法政大学学術機関リポジトリ
HOSEI UNIVERSITY REPOSITORY

PDF issue: 2025-02-06

Irish Economic Development and Problems in the 1970s and 1980s in Historical Perspective

CULLEN, Louis M.

(出版者 / Publisher)
Institute of Comparative Economic Studies, Hosei University / 法政大学比較経済研究所
(雑誌名 / Journal or Publication Title)
Journal of International Economic Studies
(巻 / Volume)
2
(開始ページ / Start Page)
15
(終了ページ / End Page)
25
(発行年 / Year)
1987-03
(URL)
https://doi.org/10.15002/00002069

Journal of International Economic Studies (1987) No. 2, 15 – 25
© 1987 The Institute of Comparative Economic Studies, Hosei University

IRISH ECONOMIC DEVELOPMENT AND PROBLEMS IN THE 1970S AND 1980S IN HISTORICAL PERSPECTIVE

Louis M. CULLEN

Professor, Trinity College, University of Dublin

Ireland has had historically an exceptionally open economy. The consequences have been a high degree of export dependence and acute sensitivity to external trends. In adverse conditions Ireland experienced economic stagnation as for instance from the 1930s to the late 1950s under the successive impact of the 1930s depression, world war and British protection of its agriculture in the 1950s. The country then recovered under the stimulus of the strong growth of world trade in the 1960s. One of the consequences of the recovery, reinforced by domestic policy, was a sharp rise in gross capital formation. The attempt to sustain this under the adverse swings in the terms of trade in the 1970s and early 1980s led to a massive rise in foreign indebtedness. In the 1970s, Ireland, a creditor country for approximately a century, was converted into a substantial debtor.

Ireland had a remarkably open economy in the nineteenth century. It was also characterised by brusque changes: the halving of population between 1851 and 1911, a sharp rise in incomes from the low pre-famine levels, and emigration on a massive and unique scale. It is hardly surprising that a country, already open in some respects, undergoing these changes, should experience a marked increase in the openess of its economy. There are complex links between demography, emigration and trade which have not been fully teased out. The upshot of these developments was that by 1904 exports were the equivalent of 40 per cent of national income. The changes also resulted in a rapid transition from the status of a capital importer to a capital exporter. This transition itself took place either in or shortly after the 1870s. In other words, while incomes were lower than in the industrial countries, Ireland was similar to them in terms of its advanced infrastructure, its large exports per capita, and its foreign capital holdings. The smallness of its economy was in part compensated by the high per capita exports, and the industrial sector was characterised by relatively large firms. Intermediate products and small-scale production were relatively poorly developed. In other words imports like exports loomed large in life, and even farmers had shifted from near subsistence to a position in which a large component of their own diet was imported.

In the Inter-War years such an open economy was bound to suffer. In the Irish Free State, which had emerged in 1922 (as part of the division of the island into two separate political units), exports fell to 17 per cent of income in the 1930s, and a country which had been a classic free trade region imposed some of the highest tariffs in the world. The economy stagnated, and only the low prices of many of its imports saved the plight from being even more desperate. Its position in the 1940s as a small isolated neutral enjoying none of the advantages of situation which boosted neutrals like Portugal, Sweden or Switzerland led to an even more brutal

contraction of output in the first half of the 1940s. Emigration, which heretofore had helped the economy in some important ways, was itself a source of problems in the 1930s: it kept up money wages in the towns, and in turn the relatively small growth of the urban sector between 1920 and 1950 actually slowed the shedding of rural labour. In net terms, rural population decline was accounted for almost exclusively by emigration: the towns played little role in absorbing rural labour. Ireland was one of the major victims of the stagnation of the 1930s and in the 1940s of the annihilation of normal trade relations. Indeed, hardly any single economy proved so stagnant over the entire period from 1929 to 1958. The 1929 level of exports was actually attained for the first time in 1959. Many of Ireland's problems are an inheritance of these thirty years which were lost years for an entire generation in Irish economic history.

