

# Ireland's Economic Transition: The role of EU Regional Funds - and other factors

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*Ireland's economy has made an outstanding progress in the last 40 years going from a relatively poor country to the present EU average per capita income. The Irish economy was deliberately opened around 1960, after decades of following an import-substitution industrialisation policy. The Irish government established an agency for attracting FDI and decided to apply for membership in the EEC. Before joining EEC Ireland signed the Anglo-Irish Free Trade Agreement (AIFTA) with the UK in 1965. Eight years later Ireland finally joined EEC together with UK and Denmark. Today, the main risk facing the Irish economy in the medium term is a global recession, especially one originating in the US which is the source of most of Ireland's FDI.*

**Key words:** Economic growth, FDI, regional policy, EU policy.

## 1. Introduction

Forty years ago, the Irish economy could be described as relatively poor, agricultural, protectionist, with declining population and high out-migration and an excessive dependence on the neighbouring British economy in terms of both exports and imports. Today, income per head is around the EU average, the contribution of agriculture to GDP has fallen to 5 percent, population is growing (fuelled by in-migration), the economy is one of the most open in the world – and it is growing at the fastest rate in Europe. But, if Tables 1 and 2 describe an economy that has experienced a remarkable transition since 1961, one should not look for miracles in seeking to explain it. Apart from the first six years of the 1980s when growth was stagnant, and the last six years of the 1990s when growth was spectacularly high, the experience over the forty-year period has been one of steady, long-term economic and social development.

What explains the Irish transition? What major events and policy initiatives have influenced it

since 1960? What role has been played by EU policy and structural funds? And, in what ways have other – specifically Irish – factors interfaced with EU factors in explaining the remarkable transition especially during the last decade?

Having followed – and finally acknowledged the limits of – an import-substitution industrialisation (ISI) policy from the 1920s to the end of the 1950s, the Irish government deliberately set about opening up the economy around 1960. The Control of Manufacturers Act – which had limited foreign ownership of Irish industry to minority holdings – was repealed and a government agency (later to be called the Industrial Development Authority, or IDA) was established to attract in foreign direct investment (FDI) with the help of grants and tax holidays. (The IDA's strategy has been refined over the years from an early shotgun approach (all investors welcome irrespective of product or technology) to a focus on specific branches and, more recently, to a systematic pursuit of individual corporations in knowledge-based industries and financial services with a view to promoting production synergies and agglomeration economies). The second major step taken by the Irish government designed to open up the

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Table 1. Structure of Irish Economy 1961 and 1998

	1961 (%)	1998 (%)
<b>SHARE OF TOTAL EMPLOYMENT</b>		
Agriculture, Forestry, Fishing	36.0	9.0
Industry	24.6	29.8
Services	39.4	61.2
<b>SHARE OF GDP AT FACTOR COST</b>		
Agriculture, Forestry, Fishing	24.4	5.3
Industry	30.7	39.1
Services	44.9	55.6
<b>SHARE OF GOODS EXPORTS</b>		
Live Animals	22.3	0.2
Other Agricultural	34.6	6.4
Industrial	41.0	91.2
Miscellaneous	2.1	2.2
<b>DESTINATION OF GOODS EXPORTS</b>		
UK	71.5	22.2
Other EU and EFTA	12.8	48.5
Other	15.7	29.3
<b>EXPORTS AS SHARE OF GNP</b>	<b>31.6</b>	<b>96.4</b>

Source: Baker (1999), p36

economy was applying to join the European Economic Community (EEC). However, given the economy's enormous trade dependence on that of the UK, accession had necessarily to await that of the latter. In the meantime, and in preparation for the shock of free trade within Europe, Ireland began unilaterally to dismantle its protectionist barriers and, crucially, in 1965, signed the Anglo-Irish Free Trade Agreement (AIFTA) with the UK. In 1973, in the first enlargement, Ireland (together with the UK and Denmark) joined the EEC (now EU, and hereafter generally so described).

In 1973, Ireland's GDP per head was 60% of the EU average. There were no motorways in the country. Moreover, investment in human capital (health and education) had not expanded at the same rate as in other northern European countries after the second world war. It was not until 1967 that free secondary education was introduced (Fitz Gerald, Kearney, Morgenroth and Smyth 1999, 37). Consequently, in 1973, human infrastructure was at the low end of the northern European standard.

