interest rates and higher incomes fueled a real-estate boom. Financial and other business services showed a 17 percent increase.[8] Forfás data suggest that international-related activity continued to provide the greater part of the jobs in this area. However, it is relevant to note that only approximately 15 percent of the roughly fifty thousand jobs in this subsector are associated with the IFSC project in Dublin (Forfás 1999, 13).

The Policy Environment of the 1990s

The initial results of the fiscal-policy reforms starting in 1987 encouraged successor governments to continue broadly similar policies. The favorable payoffs from lower tax rates stimulated further movement in this direction. When the EU began to increase pressure on Ireland to phase out the 10 percent corporate tax rate for manufacturing and selected services, in line with its effort to "harmonize" rates among its members (nearly all with substantially higher rates), the Irish government responded by announcing that *all* corporate payers would enjoy a 12.5 percent uniform rate, beginning in 2003. The rate on capital gains was reduced from 40 percent to 20 percent (except for real-property transactions) at the end of l997. Modest reductions in the top personal rate, to 42 percent, and a variety of other changes in personal tax provisions also were implemented. Their overall impact has been considerable: the OECD estimates that approximately one-third of the increase in real after-tax income per worker in the ten years to 1997 resulted from such measures (OECD 1999, 140).

8. Calculated from the Central Statistical Office's *Quarterly National Household Survey* (first quarter 2001), 5.

The government continued its policy of negotiating national wage agreements. Former ministers have continued to cite these agreements as factors in moderating inflation during most of the period. However, the elastic supply of labor and strong gains in productivity generally are considered to have been the more important factors in moderating increases in labor costs.

The developing economic boom in the final years of the decade and Ireland's decision to adopt the Euro (which required the country to reduce interest rates) contributed to a substantial increase in prices, especially in property prices. Along with the steadily decreasing unemployment rate, this change led to rising concern that higher labor costs would begin to erode the country's competitive position.

The departure of Telecom Eireann's Smurfit as chairman in 1991 appears to have coincided with a loss of aggressiveness on the part of the company's managers. Denmark and the Netherlands, for example, were pricing leased lines well under Irish rates by 1998 (OECD 1999). Domestic charges continued to be relatively high. The company lobbied hard in Brussels for a postponement of the date when Ireland was required to open the telecommunication sector fully to competition. The company was slow to install broadband capacity and as a result lost some potential investment in the late 1990s. A Forfás report concluded that the country's infrastructure and the price competitiveness of some of its services were "lagging behind that of many other European competitors and this is a potential disincentive to investors" (1998, 5). However, by the end of 2000, the government had privatized Telecom Eireann, thrown open the domestic market to full competition, and taken the necessary steps to bring broadband capacity up to needed levels.

Sources of the Irish Boom

With the record of the past thirty years thus reviewed, it is useful to classify the factors bringing about the Irish boom of the 1990s into three categories: (1) inherited factors, over which the Irish authorities of the past two decades had little near-term control; (2) policy factors, for which the authorities were largely responsible; and (3) external events. It is also useful to distinguish between factors responsible for initiating the boom and those responsible for sustaining it.[9]

Of all the inherited factors, demographic variables probably have been the most important. Extremely high birth rates (by European standards) until recently have made Ireland an exceptionally "young" country. Although this condition caused school graduates to swell the unemployment rate when jobs were not available (and led to more emigration), it provided a large potential reservoir of young workers to support rapid, sustained growth when other factors came into play. The relatively

9. Several analysts emphasize that Ireland began the 1950s roughly equal to European countries such as Italy in terms of GDP per head. They point out that the wrong-headed economic policies of the next twenty-five years opened a gap between Ireland and the others and thereby created an "opportunity" to catch up in the 1990s. See O'Grada 2002 for an extended discussion of this point.

large percentage of women who were outside the labor force in the early 1980s provided another potential "stream" into the growth of the labor force. Although their participation rate has been rising rapidly, it is still significantly below that of many other western European countries.

Previous out-migration also turned into a plus factor as job opportunities, particularly in the high-technology areas, expanded in the 1990s. Trained information technology graduates who had left the country for jobs in the 1980s now returned, in many cases to start their own firms.[10] This source of growth in the labor force is unlikely to be an important one in the future, however, because most potential returnees already have made their move. On the other hand, for young people from other EU countries, Ireland has become an attractive place to work. More than 20 percent of immigrants now come from such countries (other than the UK), compared to fewer than 15 percent in the late 1980s. Such immigrants bring with them language abilities that are important in staffing the country's numerous international call centers for marketing, reservation, and technical-service operations.

A second inherited factor is an attitudinal one: a relative openness to foreign investment, particularly from the United States. Although elements of tension always have been present, especially when the IDA-subsidized operations of foreign firms closed, Ireland has erected far fewer formal and informal barriers to large-scale foreign investment than most European countries, once the Control of Manufacturers Act had been relaxed in 1958. This openness—along with the legacy of language and a common-law legal system from England—has contributed significantly to a high degree of comfort for investors and expatriate management, especially those from the United States.

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

A fifth important policy decision affecting the 1990s boom was the significant change in government fiscal policy in 1987, described earlier. Supported by the opposition party and continued well into the 1990s, that policy was instrumental in reassuring foreign and domestic investors. It provided evidence that the country was not taking the road to a "banana republic" status that eventually would undermine the positive developments occurring elsewhere in the economy.[11]

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10. See Rapaport 1999 for a discussion of a number of such firms.

