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POLITICS AND MARKETS IN THE IRISH 'CELTIC TIGER' EXPERIENCE: CHOICE, CHANCE, OR COINCIDENCE?

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Abstract

Ireland's rate of growth and employment creation during the 1990s far outstripped performance in the rest of the OECD. To what degree is this attributable to chance fluctuations in the international economy, the coincidental alignment of Irish politics and institutions with international economic conditions, or deliberate policy choice? Two policy areas are chosen for particular attention, industrial development strategy, and social partnership arrangements. A case is made for the importance of politics, above and beyond market conditions and institutional appropriateness. The viability of the “Celtic Tiger” model is considered, and its relevance for the EU accession states of Central Europe and the Baltic states is assessed.

Keywords: Ireland, Celtic Tiger, small open economies, social partnership, industrial policy, European Union, East-Central Europe, politics and markets, state and society.

1. Introduction

Ireland experienced a remarkable surge of economic growth during the 1990s that transformed living standards and put the country at the forefront of economic performance in the OECD. Indeed, in one of its periodic economic surveys, the OECD particularly noted Ireland's "peerless performance", that made it "a world leader in a number of aspects of economic performance".¹

After stagnating for most of the 1980s, economic growth picked up in the early 1990s, and by the second half of the 1990s was running at a rate that was over twice that of the United States – then experiencing a sustained boom – and almost four times the EU average.

Other indicators of economic performance were no less noteworthy: living standards rose, tax receipts soared thus reducing current deficits and even creating a surplus of over 3% of GDP by the late 1990s. The debt/GDP ratio, the albatross of economic management efforts in the 1980s, had become the lowest in the EU by the late 1990s. Labour market participation rates rose between the mid 1980s and the late 1990s from 52% to close to the EU average of 61%.² Table 1 summarizes Ireland's position in comparative context.

Table 1 about here

This performance was perhaps most surprising to Irish people themselves. As recently as the mid-1980s, Ireland could claim a pre-eminent position within the EU on most of these measures, but for all the wrong reasons.

During the 1980s, economic management was stuck in a vicious circle of stagnation. Poor fiscal management in the late 1970s had saddled the country with large fiscal deficits and a national debt exposure that worsened with adverse exchange rate movements. Between 1981 and 1987, in a context of international recession, minority and coalition governments encountered great difficulty in adopting a coherent stance. Despite spending cuts, including deep cuts in capital projects, they relied on an already distorted tax system to maintain current spending and debt service

levels.³ This in turn further depressed economic activity levels. Ireland had long seemed to be an economy prone to chronic labour surpluses and involuntary emigration. But now emigration reached levels not experienced since the dismal late phase of protectionism in the mid-1950s.

By the late 1990s, Ireland looked like a different country altogether. Some indication of the speed and profundity of the transformation of Irish economic performance can be gained from Table 2 below.

Table 2 about here

The recessionary period of the 1980s gave way to a period of macroeconomic stabilization between 1987 and 1994, at which point unemployment still stood at 15 per cent. Growth picked up more rapidly from then on. Unemployment fell to 8 per cent in 1998 and below 4 per cent in 2001. Annual GNP growth peaked at 10% in 2000 (and GDP at 10.7%). By 2002, the boom conditions had faded, and the Irish economy was clearly entering a new phase.

The huge expansion in employment did not compromise living standards. Average disposable income between 1994 and 2000 was estimated to have risen by 54%, while consumer prices had risen by 12%. GNP per capita, stuck for most of the 20th century at about 60% of the European average, attained 103% of the EU average in 2001 and 123% of the GDP average by 2000. The difference between GDP and Gross National Product (GNP) was minimal in the early 1970s; in 2000 GDP was 17% greater than GNP, and 21% higher in 2002. GDP grew spectacularly. But this was not simply illusory, as real GNP also shows remarkable growth during this period (GNP is generally taken as a more accurate measure of national wealth in Ireland).