## 2. The role of EU regional policy and structural funds in Ireland's transition

### 2.1. Evolution of EU regional policy 1975-93

After the first enlargement, the European Commission (EC) became concerned about interregional differences in levels of living. In 1975, its regional

policy was launched and a European Regional Development Fund (ERDF) was established and divided into quotas among the member states as follows: Italy 40%, UK 28%, France 15%, Germany (West) 6.4%, Ireland 6% with the remaining 4.6% divided among Belgium, Netherlands and Luxembourg. The grants were spent mainly on (physical infrastructure) projects and the additionality principle applied. Member states were in the driving seat: they also assisted their poorer regions to improve training and job creation, and promote rural restructuring with the other two 'structural funds', the Social Fund which had been established

under the Treaty of Rome in 1957, and the Guidance section (Gu) of the European Agricultural Guarantee and Guidance Fund (EAGGF), which had been set up in 1962 as part of the Common Agricultural Policy (CAP). The ERDF was reformed in 1979 and in 1984. The effects were, first, to introduce and gradually increase, a non-quota section that was to be spent on coherent aid packages or programmes and, second, for the Commission to gradually assume more control over regional policy and spending

The 1989 reform was more fundamental. It followed in the wake of the 1986 Single European Act that was designed to complete the single European market (SEM) through the 'four freedoms'. It was assumed that this would impact negatively on the poorer regions. The new approach to regional policy affected all three existing structural funds: they were increased very significantly in size and set within a common set of objectives and a common framework. Objective 1, under which 65% of the structural funds were spent in the 1989-93 programming period, and 69% in the 1994-99 period, was aimed at developing the poorer or 'structurally-backward' regions (those with GDP per head less than 75% of the Community average) and in promoting interregional convergence. Member states produced regional plans and, following negotiations between them and the Commission, a community support package was agreed for the programming period. The entire national territories of Greece, Ireland and Portugal – and most of Spain – were classified as Objective 1 regions and, following negotiations with the Commission on their plans (*national* from their points of view, *regional* from the point of view of the Commission), the Commission produced Community Support Frameworks (CSFs) for them. The

Maastricht Treaty in 1993 led to the creation of the Cohesion Fund to strengthen economic and social cohesion throughout the Union and help the poorer member states (those with incomes per head less than 90% of the Union average) to prepare for economic and monetary union (EMU) and the introduction of the single currency. The 'Cohesion Four' (C4) were Greece, Ireland, Portugal and Spain.

## 2.2. Receipts, expenditures, and impacts of Structural and Cohesion Funds in Ireland

### 2.2.1. Receipts

Prior to 1989 reforms, inflows into Ireland from the structural funds were relatively small. In 1975, it received I£3.6 million<sup>2</sup>: in 1980, I£125 million. After 1989, inflows increased very significantly. During the programming period 1989-93, it received a total of I£3.5 billion. In the 1994-99 period, receipts totalled I£5.4 billion (I£4.4 billion under structural funds and around I£1 billion under the Cohesion Fund). Of course, structural fund grants can meet only part of the cost of operational programmes under the CSFs because of the additionality principle. The limit was 80% in the Objective 1 regions of the 'Cohesion 4'. The actual level of EU co-financing of investment in Ireland has been between 40-48%. Thus, during the 1994-99 period, complementary public and private sector funding brought total ex-

penditure to over I£8 billion. Although Ireland received the highest inflows per head of population, total inflows amounted to only 3.4% of total EU spending on structural funds and the Cohesion Fund during 1994-99.

In common with other EU member states, Ireland's agricultural sector also benefits from the relatively high output prices and the various subsidies paid to member states under the common agricultural policy (CAP). These benefits eased the burden of structural adjustment in the shrinking agricultural sector. Combined inflows into Ireland from CAP, structural funds, and Cohesion Fund over the period 1973-98 totalled I£23 billion. On average, receipts from the structural funds and Cohesion Fund amounted to around 2.5% of GDP per annum during the decade 1989-99. Estimates suggest that they boosted growth by around 1% per annum on average.

