

The Irish economy

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An economic miracle with many causes

THE figures recording Ireland's transition from Europe's worst- to its best-performing economy are remarkable. In 1987 Irish GDP per person was 69% of the EU average (adjusted to EU 15); by 2003, it had reached 136%. Unemployment fell from 17% in 1987 to 4% in 2003; and government debt shrank from 112% of GDP to 33% (see chart 2). Annual GDP growth in the decade of the 1990s averaged a tigerish 6.9%; GNP growth, usually a more appropriate measure for Ireland (see [article](#)), only slightly less. Perhaps even more impressive, after a downward blip coinciding with the American and, especially, the information-technology (IT) slowdowns in 2001-02, the economy is bouncing back: growth both this year and next is expected to be around 4-5%.

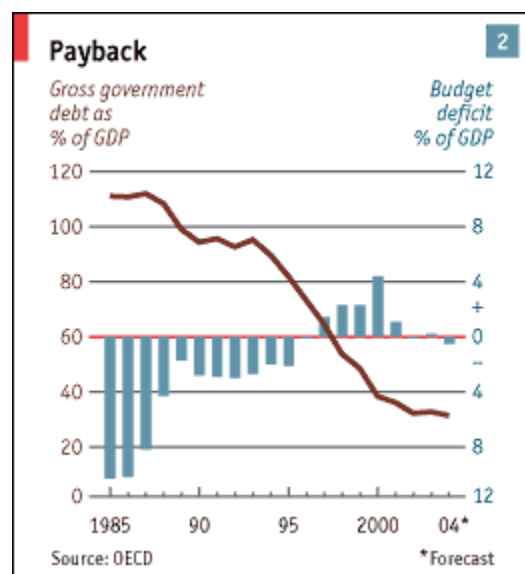
Not surprisingly, this Celtic miracle has been carefully analysed. Many different, and sometimes contradictory, explanations have been proposed, but as usual there is no single cause: it was a combination of different factors at different times.

To get a more complete answer, it also helps to ask a different question altogether. Seen in a historical context, what is striking about Ireland is not that it grew so spectacularly in the 1990s, but that it did so badly in the 1980s, and indeed for a long time before then. At independence in 1922, Ireland was as rich as most European countries, and only a bit poorer than Britain. But by 1960 it had fallen far behind, and continued to lag the rest of Europe until the late 1980s. On this reading, the emergence of the Celtic Tiger was a belated catch-up after years of underperformance.

There were, nevertheless, a number of special factors that changed Ireland's fortunes after 1987. Here are some, in ascending order of importance:

- **Fiscal and monetary consolidation.** Charles Haughey's Fianna Fail government, crucially supported by the opposition Fine Gael, started to cut spending, taxes and borrowing. Falling interest rates helped to stimulate the economy, and so did a currency devaluation in 1993. The launch of the euro in 1999 gave Ireland, a founder member, the benefit of lower—perhaps unduly low—interest rates.

- The tax cuts were also a critical component of a new **social partnership**. Unlike Britain, where the Thatcher government shifted decisively against corporatism, the Irish resuscitated social dialogue in 1987, with trade unions accepting wage restraint in exchange for more policy influence and tax cuts. Seventeen years on, unions and employers still talk up the advantages of social partnership. Even the tanaiste (deputy prime minister) and leader of the free-market Progressive Democrats, Mary Harney, considers this an important part of Ireland's success.



•**European Union subsidies.** Countries such as Germany, the chief EU paymaster, like to argue that Ireland's miracle was due to huge transfers from Brussels. Yet European money had been pouring into Ireland since 1973, at first to little obvious effect. The expansion of the EU's structural funds after the Maastricht treaty of 1992 was helpful, but even then transfers never exceeded 5% of Irish GDP, a far smaller proportion than, say, west German transfers to east Germany. The most authoritative studies suggest that EU subsidies may have added around 0.5% a year to growth during the 1990s—useful, but modest in the context of average growth of 6.9%.

•More important than EU money may have been the 1992 programme to create a **European single market**. As a big low-cost exporter to Britain and the rest of Europe, Ireland benefited from more open access. EU subsidies also played another indirect part: by requiring a planned capital programme some years ahead, they helped to protect badly needed infrastructure projects from the cuts imposed in response to the fiscal pressures of the 1980s.

•**Ireland's FDI boom.** A number of foreign manufacturers invested during the 1960s, lured by the country's low costs and zero corporate-tax rates. Among them were such high-tech companies as Polaroid and Digital Equipment. But by the 1990s they had pulled out, as did Gateway, a PC-maker. By then, after complaints from the EU, the corporate-tax breaks had become less generous (from this year the rate for all companies is 12.5%). But Ireland's Industrial Development Authority (IDA) had become good at attracting desirable companies, and it proceeded to win big FDI projects in such businesses as software, semiconductors, personal computers, pharmaceuticals and medical devices.

•**Education.** One of Ireland's bigger attractions was a ready supply of skilled workers, including scientists, engineers and business-school graduates. As far back as the 1960s, the country had been investing heavily in both secondary and higher education. Dublin's two main universities, but also those at Cork and Galway, and a new one at Limerick, became crucial to the IT, pharmaceutical and health-care companies that invested in those regions.

•**Low personal taxes.** In the 1960s and 1970s, high income-tax rates, and a high tax burden in general, discouraged domestic growth, but from the early 1990s taxes started to come down sharply, giving a big boost to home-grown enterprise. Des O'Malley, who quit Mr Haughey's Fianna Fail party to found the Progressive Democrats in 1985, says that lower income-tax rates were key to the Irish miracle.