Ireland is an odd country in some respects with an unstable structural pattern. Its astonishing economic profile of the second half of the nineteenth century was followed by an almost equally unique stagnation for thirty years after 1929. The slowness of its recovery after the second world war is to be explained largely by the fact that world agricultural trade returned to normality more slowly than world industrial trade, and that Britain, now supporting its agriculture systematically, depressed the terms of exchange of Irish agricultural produce for British manufactured goods. A more normal world trading pattern in the 1960s admitted of significant improvement in Ireland's fortunes, and made it possible to abandon without ill effects the autarchic industrial policies pursued since the 1930s. Its fortunes in the 1970s were however adversely affected by the energy crisis, and in recent years the spectre of agricultural surplus has returned to haunt the economy. In the 1970s a futile effort to cushion living standards from the effects of the energy-induced shift in the terms of trade led to a change in Ireland's status from that of a long standing and stable creditor country to that of a debtor nation whose foreign debt while emerging late has accumulated at an alarming rate.

The consequences of an open economy, always evident in Ireland's story, displayed themselves even more dramatically in the 1970s. Indeed the crisis of the 1970s has put Ireland's development in the preceding quarter century into perspective. As one would expect in an open economy, decisive changes of fortune corresponded closely to substantial swings in the terms of trade. Thus, the economic difficulties of the mid-1950s mirrored a marked adverse movement in Ireland's terms of trade. As in the 1920s, once recovery in the world economy had taken place, prospects for Irish agriculture were poor. The completion of recovery in world agriculture by the early 1950s both increased the competition faced by Irish agricultural exports and led to a worsening in the terms of trade between 1953 and 1957 which was one of the sharpest experienced in peace time. At 12.8 per cent it was almost as sharp as the later energy-induced swings in 1973–4 or 1979–81. Agriculture experienced the impact in particular. Within agriculture the prices of output rose less than the prices of inputs, and stagnation in farm output along with low incomes was a factor in the general crisis which took hold of the Irish economy. Emigration soared, although in agriculture itself the fall in population slowed down, and the numbers in agriculture actually increased in 1953. The economy was particularly vulnerable to external political events, and the fiscal crises of 1952–3 and 1956–7 corresponded to the superimposition of the effects respectively of the

Korean War in 1950–1 and of the Suez crisis of 1956–7 on broader adverse economic developments.

The first Programme for Economic Expansion (1958–62) coincided with recovery in the terms of trade, and the prolonged expansion of the 1960s took place in conditions of improving terms of trade and of a very sharp movement in Ireland's favour in 1970–72. The years 1960 and 1961 were the only years between 1958 and 1973 in which the terms of trade disimproved significantly but even in these years the prices of farm outputs kept ahead of farm inputs. Relatively good farming conditions thus helped to support the economy, a situation which was reflected in 1962 for the first time in a decade in a significant annual fall in the agricultural population. External circumstances accounted for the growth of the Irish economy in the 1960s. The moderate growth of the world economy in the 1950s was replaced by the greatest economic boom in history. This had highly favourable implications for Ireland's terms of trade. The country gained from rising prices for its own exports while the prices of less sophisticated goods, textiles, raw materials tropical foods and energy, fell. Both animal products and manufactured goods fared relatively well. In particular, dairying, the great victim in Irish agriculture of depressed demand in the 1920s and 1930s, made a very substantial recovery. Between 1960 and 1982 the volume of milk doubled, and as early as 1968 butter exports which had remained low in the 1950s had passed the highest inter-war level. The two energy crisis of 1973 and late 1979 respectively brought to an end this improvement which had raised Ireland's terms of trade by 17 per cent since 1955. In 1974 the terms of trade disimproved by 15 per cent in a single year; and between March 1979 and March 1981 they disimproved by a further 15 per cent. Cumulatively they fell by 25.5 per cent between 1973 and 1981. Swings on this scale have probably been experienced only in the early 1670s, in 1701–1704, the 1810s and the 1870s.

In normal conditions, such difficulties would have led to a sharp contraction in economic activity. But reacting against the tight budgetary policies of 1952–3 and 1956–7, which incorrectly have been held more responsible for the depression of the 1950s than was the case, in recession the government actually increased expenditure, incurring large deficits even in the current budget. The consequences were two-fold. First the share of government in total output which had already risen in the 1960s from 33 per cent to 43 per cent increased further and dramatically to 63 per cent by 1980. Secondly, the country's creditor status which had probably first emerged in the 1870s was converted into a debtor status. In the first years after 1973 the bulk of external borrowing was private, accentuating a rise in the inflow on private account from the late 1960s, but from 1976 external borrowing on government greatly overshadowed private borrowing.