2. The “Celtic Tiger”: the puzzle for comparative politics

The basic elements of the explanation for Ireland’s transformation are by now reasonably well agreed.⁴ Ireland has one of the most open economies in the world – exports of goods and services stood at 117% of GNP in 2001, and imports at 100%.⁵ Since the late 1950s it has adopted a policy stance of closer integration into

the international economy, a major milestone in which was membership of the EU in 1973.⁶ Allied to this was a policy of promoting foreign direct investment, given the low levels of domestic investment capital available. Domestic economic activity encountered the significant problems of scale, skill composition, and capital intensity that face the late industrializer.⁷

Membership of the EU made Ireland a more attractive point of access to the wider European market for foreign investors, especially American multinationals. Direct transfers from the EU Structural Funds had contributed to laying the foundations for Ireland's prosperity – but were a good deal less important to the growth phase of the 1990s than is sometimes assumed. EU direct funding contributed about one half of one percentage point per annum to GNP growth over the course of the 1990s.⁸

During the 1990s, a range of factors combined to produce the “Celtic Tiger”. Anticipation of the completion of the Single Market in the EU in 1992, and the addition of three new member countries in 1995, drew an increased flow of foreign investment into EU countries. Ireland was an English-speaking country that had an abundant supply of well-educated but under-utilized labour. With 1 per cent of total EU population, Ireland attracted over one in ten of all foreign-owned greenfield manufacturing projects coming into Europe during the 1990s, most of it American. “Annual flows of foreign direct investment into Ireland increased from an annual average of around \$140m in the 1980s to \$790m in the first half of the 1990s and \$2700m in the second half of the decade.”⁹ The rate of return on American investments in Ireland averaged 20 per cent between 1995 and 2002, the highest in the EU.¹⁰

So far so good. But comparative politics requires more than assembling the elements of a good story. We would also like to know whether some elements of the mix were more important than others in accounting for the observed outcomes. More specifically, we would like to know to what degree, if any, deliberate policy choice made a difference to the successes we are interested in explaining.

Two possibilities might be distinguished. On the one hand, we might posit that good

policy choice and appropriate institutional innovation may have played an important, even a critical role in achieving good performance outcomes. This point of view would have it that intelligent policy modification on a variety of fronts positioned the country effectively to catch the rolling tide of the international market economy. This could be presented as a classic case à la Katzenstein of the successful insertion into the global economy of a small open economy, through a combination of effective policy adjustment to international conditions and the political construction of an alliance of domestic interests.¹¹ As Kitschelt et al have argued, national political institutions are not merely a “dependent variable”, forced to change by outside pressures. They should rather be seen as “a critical component of the environment in which actors shape their strategies of adaptation”.¹² In this scenario, politics matters most of all, and choice outweighs chance.

On the other hand, we might consider the possibility that the good outcomes owe very little to intelligent policy choice or appropriate institutional adjustments. This explanation would have it that a combination of circumstances in Ireland at a particular point in time just happened to coincide with the shifting tides of the world economy. It is neither necessary nor appropriate, in this view, to posit intentional policy design or institutional development to account for good performance. Instead, the combination of demography, human capital inputs, and labour market dynamics combine to explain most of what happened, and the uncoordinated effects of markets provide the driving force. Where politics and institutions complement or support market imperatives, this is attributed to a temporary coincidence between Ireland’s existing profile and the requirements of the rapidly globalizing international economy. It is an inherently unstable moment that is bound to pass, and attempts at political intervention can make a marginal difference at most. The benefits that accrue are the product of chance or coincidence, not choice.¹³

Considering the relative merits of these two positions sharpens the analytical focus on what is at stake in explanatory terms. But the value of the exercise does not stop there. Clear policy implications follow from whichever interpretation we opt for. This is obviously important for Irish policy makers and citizens, who would like to know how they might retain and deepen the benefits of the boom years. But the implications

may also be important in a comparative policy context for countries seeking to emulate successful exemplars – particularly the countries of East-Central Europe and the Baltic that are on the point of becoming full members of the EU. In short, the issue is not only whether the Celtic Tiger model is sustainable in one country, but whether it is exportable.

Our two alternative interpretations are of course primarily of heuristic value. Any full understanding must recognize that many elements of the explanation are best seen as background variables or conjunctural conditions over which policy has little or no influence. It was indeed fortuitous that Ireland was English-speaking when large volumes of US capital were seeking an outlet, that it had a pent-up labour surplus, that educational investments were reaching fruition at just the appropriate time. And some of the relevant policies were long established. The central plank of industrial development policy, that is, the reliance on attracting inward investment through low corporation taxes and industrial grants, was essentially in place from the early 1960s. Ireland's membership of the EU had taken effect in 1973. These policies had yielded some benefits in terms of growth and employment expansion at earlier stages, but it was not until the 1990s that we see impressive levels of performance.¹⁴ So these conditions must be seen as facilitative rather than causal, as necessary but not sufficient. We should not reach the conclusion prematurely that policy decisions had no effect whatsoever on economic outcomes.