•**Demographics.** The baby boom in Ireland lasted longer than in the rest of Europe, and there were fewer elderly pensioners because emigration in the 1950s and 1960s had been so heavy. Where other European economies were facing a rapidly ageing population, Ireland has been boosted by its youthfulness. Ireland's population has been growing strongly for 13 years now, helped also by an end to the net outflow of people and the start of an inflow.

•The biggest contribution to the Irish miracle, however, came from **more people working**. Until the 1980s, women's participation in the workforce was low by international standards; today it is above average. Conversely, Irish unemployment was high, at around 17% in 1987; today it is 4%. All in all, the labour-force participation rate in Ireland has risen from around 60% in the 1980s to almost 70%. The absolute numbers of those in work rose from 1.2m in 1993 to over 1.8m ten years later. On some estimates, this accounts for half of Ireland's growth in the 1990s.

Unrepeatable

Does it matter which of these explanations for Ireland's success counts for most? Yes, for two reasons. The first is that many of them were one-offs. European subsidies, for example, are a thing of the past now that Ireland has become one of the EU's richest countries. Likewise, the stimulus to growth from the lower interest rates that came with the European single currency will not be repeated. And the sharp rise in labour-force participation is over and done with. Although the Irish population remains relatively young, it is beginning to look a lot more like that of the rest of Europe, with a falling birth rate and a rising proportion of old people.

The conclusion is stark: much of the Irish miracle (ie, higher output) was attributable to one-off changes (ie, greater input) and not to productivity growth (ie, more efficient use of that input). In effect, an economy that was suffering from 50 years of inefficiency, poor organisation and under-use of inputs (especially female workers) has spent the past 15 years catching up with more efficient, better-organised neighbours. Now it needs to find ways to keep the momentum going.

The second reason why there is so much interest in the secret of Ireland's success is that many countries in central and eastern Europe want to emulate it. This will not be easy. Some may be able to increase their female labour-force participation, but most will find their demographics a hindrance rather than a help. They can aim for better education, more foreign direct investment and fiscal and monetary consolidation, but such measures take years to produce results.

The new EU members will also discover, as Ireland has already done, that the world has become a lot more competitive. Ireland has some useful advantages to help it stay ahead, but it also faces serious short-term problems, such as the state of some public services and a dangerous obsession with property.

A model of success

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What central Europe can learn from Ireland

THERE is something alluring about a model, especially one that works. If you find one, you can hope simply to copy it—and instantly enjoy similar success. That explains why all the eight countries of central Europe that joined the European Union in May, from Estonia to Slovenia, appear so fascinated by Ireland. They each hope that generous dollops of EU money, eased down with judiciously low corporate taxes, will mean that they can follow in the tracks of the “Celtic tiger”—and get rich quick.

There is no denying Ireland's success over the past 15 years. Between 1987 and 2003, its GDP per person rose from 69% of the EU-15 average to 136%. On this measure, Ireland is now the third-richest member of the club. Even when measured by GNP, which is usually more appropriate for Ireland because of its heavy dependence on foreign investment, it has caught up with the EU average. The country has become the prize exhibit for those who wish to advertise the huge benefits that flow from membership of the EU.

And yet, as our [survey of Ireland](#) argues, the roots of its economic success lie a lot deeper. For one thing, it was mainly a matter of catching up, after several decades of poor performance. Ireland largely missed out on Europe's post-war boom, and it also suffered after the oil shocks in the 1970s. By the late 1980s its economy had done so badly that it

was poised for an economic spurt, with a young and growing population and plenty of scope to raise employment. All it took was a period of stable and sensible macroeconomic policies, something that Ireland had avoided for most of its history, to unleash its potential.

Money from the EU helped, of course. But it had flowed in ever since Ireland joined in 1973, usually to little effect. Even when they were at their peak in the early 1990s, transfers from Brussels were worth less than 5% of GDP. The best estimates are that EU cash may have raised annual growth in the 1990s by about half a point: helpful, certainly, but still modest when measured against average growth of 7%. Access to the European single market and Irish success in attracting foreign investment counted for more than EU budget transfers. But it was the country's favourable demographics, plus a sharp rise in female participation in the workforce, that were the biggest contributors to Ireland's boom of the 1990s.

Eastward, ho!

This is not to say that central European countries have nothing to learn from Ireland. But they should be careful to draw the right lessons. One that they have understood is the value of low corporate taxes in helping to attract foreign investment. The new EU members are right to resist the pressure now being piled on them by France and Germany to raise their corporate tax rates. But an even bigger lesson is the need to cultivate their workforce skills and knowledge base. For now, the biggest lure for investors in central Europe is not low corporate taxes but low labour costs, just as it was in Ireland in the late 1980s. But after 15 years of boom, Ireland has lost most of its low-cost advantage; it now relies on its years of investment in education and training to produce a higher-skilled workforce that still appeals to foreign investors. The central Europeans need to think ahead and follow suit.

Unfortunately, they cannot copy Ireland's favourable demographics, as most of the countries of central Europe are ageing even faster than those of greying western Europe. Nor do they have the same scope as Ireland had to draw more women into the workforce or to cut unemployment, though they could be doing a bit more of both. For these two reasons alone, the countries of central Europe are unlikely, even if they get all else right, to match Ireland's dizzy growth of the 1990s.

The biggest lessons they should take from Ireland's experience apply in two areas they risk getting wrong: fiscal policy and labour-market flexibility. Since the late 1980s, Ireland has cut both its overall tax burden and its annual budget deficits; indeed, in most years it has repaid public debt, reducing its debt burden from one of the highest in western Europe to one of the lowest. If they are to act likewise, the central Europeans must be much tougher about cutting public spending, something that many governments in the region are finding politically tricky. And they also need to make their labour markets more flexible, instead of pursuing their current path of importing Europe's excessive regulation. For the central Europeans, in short, the road to prosperity is the same as it always was: freer markets, deregulation and smaller government.