During the 2000-06 programming period, Ireland's receipts from structural funds and the Cohesion Fund will fall to around I£3 billion. Because of its progress to date in converging toward average EU incomes measured in terms of GDP per head<sup>3</sup>, Ireland's structural funds receipts are being substantially reduced during the current period. By 2006, it will receive around 20% of what it received a decade earlier. The country has been divided into two regions: the Border/Midlands/West region retains Objective 1 status while the East/South region is an Objective 1 region in transition. After 2006, it is likely that the whole territory will be classified as an Objective 2 region (an area undergoing change in its

Table 2. Some Indicators of Irish Economic Performance 1961-97

Annual Average Percentage Growth	1961-65	1965-70	1970-75	1975-80	1980-85	1985-90	1990-95	1995-97
GNP	3.7	4.1	3.8	4.1	0.4	3.6	4.7	6.9
Investment	12.4	6.1	3.2	8.2	-3.2	3.9	1.9	12.2
Employment	0.4	-0.2	0.6	1.5	-1.4	1.0	1.9	3.5
Average Industrial Earnings	7.1	10.8	18.1	18.8	13.5	4.8	3.9	6.1
Consumption Deflator	4.5	5.5	13.7	14.6	11.2	3.3	2.5	1.1
<i>Five Year Averages</i>	<i>61-65</i>	<i>66-70</i>	<i>71-75</i>	<i>76-80</i>	<i>81-85</i>	<i>86-90</i>	<i>91-95</i>	<i>96-97</i>
EBR as percent of GNP*	6.0	5.7	8.9	11.5	13.3	5.7	2.2	0.9
Current A/C as % of GNP	-4.0	-3.1	-5.0	-9.7	-9.4	-1.7	2.5	3.2
Balance of Trade as % of GNP	-8.0	-7.0	-8.6	-12.6	-5.9	5.0	9.9	14.2
Unemployment Rate**	4.8	5.1	6.0	8.1	13.6	16.1	15.4	12.3
Net Emigration (000s)	14.8	14.2	-11.5	-8.5	8.4	32.0	0.3	-11.5

\* Prior to 1975, Exchequer Borrowing Requirement data refer to Public Authorities Borrowing Requirement.

\*\* Measured on Labour force PES basis, not on ILO basis.

Source: Fitz Gerald, Kearney, Morgenroth, and Smyth (1999), p31

industrial and services sectors, in declining rural and urban areas, and in areas of high unemployment). Ireland's net beneficiary position has already declined from 6.3% of GDP in 1991 to 3.9% of GDP in 1998. By 2007, Ireland will be a net contributor to the EU budget.

### 2.2.2. Expenditures

Four main expenditure priorities were identified under Ireland's Community Support Framework (CSF) for the 1994-99 programming period – as they

**Table 3. Total Financing of Ireland's 1994-99 CSF by Priority (Euro billions and %)**

Priority	Total Investment	%	EU Contribution	%	(1989-93)
1. Productive Sector	3.41	23.2	2.18	38.9	36.9)
2. Economic Infrastructure	6.50	44.0	1.11	19.8	22.4)
3. Human Resources	4.52	30.6	2.11	37.6	39.5)
4. Local Urban and Rural Development	0.31	2.2	0.2	3.7	0.2)

Source: Irish Business Bureau (1995), *Ireland and the Structural Funds*, p23, Brussels.

had been during the 1989-93 period. These were: the productive sector, economic infrastructure, enhancement of human resources, and local urban and rural development. Table 3 shows the amounts in Euros and as percentages of total investment expenditures and of EU receipts under the four priority headings. Percentages for the 1989-93 period are shown for comparative purposes.

Under Priority 1, four operational programmes provided direct support for productive investment, as well as accompanying measures to improve the business environment in the industrial sector; agriculture, forestry, and rural development; fisheries; and tourism. In the industrial sector, the structural funds supported strategies to promote employment and enhance the competitiveness within the SEM of both domestic and foreign enterprises – as well as linkages between them – by promoting marketing and research and technological capabilities. There was a somewhat greater focus on domestic firms especially in food processing) and SMEs than had been the case with the 1989-93 CSF. Within agriculture, forestry, and rural development, the focus was on diversification into non-surplus products and non-agricultural activities (including farm-based tourism) in rural areas. The objective of the third operational

programme was to enhance the contribution of the fisheries sector to growth and employment in coastal communities. Under the fourth operational programme of Priority 1, supports for investment in construction and in training in the tourism sector were designed to expand employment and extend the tourist season.