The argument of this paper is that in two distinct policy areas, we can identify processes of decision-making, conscious policy adjustment, and changes in institutional configuration, that can be argued to have been necessary and indispensable contributors to the outcomes we have noted. The first of these concerns “external adjustment”, or the mode of insertion of the Irish national economy into the international context, and the policies that underpin this. The second is “domestic adjustment”, that is, the macroeconomic stance adopted by government, and the domestic coalitions that were constructed to attune the cost base of the national economy to international competitiveness conditions.

3. External Adjustment: FDI- Led Growth

Industrial policy has been geared toward export-oriented growth since the late 1950s. The principal means of boosting the exporting base of the economy has been to facilitate foreign direct investment (FDI). One of the chief policy instruments to attract FDI has been that of low corporation tax rates. These policy instruments had been in place for some three decades before the Celtic Tiger got under way. There is a considerable element of chance and coincidence in the confluence of Ireland's policy stance with the needs of volatile investment capital, and especially the boom in ICT, during the 1990s. However, Ireland benefited disproportionately from the flow of investment into Europe. The argument here is that the strategic adaptation of industrial policy played an important part in making this happen. Two elements may be identified: active commitment to and defence of the low rate of corporation tax, and the strategic activity of state agencies.

Corporation tax

Low rates of corporation tax are a prominent feature of Ireland's industrial strategy. From the late 1950s, tax incentives were targeted toward manufacturing exports; these were consolidated in 1981 into a 10 per cent tax rate on all manufacturing, while corporation tax on other activities was set at a much higher rate.

Table 3 shows the profile of corporation tax rates across a range of European countries, indicating that Ireland's corporation tax rates are well below those of most other developed countries. However, they are also comparatively low among the EU accession states, and Estonia went for broke in 2000 by reducing its corporation tax rates to zero.

Table 3 about here

Successive governments maintained the same central commitment to a low corporation tax regime. This non-partisan stance gave stability and reliability to Ireland's industrial development policy. The preferential rate of 10 per cent was extended over time to embrace other activities. Some service activities, including software, were included in the early 1980s. In 1987 it was further extended to include internationally traded financial service activities. This proved very

successful and by the end of the 1990s the International Financial Services Centre in Dublin comprised some 300 firms employing over 10,000 people.¹⁵

The 10 per cent preferential corporation tax rate was due to expire for many firms in 2010. By the mid-1990s, it became clear that something had to be done to maintain the predictability of the policy. Any changes would have to be acceptable to policymakers at EU level. Tax policy is not subject to Qualified Majority Voting procedures. But Ireland's dual tax rate – a standard rate for non-traded services and a preferential rate for manufacturing and traded services – might be thought to be inconsistent with the principles of the single European market. After intensive and targeted lobbying, the Irish government gained permission in 1998 to extend the timeframe of existing tax reliefs. More significantly, it secured agreement for the phased introduction of a uniform 12.5% corporation tax rate for all enterprises, from 2003. Ireland thus moved from a situation in which the top corporation tax rate had been among the highest in Europe, and the preferential rate the lowest, to a situation in which all corporation tax was set at what was, in EU terms, a very low level.

How important was low corporation tax in securing “windfall” investment flows during the 1990s? Until recently relatively little was known about the process of corporate decision-making, especially in the headquarters of the US companies which have gained such a significant profile in Ireland in recent years. But research conducted in the late 1990s among “ten large ‘blue-chip’ US firms with very significant subsidiary operations in Ireland” finds that “for most organizations, the critical factor positively influencing the final decision in Ireland's favour was its low rate of corporation tax”.¹⁶ CEOs commented that corporation tax was “critical... very important in differentiating Ireland from Scotland”.¹⁷

Strategic targeting

The argument so far is that in addition to chance and coincidence, policy choice made a difference. But it would be overly reductionist to conclude that all that is necessary is to get the market parameters right in terms of corporation tax and demographics, and then wait for the investment to come rolling in.