Irish governments thus responded as they had done in the 1950s by overreacting to the impact of external circumstances although in a reverse direction. In both periods they committed the fundamental sin for the managers of an open economy of failing to appreciate fully the external component of the crisis. In the 1950s two quite different governments successively discounted the exceptional events in the worsening terms of trade: in the 1970s different governments successively failed to appreciate the implications of the shift in the terms of trade, and assumed that they could spend their way out of difficulties. Indeed in the interval between the two crisis of 1973 and 1979, the government of the day in the face of more favourable

circumstances in the world economy and the prospect of some improvement in the terms of trade, launched in 1977 on a mammoth post-electoral spending spree. The current budget deficit which had fallen in 1976 and 1977, doubled in 1978, gross capital formation spiralled to a huge 34.5 per cent of output in 1979, and net foreign borrowing which had been reduced in the aftermath of its high 1975 level soared to almost unmanageable proportions in 1979 and 1980. This was the most unsophisticated economic exercise in over three hundred years of Irish history, a miscalculation of gigantic proportions devoid of a coherent purpose and lacking the justification of previous years (1974 and 1975) or of 1980 and 1981 when the terms of trade swung sharply against the country. It deprived governments of all subsequent room for manoeuvre, and the indecision of government policy in 1980 and 1981, is easier to appreciate if the scale of the swing in the terms of trade and the extent to which the neckless exercise of 1977–79 had made government dependent on foreign borrowing even for its current income is allowed for. In 1981, net foreign borrowing had reached a peak of £1389 million and over 1980–82 the inflow exceeded net national saving.

By the end of the 1960s gross capital formation had risen to 24 per cent of output. Over the 1970s it averaged 30 per cent, and went above it in the year 1979. Investment on this scale is rare in individual countries, and it corresponds to Japan's rate. There has been much discussion of the failure of investment to raise income in Ireland. In fact, it is necessary to make a distinction between rises in physical output and rises in income, which in an import-dependent economy depend heavily on the terms of trade. The adverse terms of trade meant that an increased output was necessary even to maintain existing income in terms of its foreign purchasing power. Gross output in stable prices rose quite sharply from 1970 to 1981 at an average rate of 4 per cent per annum before falling in 1982 under the impact of budgetary discipline. Net agricultural output rose by a substantial 30 per cent between 1968 and 1975. Industrial output also rose sharply, and between 1970 and 1978 the rate of growth of Irish exports has been exceeded among industrial countries only by Japan. If the rate of growth of output had not been even higher, it is in part due to two circumstances. First, some capital investment was misapplied especially in the semi-state sector which was distinguished by the profligacy which characterised governments also in treating capital almost as a free good. Second, with a young population and rapidly rising population, the costs of infrastructure which yield a low return are high. It is significant for instance that Ireland is the only industrial country where the rate of urbanisation actually increased in the 1970s. Construction accounted for 50 per cent of fixed investment in Ireland.

The real nub of the problem is of course that high rates of growth in physical output ceased to be reflected in incomes. This is due to two circumstances. First, the rise in population caused by a high and stable birth rate and the conversion of emigration into a net inflow in the 1970s. The net inflow averaged 4,000 per annum in 1971/9 and 14,000 in 1979/81. Dependents have risen more rapidly than the active earning population, and this has tended to reduce per capita income. Secondly and more importantly, the adverse terms of trade have meant that more output has to be traded for a given quantity of imports. Ireland is particularly vulnerable because its use of energy is relatively inefficient. Its energy consumption per pound of Gross Domestic Production is exceeded by only two industrial countries, both of

them rich in energy sources. A consequence of these factors is that high rates of growth in the 1970s ceased to be translated into real incomes. Real incomes per capita rose between 1958 and 1972 probably at an average rate of 4.4 per cent. Between 1973 and 1981 this rate was reduced to a bare 1.1 per cent per annum. Real per capita income stagnated from 1979 to 1983. If direct taxation is taken into account, real disposable incomes have fallen quite sharply: a good measure of this is a 10 per cent fall in retail sales between 1979 and 1983. They have continued to remain sluggish since, and the government failing to cut its own expenditure, has raised its tax take further. In particular, Social Welfare payments have been increases, in line with inflation, while salary and wage increased falling behind inflation, have been reduced still further by the rise in the real tax burthen.

Under conditions of sustained growth in real output as in the 1960s and 1970s, growth was reflected in structural changes. The percentage of the population engaged in agriculture fell from 36 per cent in 1960 to 17 per cent in 1983, and agriculture's share of gross domestic product fell from 22 per cent in 1960 to 12 per cent in 1983. Industrial exports which were only 6 per cent of total exports in 1956 rose to over 60 per cent of the total, and whereas the United Kingdom once took three-quarters of exports, it took only 37 per cent in 1983.