Investment in physical infrastructure (Priority 2 in the CSF) performs a crucial role within the CSF, given Ireland's peripheral location within the EU. The operational programme included support for investments in motorways and urban bypasses, upgrading of the rail network, the three national airports (Dublin, Cork, Shannon), and the ports of Dublin and Cork. Within the energy and telecommunications sector, the focus was on electricity (the main source of energy in Ireland) and on developing alternative and renewable energy sources.

The single operational programme under Priority 3 (Human Resources) was designed to enhance human capital and promote competitiveness and employment opportunities through investments in education and training. It also included training schemes for managers in SMEs and for the unemployed. Under Priority 4 (Local urban and rural development), support was provided, through one operational programme, for a range of services at local level, based on development plans prepared by Area-based Partnerships in designated disadvantaged areas and communities in other areas, and area renewal plans prepared by local authorities.

The Commission reserved 9 percent of the structural funds for its Community Initiatives. A total of ten initiatives are financed in Ireland during the 1994-99 period. They included support under INTERREG 11 for cross-border cooperation and the peace and reconciliation programme being implemented in the border counties in both Ireland and Northern Ireland.

In addition to receipts from the structural funds, Ireland received over I£1 billion (c1.3 billion Euros) from the Cohesion Fund during the period 1994-99. These funds were spent on investments in physical infrastructure including roads (37%), railways (12.4%), ports (7.7%), water supply schemes (16.3%), waste water schemes (24.8%), and technical assistance (1.8%).

### 2.2.3. Impacts

A number of attempts have been made to evaluate the impacts resulting from structural funds spending throughout the EU. Results are to be found in the Annual Reports and Mid-term Reviews published by the Commission as well as in the academic literature. In summary, they all suggest that the impacts are positive. The 1993 Report (European Commission 1995) provided an initial assessment – provided mainly in terms of expenditure ‘outcomes’ – for the 1989-93 programming period. In terms of ‘impacts’, it concluded that Ireland’s GDP would be 2.5% higher at the end of the period than it would have been in the absence of CSF inflows and that the negative effects of the country’s peripherality was being significantly reduced.

The most interesting attempts to measure impacts use macroeconomic models. Four such models have been used to date: Beutel, Pereira, QUEST, and HERMIN. However, detailed quantitative conclusions need to be treated with caution because the assumptions upon which the models are based are often very restrictive. The approaches used can also be questioned. As the *Sixth Periodic Report* points out (European Commission 1999, 155), the evaluations use macroeconomic models that compare developments in the regions in the post-assistance period with those before: they estimate what would have happened had the trends observed in the pre-assistance period continued and thus ‘an impression can be gained of the possible effect of the assistance’ (*ibid*). These estimates do not directly measure policy impacts. Instead, they imply that any divergence from previously observed trends result from the measures implemented: the main difficulty arises from the assumption that there has been ‘no change in the behavioural relationships observed in the past and that no new factors emerge during the post-assistance period, other than the introduction of the policy itself, to affect the outcome’ (*ibid*). Certainly, in the case of Ireland, such an assumption would be unrealistic. Changes at the level of institutions, in the macroeconomic environment, in the growth of FDI, and in the demographic structure, to name but four factors (section 3 below) that could be classified as mainly domestic in origin, have played very significant roles in Ireland’s transition, in addition to those played by structural funds.

Despite such reservations, it is useful to examine the results of these evaluations. Given data constraints, they are most relevant to the study of structural fund impacts in the Cohesion 4 member states whose territories, during the 1989-93 and 1994-99 programming periods were entirely (Greece, Ire-

land, Portugal) or almost entirely (Spain) classified as Objective 1 regions. Apart from listings of ‘results’ or ‘outcomes’ (for example, miles of road built or training programmes conducted), they provide the best available estimates of ‘impacts’ of structural funds on levels of income, employment, and so on.