The role played by the industrial development agencies was not merely to act as a passive conduit for grant aid and tax reliefs. The Industrial Development Authority (IDA) was established in 1950 to support domestic industrial development, during the era of protectionism. The outward policy turn from the late 1950s gave it a broader remit.¹⁸ Besides the attractive tax and grant incentives, other aspects of Ireland's cost base were still relatively low at the outset of the rapid growth phase of the 1990s, as GDP per capita and therefore wage levels were still considerably below those of other European countries. However, the nature and composition of the capital inflow during the 1990s was also the product of strategic orientations within the development agencies themselves, and was based on extensive research, targeting, and networking.

During the 1980s and 1990s, various measures were undertaken to strengthen the supply base of Irish firms and their linkages with foreign firms. Industrial development strategy began to focus more on building up clusters of strategically located activity, and a series of policy initiatives focused on strengthening the links between third-level institutions and these emergent clusters.¹⁹

Over time, the IDA developed a greater capacity for strategic planning about targeting specific forms of investment in order to "move up the value chain". This entailed a shift away from the process and assembly activities that had formed a large part of inward investment during the 1960s and 1970s, toward a concentration on the newer and more high-tech industries. It is entirely consistent with the sort of technical upgrading strategy pursued in the "Asian Tiger" countries. Capital investment in Ireland had to be overwhelmingly imported; but industrial repositioning had to be achieved according to market criteria and using market incentives.

Thus the state's development agencies, chiefly the IDA, shifted their emphasis with respect to the sectors and priorities in which they wished to see development. They targeted key firms in what they identified as growth areas from the mid-1980s on, in industries such as microelectronics and office equipment, pharmaceuticals, chemicals, and biotechnology. Attracting one "blue-chip" firm could be used as a magnet to attract the presence of related or complementary firms in that area. The IDA acquired considerable experience in using expatriate networks, and "courting" chief executives

in major multinationals.²⁰

For example, the IDA lobbied hard in 1989 to secure the location of Intel's European manufacturing base for both its computer systems and semiconductor facilities in Ireland, against competition from Scotland, Wales, and Austria. To ensure the availability of a large volume of high skills, the IDA had canvassed extensively among several hundred Irish engineers working abroad, mainly in the US, who would be willing to relocate to Ireland. The investment was secured, despite last-minute intervention by British Prime Minister Margaret Thatcher, who sought to secure the deal for Scotland. The IDA concluded that "the availability of skills, a low corporate tax rate and financial support" were crucial to their bid, but that "what pushed Ireland ahead in the tight race at the finish was the attitude of the Irish workforce. Intel admired the 'can do' attitude of the Irish".²¹ And of the IDA in particular, we may well conclude.

By the end of the 1990s, almost all the largest international firms in information and communications technology (ICT) and in pharmaceuticals had a presence in Ireland, including firms such as Microsoft, Intel, Hewlett-Packard, IBM, and Motorola on the one hand, and Merck, Johnson and Johnson, and Novartis on the other. The creation of industrial clusters centred round world-class firms made it easier to attract others to come. The "agglomeration effect" of industrial concentrations in turn contributed to further spin-off growth, including backward and forward linkages with domestic firms in both production and services. One analyst has suggested that we should now envisage Irish development agencies as committed to a "glocal" role. By this is meant that the agencies both facilitate the local establishment of multinational enterprises, and smooth access to global markets for nationally-based firms, acting as critical gateways between the national economy and the transnational domain.²²

Low corporation tax, a plentiful supply of labour at relatively low cost for its quality compared to other EU member states, and proximity to the European market, made a difference to foreign investors, and are thus important elements of the explanation for Ireland's economic successes. These factors owe much to chance and coincidence. But it took more than just getting the market parameters right. The state industrial

development agencies adopted a deliberate strategy of focusing investment into particular sectors, actively targeting the paramount firms in those sectors, and networking to promote Ireland's merits as a business environment. Choice and strategic planning also proved significant.

4. Domestic Adjustment: The Role of “Social Partnership”

Creating a domestic policy environment to promote and sustain economic growth is not a task that governments can readily accomplish through the exercise of hierarchical authority. And cost stabilization and wage formation patterns are not always effectively disciplined, particularly in the short to medium term, by market factors alone. As Linda Weiss argues, “state capacity” should be seen, not in terms of autonomy from social interests, but as a function of the manner in which policy-makers integrate social interests into processes of policy implementation.²³ Politics – choice – comes into play in explaining the domestic conditions that underpinned Ireland's strong growth phase.