The boom in 1969–1972 preceded entry to the Common Market on 1 January 1973. The attractions of the Common Market were access to Europe for Irish products, and the disposal of agricultural products in greater quantities and at higher prices than on the British market. Industrial output and exports both expanded rapidly. There are two features in this process. First, as tariffs disappeared, import substitution increased rapidly, and imports now account for around 50 per cent of consumption of some staple Irish manufactures. While job creation in IDA-assisted industry increased enormously – no less than 37,000 jobs were approved in 1979 – redundancies in older industry increased dramatically. Net job creation was more moderate and in recent years jobs loss in older or traditional industries have exceeded new jobs created. Second, export-oriented industry has come largely from foreign firms attracted to the country, and a dichotomy has developed between foreign-owned export-oriented industry, and more traditional industry, home-owned and largely reliant on an increasingly open market. It has been estimated that 55 large foreign firms account for 18 per cent of industrial output and for 62 per cent of industrial exports.

The benefits of entry for agriculture were at first considerable. Between 1970 and 1978 per capita real incomes in agriculture increased by 72 per cent. But the impetus to growth had spent itself by 1975. Net output stagnated after 1975, and prosperity between 1976 and 1978 was accounted for simply by a favourable relationship between prices of inputs and outputs. Subsequent domestic inflation, fuelled by the second energy crisis and government policy, meant that input prices out-stripped output prices in agriculture, and most of the gains of the 1970s were quickly lost. More fundamentally still, some of the benefits of agricultural policy have been illusory. Precisely because it is a common policy, price support mechanisms within the Common Market have boosted agricultural output enormously in other common market countries. The consequence is that agricultural self-sufficiency has increased in the industrial countries of western Europe at large, and that efficient low-cost producers, like Ireland, employing relatively few inputs from

outside the Common Market, have been disadvantaged. Cheap inputs from outside the Common Market have fuelled factory farming. In addition exchange compensation mechanisms, designed to offset the disadvantages of currency movements, made Irish products dear in some Common Market countries and the policy supported Irish production in part only by sale into intervention stocks. The consequence is that the Common Market has not created large markets for Irish agricultural produce in Europe and that Irish sales are heavily dependent, where they are not sold into intervention, on sales outside the Common Market. These are largely new markets, but their permanency depends on many factors. The benign contribution of common agricultural policy, its price support aspect apart, has been much smaller than anticipated, though it must be appreciated that the large sales of Irish produce outside the Common Market benefit from Common Market subsidisation.

One of the controversial aspects of Irish policy in recent years has been entry into the European Monetary System (EMS) in 1979. The EMS is a cartel in which members support stable exchange rates which are modified only by general agreement. Britain did not enter, and in becoming a member in 1979 Ireland abandoned the one for one parity which had existed unbroken between the Irish and English pound since 1826. Ironically, reflecting the lack of realism in the economic policies of 1977–9, this step was advocated by the government of the day on the grounds that the Irish pound was going to strengthen relative to sterling, and by entering the EMS the Irish pound would avoid the disadvantages of being tied to a weak currency. In reality of course, this belief was unfounded, and the Irish pound was soon at a discount relative to the English pound. But however wrong the reason behind Irish entry to the EMS, the decision was itself justified. If the Irish pound had remained tied to sterling at the old parity, the consequences would have been that as sterling strengthened, industrial exports which were the dynamic aspect of Irish export trade especially to other EEC countries would have been priced out of the market. At the same time, given high inflation in Ireland, the maintenance of the one for one parity with sterling would have ensured that Irish goods would have become increasingly uncompetitive in Britain. The effect of entry in conjunction with heavy capital investment which accelerated the replacement of labour by capital has been broadly to ensure that Irish industrial exports remained competitive. The agricultural benefits of the EMS have been more problematic, given the adverse outlook for agricultural exports to other Common Market countries and the Community's complex levies. The benefits to farmers have been offset by inflation, although to the extent that many of the outlets for exports lie outside Britain, the break with sterling has helped to prevent Irish agricultural products from becoming overpriced on such markets.