CSFs have both demand-side and supply-side effects. Through the former, inflows of funding lead to increases in public spending which, in turn, promotes economic activity, incomes, jobs, and taxes. Through the latter, the CSFs improve infrastructure, raise skills, subsidise investment by the private sector, reduce costs, improve productivity, and promote economic growth. However, supply-side effects are more difficult to estimate since their impacts take more time to mature. Structural funds are designed to effect permanent impacts on poorer regions and to make a permanent contribution to interregional convergence. If the transfers are used to fund investment in activities that improve output per head, rather than merely boost short-term income improvements, then permanent improvements in income are more likely even if structural transfers are subsequently cut off.

The Beutel model used input-output analysis and focused on the overall and sectoral effects arising from the stimulus to demand. According to its results, CSF funds during the two programming periods 1989-93 and 1994-99 are estimated to have increased GDP growth by an average of 0.9 percentage points in the first period and 1.0 percentage points in the second period in Greece and Portugal, 0.8 and 0.6 points in Ireland, and 0.3 and 0.5 points in Spain. This compares with annual transfers from the structural funds equivalent to 3.4% of GDP for Greece, 3.2% of GDP for Portugal, 2.1% for Ireland, and 1.1% for Spain. This implies that, compared with transfers received, the additional growth achieved was somewhat greater in Ireland and Spain than in Greece and Portugal. According to the Beutel model, CSF transfers, together with the associated national contributions, were responsible for financing over 30% of total investment in Ireland and Portugal and over 40% in Greece. Thus, around 2-3% of the capital stock in each of the four countries was attributable to the EU transfers. Although impacts on employment were not as significant (because grants and subsidies to the private sector led to more capital-intensive production methods), Beutel estimated that, by 1999, around 800,000 jobs, or 3.5% of total jobs in the four countries would depend upon CSF interventions.

The richer member states also benefit from EU transfers to the poorer regions. Beutel estimated that over 25% of such transfers to the Cohesion 4 have

leaked back to other member states through increased imports. (A Commission study (European Commission 1996) estimated that 40% of structural funds provided to Greece, Ireland, and Portugal during the 1983-93 period flowed back to other member states for imports of equipment and technology).

Results obtained from the Pereira model, although focused exclusively on supply-side impacts (increases in GDP arising from improvements in physical and human capital), are fairly similar to Beutel's. The CSFs for the period 1994-99 are estimated to have increased GDP on average by 0.4 to 0.6 percentage points per annum in Ireland and Greece and by 0.6 to 0.9 percentage points in Portugal. The QUEST 11 model, comes up with lower results than either Beutel or Pereira (mainly because of the model's assumptions regarding monetary and fiscal sector influences). GDP growth is estimated to have increased by only 0.3 and 0.1 percentage points respectively in the two programming periods in Greece, by 0.3 and 0.2 percentage points respectively in the two periods in Portugal, by 0.3 percentage points during both periods in Ireland, and by 0.1 percentage points during both periods in Spain.

HERMIN models, like QUEST 11, incorporate both demand-side and supply-side effects.

One of the most interesting uses of HERMIN models was that made by Bradley *et al* (1995) to analyse, not only CSF impacts but also the effects of the single European market (SEM impacts) on the Cohesion 4 during the 1989-93 programming period. The simulations were carried out with various assumptions as to whether or not the CSFs would continue after 1999, whether or not there would be spillover effects (externalities) for the private sector and the wider economy as a result of improvements in infrastructure and skills, and the size of CSFs relative to the size of GDP. Some of the conclusions were: Assuming the CSFs continue indefinitely but there are no beneficial spillover effects for the private sector, GDP would be 7% higher by 2010 (than it would have been in the absence of the CSF) in Portugal, 6% higher in Greece, and 1% higher in Ireland and Spain. If it were assumed that the CSFs would end in 1999 and that there were relatively strong spillovers for the private sector, then GDP would rise by 2% in Greece and by less than 1% in each of the other three countries. (The results of a more recent evaluation (Honohan 1997) suggests that if structural funds were to be cut off after 1999, Ireland's GNP would remain at least two percentage points higher than it would have been without the transfers).