Social Partnership – Reconfiguring Preferences

The principal domestic policy innovation bearing upon economic stabilization and growth promotion is the process termed “social partnership”. The social partnership agreements are centrally negotiated framework pay and tax agreements, worked out between government and the peak associations of employers and unions, each lasting about three years. Six such deals have been negotiated to date since 1987.²⁴ Since 1997, voluntary sector representatives also participate, and the agenda has expanded to take in social policy issues. The pay element of the social partnership agreements, while centrally negotiated, is implemented through decentralized bargaining, mainly at plant or enterprise level. Public sector pay settlements are applied nationally. During the 1990s, buoyant growth permitted government to make quite sizeable tax cuts as part of the overall package, without compromising its rising revenue intake.

To what extent did moderation in the rate of wage increases require the construction of new institutional mechanisms of consultation and decision-making? Two possibilities may be considered here. One is that market pressures, combined with

relative trade union weakness, made it difficult for employees to capture the benefits of rapid growth in the form of increased incomes. The other is that wage restraint was a deliberate and strategic stance to which an effective trade union movement not only assented but which delivered better outcomes for them than would otherwise have been possible.

Social Partnership – An Optional Extra?

The argument that social partnership is irrelevant to explaining Ireland's impressive economic performance during the 1990s can take different forms. Some economists have taken the view that the labour market in Ireland was essentially self-regulating. Insofar as growth did not result in a wages explosion during the 1990s, they argue, this is largely attributable to the greatly increased supply of labour that became available with the expansion of employment opportunities. Participation rates rose among women, many of whom, especially in the younger age groups, had relatively high levels of education and training. The influx of skilled people, the majority of them Irish, who had emigrated at an earlier stage and gained additional skills and experience working elsewhere, also served to discipline wage pressures in the fast-growing high-skilled sectors of employment. Thus wage competition provides a sufficient explanation for the fact that wage growth trailed profits growth. Analysts who take this view point to the growth in wage pressures toward the end of the decade with the noticeable tightening in labour supply throughout the economy, and as something close to full employment was reached. Social partnership, in this view, may at most play a role in legitimating the outcomes that markets are producing anyway.²⁵

Social Partnership – Legitimizing Exploitation?

An alternative but equally negative assessment would have it that social partnership did play some effective role in containing wage pressures throughout the 1990s, but that this has to be construed as a malign rather than a beneficial outcome for the majority. In this view, social partnership serves primarily to legitimate a neo-liberal economic strategy on the part of employers, backed by government; the trade union movement has been suckered.²⁶ These critics point to the decline in the share of wages relative to profits in GDP, which fell from 71 per cent to 57 per cent of

GDP between 1987 and 2000.²⁷ Workers have been left trailing behind in the resurgence of business expansion.

This view contends that the trade union movement is working from a position of weakness. Aggregate trade union numbers displayed some growth during the 1990s, but at a slower rate than the expansion in the overall workforce, so that overall trade union density was estimated to have been about 55% during the 1980s, and 48% during the 1990s.²⁸ While the public sector remains well organized, employees in growth sectors such as private sector services and small firms are particularly hard to organize.

Moreover, whole sectors of the workforce remain resistant to unionization. During the 1970s, the IDA sought to facilitate single-union representation in newly locating firms in established manufacturing sectors, to minimize the likelihood of union turf wars. But the strategy of engaging with high-tech firms caused them to stop trying to facilitate a union presence among the workforce from the mid-1980s onward. US firms, firms in high-tech activities, and firms newly arriving in the 1990s – overlapping categories in any case – are particularly likely to oppose union membership among their employees.²⁹ About 85 per cent of US companies established in Ireland since the mid-1980s do not recognize trade unions.³⁰

Thus, concludes this argument, trade union leaders are motivated by a combination of desperation at their structural weakness, and the lure of financial and status rewards, to agree to sign up to a process that disenfranchises workers from the fruits of growth, and leaves them exposed to whatever rewards the market can spare.

Assessing Social Partnership

An alternative interpretation may be advanced that sets the trends of the 1990s in a somewhat different overall context.