It is instructive to compare the Republic with Northern Ireland at this stage. In the 1960s the north had fared better than the south: it was more successful in attracting new industries and up to 1968 incomes there rose more rapidly. All this was reversed post-1968, and in addition a rise in emigration from the north coincided with the emergence of a net influx to the south. It is easy to blame the troubles in the north for this, though their impact can be discounted because of massive financial support from Britain for Northern Ireland and the fact that before recession in the world at large deepened the troubles had little direct impact on output itself. A fundamental factor in the reversal of its industrial fortunes was the

energy crisis. The concentration of manmade fibres in large plants which resulted in one quarter of the synthetic fibre industry in the United Kingdom being located in Northern Ireland seemed to be an exceptionally successful and rational policy. And it was as long as energy costs were reasonable. But the rise in energy costs after 1973 combined with the low prices of American synthetics because of American policy of pricing energy low, made the industry in Northern Ireland as elsewhere in Europe uncompetitive. The recession in mainland-Britain also took an increasing toll; the exchange policy involving a strong pound, while it suited some sectors of the British economy, was hardly appropriate to an area intent on reindustrialising rapidly. After 1979 in line with trends in Britain growth rates in Northern Ireland were negative. One of the consequences of deceleration in growth in Northern Ireland was that per capita output in the south came to exceed output in the north. This is of course before allowing for the terms of trade. The strong pound of the early and mid 1980s which disadvantaged the growth in output at the same time ensured that the purchasing power of output was significantly higher than in the Republic and the closing of the gap between the two divisions of Ireland was not quite dramatic as has been assumed. But it is very real nevertheless. It shows in industry. Industrial output in the two areas in 1960 was about equal; in 1981 it was twice as large in the south. Agricultural incomes have always been higher in the north mainly because of its smaller farms with more labour-intensive enterprises, but between 1974 and 1980 real per capita farm incomes were higher in the south.

The structural changes of the 1960s and 1970s, notably those in the payments field, were on such a scale that they will be permanent. The classic pattern of eighteenth century Ireland – a large trade surplus which financed payments to absentees – emerged in the agricultural depression of the 1660s and 1670s, just as its reversal – the emergence of a deficit in commodity trade – coincided with another agricultural depression at the end of the 1870s. A large favourable balance of trade was hardly consistent with a substantial rise in living standards because it depleted the stock of goods by sending more goods out than were received. The sharp rise in imports relative to exports in the 1850s and 1860s probably cancelled the export surplus by the end of 1870s, and betokened a significant rise in living standards. A swing from home investment to foreign investment in the same period helped to swell the volume of imports: as interest on investment rose, imports in or before the 1890s began to exceed exports. The problem in the 1980s is that adverse terms of trade require a rise in exports relative to imports, thus imperilling living standards. As movements in the terms of trade are self-reversing over time, this is not in itself unduly alarming. The collapse in oil prices in 1986 is itself a clear illustration of that. But massive debt ensures that even if the terms of trade become favourable, a transfer of real resources, in other words, a rise in commodity exports relative to imports, is necessary to discharge the liability on foot of interest and principal. If export trends and terms of trade are favourable, this will not be unduly onerous. If they are not, then the transfers will be onerous, and will depress living standards. The whole process of shifting terms of trade combined with the novel condition – for Ireland – of foreign indebtedness has ensured that Ireland is even more dependent on foreign trade. In twenty years exports have doubled to 50 per cent of gross national product. It is thus more than ever a hostage to favourable external conditions and to access to foreign markets. Moreover its industrial policies bear their own

risks. The synthetic fibre industry in Northern Ireland is a classic example of a perfectly rational policy which failed because of unforeseen circumstances. Most of the south's new industries are not energy-intensive, and are not exceptionally vulnerable on that score. But they are susceptible to a general rise in domestic costs, or barriers to access to foreign markets. Where they have a significant niche in their markets, as some of them have, their chances of survival are best, but increasingly the industrial sector will depend on an adaptable well-educated work force and on an efficient general domestic environment. It is ironic too that while Common Market support has been important for the south, the agricultural policies have not worked uniformly to Ireland's advantage. The Common Agricultural Policy has stimulated self-sufficiency in industrial countries to an extent greater than was foreseen or even intended. The Regional and Social policies have been purely token, earlier optimism in Ireland and abroad about the development of the peripheral areas of Europe has been misplaced, and there is a real danger of the development of a two-tier Common Market of conspicuously successful and lagging regions respectively.