The single European market (SEM) has three kinds of impacts on the Cohesion 4 countries: Static impacts (effects on the economy as some sectors expand and others contract as a result of integration into the SEM); Locational impacts (is increased FDI due to the SEM or to original EU accession?); and Growth impacts (due to increased openness and growth in the larger EU economies and increased FDI). The results of the simulations suggested that the static effects were positive for Ireland, marginally negative for Portugal, moderately negative for Spain, and strongly negative for Greece. Why these differences? Ireland and Portugal have the largest shares of output and employment in expanding sectors. Moreover, Ireland had already experienced its most significant negative impacts from being integrated into a free trade area after the AFTA was launched in 1965. As regards locational effects and growth effects, if increased FDI inflows are assumed to be due to the SEM, then GDP in Ireland and Spain would grow by an extra 9% by 2010, by 11.5% in Portugal, and only marginally in Greece. On the other hand, if increased inflows of FDI are assumed not to be due to the SEM, then Ireland's GDP grow still grow by an extra 9% by 2010, Portugal's by 7.5%, and the SEM would have only an insignificant impact on GDP growth in Spain and Greece.

As regards estimation of the combined effects of the CSFs and the SEM on the Cohesion 4, Bradley *et al* concluded that there were too many factors at work and too many imponderables to come up with definitive answers. Their 'worst case scenario' suggested that GDP would grow in Ireland by an extra 9%, by 7.5% in Portugal, and effectively by zero in Spain and Greece by 2010. Its 'best case scenario' suggested that GDP would grow by an extra 23% in Portugal, an extra 12.6% in Spain, and extra 11% in Ireland, and an extra 7.5% in Greece by 2010.<sup>4</sup>

Is convergence working across the Union – and is it working for Ireland? According to the Commission (European Commission 1996), regional funds (including the Cohesion Fund) have reduced income gaps between EU member states. Disparities between *states* have narrowed more than have those between *regions* (mainly because of strong growth in Ireland, Portugal and Spain). In terms of narrowing the gap vis-à-vis EU average GDP per head, Ireland made the biggest improvement between 1983 and 1995. The Commission reported that, for all (NUTS level 2) regions, widening disparities occurred during the first half of the 1980s, followed by a gradual narrowing during the second half of that

decade, and a levelling off in the 1990s (*ibid*). For Ireland, the experience has been one of progressive convergence albeit one that took a long time to gather momentum. When it joined the EEC in 1973, Ireland's GDP per head was 60% of the Community average. It rose to 62% by the end of that decade and convergence continued at a slow pace during the 1980s when GDP per head in Ireland reached 66% of the Community average. Thereafter, convergence was rapid. It was during the 1990s that the pace accelerated, driving GDP per head to 79% of the EU average by 1992, to 88% by 1994, to 103% by 1997, and to around 107% by the end of the decade.<sup>5</sup> Of course, given the 14% gap between GDP and GNP in Ireland, there remains much 'catching up' to be achieved. By the end of the 1990s, Ireland's GNP per head was around 85% of the EU average. In terms of wealth (the stock of physical and human capital), the gap is even more pronounced.

### 3. The role of 'other factors' in Ireland's transition

As already noted, the Commission, in its *Sixth Periodic Report*, had cautioned against placing too much importance on the precise magnitudes of the estimates for GDP growth that arose from the four sets of evaluations based on the Beutel, Pereira, QUEST and HERMIN macroeconomic models. Nevertheless, it argued, the results of the four models all point in the same direction: '...structural funds have had a significant effect in reducing disparities in economic performance across the Union and narrowing the gap in GDP per head between the four Cohesion countries and the rest of the Union' (European Commission 1999, 157). It also adds, however, that if the estimates derived from the models are compared with changes in GDP per head in the four it becomes clear that other factors, apart from structural funds, have had a significant influence on relative performance. 'This is most notably the case for Ireland and Greece which represent the two extremes in terms of GDP growth' (*ibid*). The Commission lists these 'other factors' as: macroeconomic and other government policies, FDI inflows, initial structure of economic activity, business enterprise, and institutional factors including social capital. A brief examination of some of these factors, as they operate in Ireland, helps to fill out the picture of the country's transition.