For example, the relative decline in the wage/profit ratio is not as straightforward as it may seem. It is true that incomes did not grow as rapidly as output. But business profitability was improving from what had been a very low base in comparative

terms. Besides, some of the super-profits recorded may overstate real output.³¹ Tax cuts negotiated as part of the social partnership agreements provided significant increases in disposable income. Between 1987 and 2001, real take-home employee pay rose by between 55 and 60 per cent.³² This was a marked contrast to the period of “free-for-all” collective bargaining between 1981 and 1987 when, despite rapid increases in nominal earnings, real disposable incomes were estimated to have fallen by between 8 and 10 per cent.³³

Assessment of trends in earnings is complicated by the rapid shifts in the composition of the workforce during the 1990s. But wage drift between 1987 and the late 1990s has been estimated at only about 1 per cent annually in manufacturing as a whole.³⁴ This would seem to suggest that effective wage disciplines were in place.

So what explains wage moderation? Apart from Ireland, countries such as Spain, Italy, Greece, Finland, and Denmark saw a revival of interest in political mediation to deal with the challenges of growth, rising real incomes, and tax reform, particularly in the context of impending membership of the Euro.³⁵ But in Britain, for example, and in New Zealand and Australia, market forces dealt with labour pressures.³⁶ Perhaps Ireland belongs to the second rather than the first group, and social partnership should be seen primarily as window-dressing to purely market-driven adjustments.

Sectoral trends need to be examined to see what was going on. In a small open economy the sheltered sector, particularly public service activities, may generate wage pressures in excess of what the exposed or competitive sector can sustain.³⁷ Within the manufacturing sector itself, different degrees of profitability and export-sensitivity might produce a “multi-speed” economy in which a single pay norm would be difficult to maintain. Both these features were apparent during the phase of uncoordinated pay bargaining between 1981 and 1987 in Ireland. The “modern” and more productive sectors of the economy were dominated by foreign-owned industry. The “traditional” sectors, also more employment-intensive, were predominantly domestically-owned. During the late 1970s and the first half of the 1980s, wage norms tended to be set by the more profitable foreign sector. Some have gone so far as to identify an “Irish disease”: higher profitability in the foreign sector tended to result in

higher wage rates, which then spilled over into the sheltered sector, fuelling wage inflation.³⁸ Adjustments were then borne in the form of job losses and rising unemployment.

During the 1990s, the manufacturing sector became even more differentiated.³⁹ While the number of Irish manufacturing firms was about five times that of foreign manufacturing firms in the late 1990s, the performance of the foreign sector far exceeded that of the indigenous sector. As Table 4 below shows, manufacturing jobs in foreign firms accounted for almost half of all manufacturing employment. The foreign sector was made up of enterprises that were on average not only considerably larger than the norm in the domestic sector, but also more successful in terms of output and exports. They accounted for almost four-fifths of output and 90 per cent of all exports in 2000.

Table 4 about here

Within the foreign sector, US firms' share of total employment grew rapidly, and US firms outperformed other foreign firms in both the value of output per person employed, and the value of exports.⁴⁰ Foreign, and especially US firms, were concentrated in two "modern" industrial sectors, information and communications technology (ICT), and chemicals and pharmaceuticals. As Table 5 below shows, these showed significant growth in both output and employment, especially in the latter half of the 1990s, while the performance of the "traditional", mainly domestically owned sectors such as food and drink was much more modest.

Table 5 about here.

Thus output and profitability were higher in the foreign, high-tech sector than in the domestic sector, even if this is overstated by factors such as transfer pricing, and this difference was more marked during the 1990s than during the 1980s.

However, sectoral wage trends indicate that despite the higher profitability in the high-tech sector, wage trends in both high-tech and traditional sectors stayed quite

close to output trends in the domestic sector. This trend line in fact is also very close to the pay terms of the social partnership agreements. This is in marked contrast to the experience of uncoordinated collective bargaining between 1981 and 1987. Pay trends in different sectors are shown in Figure 1.

Figure 1 about here

How can the apparently high levels of compliance with the terms of the pay agreements in manufacturing industry be explained? Economists' analyses of the role of labour supply and tax incentives in suppressing wage competition are certainly pertinent. However, institutional and strategic factors also need to be considered.