The structure of the country is still such that it is more properly to be regarded as standing somewhere between an industrial and less developed country. Not only is its agricultural population relatively much larger than in industrial countries but it has fallen more slowly. Its agricultural population is divided moreover between relatively developed regions and disadvantaged regions whose poor living standards can be paralleled in Western Europe only in the most disinherited regions of the Mediterranean. The birth rate is not only high, but has fallen surprisingly little. This ensures especially when the costs of supporting disadvantaged sectors and regions are taken into account that much capital investment will continue to be absorbed in low-return infrastructural investment. A continued flow from agriculture which will rise if good economic conditions return, combined with a birth rate which will fall only slowly, ensures that if conditions improve the pace of urbanisation will quicken and infrastructural costs will remain high. Educational attainments, though good for secondary schooling, have fallen behind industrial countries for higher education.

In extenuation of Ireland's plight, it should be recognised that more developed countries like Denmark and Belgium with much less excuse managed their public finances deplorably in the 1970s, and while Ireland lags in a number of respects, the gaps have been narrower than in the past. At various times, Ireland has been exceeded for the highest unemployment rate by Britain, Belgium and the Netherlands. Comparing relative positions in the 1950s and 1980s this is in a sense an achievement, though its scale is of course mitigated by its resting on foreign credit.

Four points merit special comment. First, the structural problems of Irish society are considerable, involving the need to placate both an industrial and urban sector, and a large farming community (and within the latter some dramatically disadvantaged regions). This helps to explain the inconsistencies and contradictions in policies, and governments have tended as structural changes took place to resort to a form of populism intended to please all sectors of the community in the short term. Government policy over the 1970s countenanced overlarge wage settlements within the public sector, financed in the last analysis out of a growing deficit in the current budget. In 1983 however devaluation within the EMS against the advice of economists and bankers was on balance the best course. Secondly, it is a conservative society which has still to display a capacity to adapt quickly enough to the re-

quirements of an industrial society. Not only have demographic trends remained surprisingly rigid, but the conservatism they suggest was reflected in poor industrial relations largely modelled on British ones, in opposition to new work practices and to the erosion of wage differentials. In public administration at all levels it was reflected in opposition to change, a high degree of bureaucracy and a poor capacity both to formulate administration reforms and above all to implement them. Such a society is lacking in some of the adaptability that modern industrial society requires, and while it has made and will continue to make some of the adjustments necessary, the course of change is uneven.

Thirdly, wage settlement patterns have been quite original compared with neighbouring countries. Settlements have been high, and the rates have tended to be applied fairly uniformly to all workers. This pattern originated in the fact that wages were rigidly controlled during the war years and successfully held down well below the rate of inflation. When controls were relaxed in 1946 a general round of increases spread through the community; in all there have been 25 rounds to date. More significant than the high level of settlements was the effort of all workers to secure identical settlements (until recently fairly successfully). This pattern has not disadvantaged highly competitive or capital-intensive industry, but it has been a factor in accelerating the decline of traditional industries; and in securing inflated wage increases for public servants in the 1960s and 1970s it has been one of the main factors in accounting for the large deficit in the current budget which established itself as a feature of Irish finances in the 1970s. However, settlements in recent years have fallen behind the rate of inflation, and the pattern of applying broadly equal increases throughout the community both to successful and ailing industries and to the public sector despite its deficit, has faltered. The pattern may decisively change, reflecting the plight of the public finances and the widely varying economic health of different sectors of industry.

Fourthly, rapid growth rates in the new industrial sectors, electronic in particular, have something of a distorting effect on the performance of the industrial sector as a whole. Industrial output has continued to grow, and industrial exports in particular have risen at a sharp rate. Superficially, between 1975 and 1983 productivity per manhour rose more rapidly than in industrial countries, not excluding Japan. This has been particularly evident in the case of electronics. Yet economists experienced growing disbelief about the healthy situation represented by this picture. It would suggest a remarkably high value added in industry and in particular in electronics. Some of this is true enough: there has been a massive substitution of capital for labour in some industries, and a sharp decline in traditional labour-intensive industries such as clothing and footwear. However, not all new firms have a high value-added content. Enquiry in the last year has borne out the apprehensions of economists; a process of transfer pricing, as they suspected, existed. Because of the fiscal advantages foreign firms enjoy in Ireland, their imported inputs – and many of the firms not only have a very high import content but draw these inputs from their own plants – were artificially undervalued, and their true Irish output – or value added – equally artificially inflated. This ensured that much of the value added was notionally transferred from their plant in the United States which supplied components and services to their Irish centres of operations where it was taxed lightly if at all. Profits remitted from Ireland have proved to be much larger than previously

estimated for purposes of the Irish national accounts, and the profile of the balance of payments, less rosy than it has formerly appeared, has had to be revised.