11. Some observers suggest that the shift of fiscal policy in the 1980s was "the key precondition" to enable Ireland to catch up with the rest of Europe in the 1990s (Honohan and Walsh forthcoming). The analysis in this article suggests that other policy initiatives and a bit of luck were of comparable importance and that the "convergence" of countries' living standards is by no means inevitable. On this point, see also Barry 2000.

In all of these decisions, the opportunity to say "no" or to implement them poorly was certainly present. In that respect, they differ significantly from the "decision" to join the Common Market in 1973, an action that was preordained ("virtually inevitable" in MacSharry's view) once the UK's admission had become clear (MacSharry and White 2000, 148). I am not denying the importance of Ireland's entry into the EU's predecessor organization, but only distinguishing that action from decisions that government officials had far more latitude to take or not later on.

One aspect of EU membership over which Ireland did exert considerable control was exchange-rate policy. Although Ireland did join the European Monetary System (EMS) in 1978, the political argument in favor of breaking the long-standing link with the British pound was probably as great as any economic argument. Analysts differ as to whether or not Irish policy after entering the EMS was generally constructive or a hindrance to sustained growth (Honohan 1999, 89). A reasonable conclusion might be that it did not play much of a role in either way and that the government should at least take credit for not pursuing a consistently poor policy for any extended period. Joining the Euro in the late 1990s was certainly another preordained decision. However, by losing control of its monetary policy, Ireland has enjoyed lower (Euro) interest rates.

IDA's role in fostering Irish economic growth is controversial. Most of the commentary has focused on the agency's sometimes lavish subsidies of foreign investors and its mixed record in "picking winners." However, in this article I have tried to suggest that in addition to its marketing role, the IDA's most important contribution might have been as a lobbyist for and advocate of sensible policies: in bringing to the attention of both the Irish government and the public the importance of low tax rates, a well-trained workforce, and a first-class telecommunications system if jobs were to be created for young Irish workers.

"The Death of Distance"

The impact of the unexpected, whether good or bad, in countries' economic performance is often underestimated. However, Michael Porter, in his widely read book *The Competitive Advantage of Nations,* cites "chance"—an oil price shock or "major technological discontinuities," for example—as an element that frequently helps to explain the global competitiveness of specific groups of firms in a particular country (1990, 124–26).

For Ireland, the catalytic event over which policymakers had no control was "the death of distance," beginning in the late 1980s. This phrase, which first appeared in *The Economist* in 1995,[12] refers to the fact that over a short period of time modern technology (and fierce competition in the marketplace) essentially has eliminated distance as a cost factor for data, images, voice, music, engineering or architectural draw-

12. See "The Death of Distance," *The Economist,* September 30, 1995, 5. The author of this supplement, Frances Cairncross, subsequently published her thesis in a well-received book of the same name.

ings, books, control of instruments or machinery—anything of value that can be created and "digitized" or transmitted electronically. The death of distance had a disproportionately favorable impact on Ireland because the country was well situated and well prepared to take full advantage of it. (Recall that 51 percent of the jobs gained during the 1990s appear to have been in internationally traded and financial services, where telecommunication is a critical factor.)

The Irish were well aware of the importance of cheap, reliable telecommunications because in 1980 their antiquated, unreliable, high-cost system was beginning to cost the country jobs. Foreign investors, with plenty of alternatives to Ireland, were ready to vote with their feet, taking hard-won jobs with them.

A scared, not visionary, government determined to go from last to first in this sector. It was able to do so by the early 1990s, even though Telecom Eireann was still a state monopoly. The timing was fortuitous because advances in telecommunication-related hardware, software, optical-fiber lines, and computers had begun to drive down costs of transmission and routing extraordinarily quickly. The economic impact on Ireland initially appears to have been in processing operations, such as insurance claims and magazine fulfillment. By the late 1980s, the economics of international call centers for marketing, technical assistance, and regular servicing of customers began to become apparent to the computer hardware and software companies that had set up manufacturing facilities in Ireland. In the early 1990s, IDA and Telecom Eireann established joint marketing programs, focused on the United States, to point out to investors the happy coincidence of a young, literate, English-speaking (in many cases multilingual), technically trained labor force in a low-tax environment with a technically advanced and relatively inexpensive telecommunications infrastructure—a place where many multinational firms already were established comfortably.

Although Ireland had plenty of competition from other countries in profiting from "the death of distance" (especially from the Netherlands and the UK), none of the others had the entire range or robustness of favorable factors just recited. Furthermore, the relatively large concentration of internationally oriented firms already in the country provided new investors a high degree of reassurance that the location would be suitable. To the traditional advantages of "clustering" similar or related activities within a region were added the powerful "demonstration effects" of firms with successful experiences in Ireland, which helped to produce "a cascade of followers," in Paul Krugman's words (1997, 50). In addition, the extended economic boom in the United States, especially robust in the telecommunication-related industries, encouraged an investment boom that had worldwide repercussions. Ireland gained all the benefits of being, in effect, a "first mover" in taking advantage of the revolution in telecommunications.

Finally, the sustainability of Ireland's first-mover position throughout the 1990s received a major fillip from its favorable demographic conditions: the potential to draw women into the labor force and the ability to attract educated immigrants, both Irish living abroad and people of other nationalities.

Conclusion

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

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

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

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Acknowledgments: The author would like to thank Frank Barry for encouragement and Ian Vázquez and two anonymous referees for helpful comments and suggestions.