### 3.1. Macroeconomic policy and the public finances

As Table 2 shows, the late 1970s was a period of high economic growth in Ireland. But, in contrast to that of the 1990s, it was unsustainable, driven by huge public sector borrowing, high balance of payments deficits, and high inflation. During the 1980-85 period, the average annual growth in industrial wages and the rate of unemployment were both increasing by over 13%. The economy had virtually stopped growing and emigration had picked up strongly. **Beginning with the budget of 1987**, the public finances were brought under control – and have remained so. The general government balance moved into surplus in 1993. It is expected to remain in surplus in the medium-term, rising from 1.6% of GNP in 1998 to 3.2% in 2006 before falling thereafter (Duffy, Fitz Gerald, Kearney, and Smyth 1999, 96). The ratio of public debt to GNP fell from 108.5% in 1993 to 55.1% in 1999. Thus, apart from the relatively short but wasted period in the 1980s, Ireland's transition has been characterized by sound macroeconomic management and 'a prolonged series of policy choices which harnessed the favourable trends and encouraged the responses which resulted in sustained progress' (Baker, *op.cit.*, 40).

### 3.2. FDI inflows

One of the most decisive policy choices was to abandon autarchy and to open up the economy to free trade and FDI from 1960 (*cf* section 1 above). From this emerged an industrialisation policy that offered free remission of profits and dividends to foreign firms, and included a variety of grants and tax incentives for all enterprises, all underpinned by an industrial development agency whose approach grew more sophisticated and focused over time. As already noted, it is estimated that the contribution of FDI to the growth of Ireland's GDP exceeds that from the structural funds, it is important to remember that some of the operational programmes within the Ireland's CSF include funds 'for the attraction of FDI' and funds 'for the creation of linkages between indigenous and foreign industry' (*cf* section 2.2.2 above).

### 3.3. Current demographic structure

The Irish demographic structure at the beginning of the new century is very favourable. Very significant changes have taken place since the early 1960s. The population fell steadily between the censuses of 1841 and 1961 from around 6.5 millions to 2.8 millions. However, as a result of the baby booms of the 1960s and 1970s, it increased by 32% over the past 35 years. The labour force has risen over the same period by 42.6%, not only because of population growth but also because of a strong rise in female participation rates. While the birth rate was almost 22 per thousand in the 1960s, it has fallen to 14 per thousand today. The dependency rate has now fallen to around the EU average. It will soon fall to an unusually low level mainly because a large percentage of those who could be expected to be in the over-65 age cohort today emigrated from Ireland in the period 1930-60 and did not return (Duffy, Fitz Gerald, Kearney, and Smyth 1999, 52-60). The combination of all these favourable demographic factors has played a significant role in Ireland's economic transition in recent years.

### 3.4. Investment in human capital

The Irish government was slower in making the decision to invest massively in education than were other governments in northern Europe in the post-world war two years. Free secondary education was introduced only in 1967. This delay means that a large proportion of the labour force still has limited formal qualifications – although the situation is changing in more recent years. Of the generation now retiring, about 60% had no more than a primary education; of the generation now entering the labour force, almost half have third-level education. Given that new entrants greatly outnumber retirees, the average educational attainment of the labour force is increasing steadily and substantially (Baker, *op.cit.*, 41). There has been a major increase in investment in education at both secondary and tertiary levels since 1980 and data on participation suggest that the current high level of investment in Ireland is on a par with the EU average (Fitz Gerald, Kearney, Morgenroth, and Smyth 1999, 59-61).

### 3.5. Institutional factors and social capital

What could be described as a process of domestic cohesion and inclusion has been developing within Ireland in recent years. Beginning in 1987, a series of national wage pacts have been agreed between the 'social partners'. They have delivered a large measure of industrial peace and have made a significant contribution to Ireland's level of international price competitiveness. They have also contributed to the attractiveness of the country for FDI. Initially, there were three 'pillars' (government, private sector employers, and trade unions) in the partnership but, more recently, this has increased to four as representatives of the unemployed and of community groups have joined the partnership. The content of the negotiations and bargains have also expanded: they now include tax as well as wage agreements and entitle all the negotiators to a place at the policy discussion table. Reflecting this greater inclusiveness, the fifth and most-recently agreed programme, covering 33 months to end-2002, is called the Programme for Prosperity and Fairness.