Given the difficulty of taxing farmers realistically, and the large amount of export relief for exports, the tax base of the Irish economy is disturbingly narrow, and taxation rates on the lowest incomes in the world's industrial countries, are now among the highest in the world. The distortions caused by government policies in industrial dèvelopment are probably larger than are readily appreciated. Government policy and especially its ill-thought-out fiscal dimensions has contributed to the decline of some of the industrial firms catering for the home market, and to the enhancement of the country's already inflated export dependence.

The balance of trade itself is not a problem. The combination of adverse terms of trade and crushingly high taxation to service government foreign borrowing which only emerged in the 1970s has ensured that depression has affected most industries and services apart from export-oriented ones. In 1984, for the first time in a hundred years (apart form war years), exports came near to equalling imports and finally exceeded them in 1985. This is not in itself either a recipe for growth or a source of reassurance. In the last four years also the immigration of the 1970s has been replaced by a significant resumption of emigration. Improvements in the balance of payments are a result of government fiscal policies at large and of fiscally-encouraged exports combined. Indeed to the extent that they have further enhanced the export dependence of the Irish economy, these factors leave the economy all the more vulnerable. This dependence combined with heavy foreign borrowing leaves the Irish economy in a situation which in a recession in world trade would make one think of highly-developed primary producing countries like Australia or New Zealand in the 1930s as the nearest approximations of what the impact would be likely to be.

The Irish economic future (if we can leave the folly of politicians aside) depends almost exclusively on the prospects for world foreign trade. Domestic policies have deprived the State of almost all room for manoeuvre in an economic crisis triggered off by a real recession in the world economy. The problem is exacerbated by rigidities in the economy, but the small scale of the economy is a particular drawback. Long-term shifts in the terms of trade have not hit Ireland as adversely as for instance in the Japanese economy. But movements in the terms of trade must be related to the importance of foreign trade in GNP. Japan is cushioned by the fact that exports are only 12 per cent of output. At 54 per cent of output, export dependence leaves Ireland cumulatively more vulnerable than Japan in respect of swings in the terms of trade which in absolute terms were comparatively more moderate in Ireland than in Japan. Moreover, the smallness of foreign trade in relation to total output in Japan helps to explain why Japan's distribution is good at distributing supplies, but not imports which require a more sophisticated and centralised distributive system. The situation is quite the reverse in Ireland. The distributive system works well in distributing imports (and even exports) but a distributive system dominated by highly-developed distributive mechanisms for imported goods, gives no comfort whatever to home-produced goods on the domestic market.

Ireland is of course to some extent a victim of fortuitous circumstances or even unforeseen ones. The energy induced swings in the terms of trade have been compounded in their effect by the sheer success of the Common Agricultural Policy

which has created problems for many, not least for Ireland. It is also in part a victim of the fashionable doctrines of economic development pedalled through the world by western governments, economists, bankers and development agencies in the 1950s and 1960s, especially the heavy emphasis an capital investment, often defined uncritically as the key factor in economic development. However, if the adverse terms of trade in the 1970s are allowed for, the deterioration in the capital accounts roughly corresponds to the impact of that change. The great mistake of politicians and public alike was not to appreciate that that entailed some rise in the transfer of real resources out of the country and that fiscal policy should be dictated accordingly. Fiscal policy failed totally to appreciate that in the mid-70s, a mistake that could be lived with easily enough on a once-off basis, but which was made infinitely worse by the disastrous expansionist policies of 1977–9. The consequence was that the economy became saddled with a burden of debt whose management now proves difficult. The efforts to cut it back have faltered once again. In 1985 government borrowing at 13 per cent of GNP was cut back only notionally, and the proportion of that borrowing, almost half, devoted to financing the current budget deficit, actually rose. Many European governments made serious mistakes in the 1970s and 1980s. Ireland's might not stand out so much except for the errors of 1977–9, and their long-term consequences are not yet fully apparent. The massive rise in foreign indebtedness will also reinforce the process of structural change in the economy: the need to finance payments to foreign creditors combined with continuing high domestic taxation will reinforce the high level of exports to income. The small size of the domestic market combined with dependence on foreign conditions will leave the country painfully vulnerable to trends abroad, sensitive to every change in the international barometers.