The Irish government set up a national anti-poverty strategy (NAPS) in 1997 as a consequence of its commitments made at the UN Social Summit. It included a definition of poverty, its main causes, and a series of objectives to be achieved by 2007. Although the number of people with incomes less than half the average is the same or higher than it was in 1994 – and 20% of the population still fell below half the national average in 1997 – significant reductions have been reported in the numbers experiencing 'basic deprivation' (defined as those deprived of basic necessities in the present Irish context) since 1994 (Callen et al 1999). As a result, the government revised the target in 1999 to one of reducing 'consistent poverty' (households with low incomes and deprived of basic necessities) to less than 5% by 2004.

## 4. Conclusion

Because growth is export-led, and because it is extraordinarily dependent on FDI, the main risk facing the Irish economy in the medium term is a global recession, especially one originating in the US which is the source of most of Ireland's FDI. If we can assume that this will not happen, then the issue is whether the spectacular growth of the sec-

ond half of the 1990s will end in a hard landing or a soft one. International organisations such as the IMF, the OECD, and even the European Commission have been issuing warnings recently about rising prices – especially in asset markets including housing – and wage pressures. The first is certainly true (as it is in most rapidly growing areas including the Netherlands, Finland, and cities such as London) but the recently concluded Prosperity and Fairness agreement will help to restrain wage increases over the next few years even if it cannot control them in sectors where there are very acute skill shortages.

The general consensus among Irish economists is that the landing will be a soft one and that the rate of growth will gradually revert to a more 'normal' European growth rate after 2010. Most would agree with the Economic and Social Research Institute (ESRI) forecasts that growth of GNP over the next five years will average 5% per annum with Irish income per head (measured in terms of GNP, not GDP) reaching EU average levels by 2005 (Duffy, Fitz Gerald, Kearney, and Smyth 1999, 110).

Ten years ago, there were one million people working in the Irish economy: today it is 1.6 millions. Just as remarkable is the fact that an unemployment rate of 17% has been reduced to less than 5% today. Indeed, in a number of activities, there

are now severe labour shortages. If unemployment falls below 3%, some of the more extraordinary wage increases that are currently being demanded in the non-traded sector (especially services) could become more generalised. However, there have been significant improvements in productivity and, to date at least, no loss of international competitiveness. The analysis of many outside commentators tends to be misplaced. Ireland is a small, open economy. Inflation is largely externally determined. As a member of Euroland, domestically generated inflation will not affect international competitiveness.

As part of the negotiating process between the Irish government and the European Commission in the period leading up to the launch of the 2000-06 CSFs, the country was divided into two regions and the government prepared a National Plan for the programming period. The huge investments in physical and human capital will be continued and, given the reduced importance of EU funding, there will be an increased focus on public-private partnerships in implementing some of the transport projects. The total cost of the plan will be IL40 billion and contributions from structural funds and the Cohesion Fund will amount to IL3 billion. In other words, the greater part of the new national plan will be financed out of domestic resources. ■

## NOTES

1 In analyzing the Irish economy, it is always useful to consider it as a region of some economy larger than itself: in the period up to 1973, this was the UK economy; since accession, it is the large EU economy.

2 1 Euro = 0.787564 Irish pounds

3 The authorities in Ireland have always argued that the income criterion for assistance from structural funds should be GNP per head (as it is for the Cohesion Fund) rather than GDP per head. In Ireland's case, because of very high repatriation of profits and dividends by transnational corporations located in Ireland, GDP is around 14% higher than GNP.

4 Apart from the assumptions already mentioned, among the reasons suggested by Bradley *et al* for the results were the following: Restructuring within the manufacturing sector in

Greece was having very negative effects during the period; on the other hand, it was benefiting from greater openness. The opposite effects were operating in Spain at the time: restructuring of manufacturing was not so negative but the economy was relatively less open. Ireland was benefiting from both effects while Portugal was benefiting from increased openness and suffering only marginally from restructuring with industry. Indeed, it scored highest overall because its CSF was the largest as a percent of GDP and its multiplier was also highest among those of the Cohesion 4.

5 The GDP per head in Ireland compared with the EU average for the period 1994-96 was 90%. This was the basis on which the Commission calculated structural fund entitlements for the 2000-06 programming period.

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