In unionized sectors of the economy, strong wage norms that reinforce wage relativities and prevent market pressures from exerting downward pressure have long been noted as a feature of Irish industrial relations.⁴¹ The argument advanced here is that the change of strategy on the part of the trade union movement from the mid-1980s onward contributed to a change in the norms and practices of wage bargaining.

The core leadership of the Irish Congress of Trade Unions (ICTU) went through a painful reconfiguration of their strategic preferences during the terrible years of recession during the 1980s. During the 1990s, they held that it would be preferable to facilitate employment growth than to seek to capture all the benefits of growth in the form of rewards for those already at work.⁴² In a weakly centralized trade union movement, the experience of rising real disposable income also undoubtedly reinforced the "virtuous circle" of commitment to social partnership among the union membership.

Furthermore, the Irish trade union movement enjoyed a greater degree of assured political access than its counterparts elsewhere in the English-speaking world. The Irish party system features a weak left-right divide and the Labour Party is the smallest in western Europe.⁴³ But the two largest parties draw on a cross-class support base and tend toward "catchall" policy preferences. In general, there is little to be gained for any party in adopting an exclusionary, anti-union stance à la Thatcher.

But how and why did the wage trends of the domestic sector translate over into the multinational, high-profit sector, most of which did not recognize unions, when the traditional pressures had run in the opposite direction? The role of employers is undoubtedly central here, although relatively little is known about their wage-setting priorities. Virtually all the multinational companies were members of the Irish Business and Employers' Confederation (IBEC). IBEC's commitment to social partnership could not be made binding on its members. But like ICTU, the extensive consultative process they engaged in prior to each agreement meant that the agreements they struck carried widespread legitimacy for members, and employer coordination was estimated to have been more effective during the 1990s than previously.⁴⁴

While labour costs were not as vital to many foreign employers as to domestic employers – the supply and quality of labour mattered most – foreign employers were far from indifferent to the matter. It would appear that employers in non-union employments were happy to follow the broad parameters of the social partnership deals, and to use additional financial reward systems such as bonuses and profit sharing to achieve the flexibility they also wanted in labour supply.⁴⁵

In the story thus far, we contend that the institutional features of social partnership did play a role in stabilizing wage trends between 1987 and the late 1990s. But the contingency of the arrangements became clearer as the labour market tightened thereafter. Indeed, wage drift had already appeared earlier in some sectors in which skilled labour was particularly scarce – in the software industry, for example, pay increases were estimated to be running at between 10 and 15 per cent per annum in the late 1990s.⁴⁶ Public sector militancy also accelerated in the late 1990s, especially among health and education employees.

Employers were anxious about the negotiation of a sixth pay agreement. But the slowdown in the international economy since 2001 cooled off some wage pressures – and in spring 2003 they signed up for a further pay deal.

A capacity for cost-based flexibility becomes more rather than less important for small, open economies within the Eurozone, if growth and employment are to be sustained. Ireland's relative costs and therefore export capability in the early 2000s benefited from the relative weakness of the Euro relative to sterling and the dollar. These conditions are necessarily transient, and it is possible that an expectations lag on the part of the trade union movement may yet present problems. But the institutions of social partnership have displayed robustness to date.

Social Partnership – Solid Gains or Sellout?

The story thus far may cast some light on why trade union leaders and membership observed restraint in the rate of increases in wages during the 1990s. We have argued that this is a real phenomenon, and that it followed from strategic decisions made by the key actors on the basis of their conscious policy preferences – that is, that a key role must be accorded to the capacity for choice.

But the challenge posed by the critics of social partnership still remains, that is, to assess the degree to which the choices made were beneficial to trade union members' interests. Is it plausible to argue that social partnership did no more than to legitimate the restoration of capital's privileges?

While different normative or ideological versions of this interpretation may be found, they share a recognition that modern forms of social partnership differ in important ways from the classic model of social corporatism. In the earlier model, wage moderation agreements supported adjustment to internationally determined economic conditions, but were compensated by social programmes that offset the hazards of the market. These could take a variety of forms, leaning in some countries toward "liberal", means-tested schemes that maximize individual initiative, and in others toward "social democratic", market-replacing, services-rich, collective provision.⁴⁷ Much interest has recently been directed toward the manner in which the social democratic variant has lost credibility and economic competitiveness.⁴⁸ Social pacts have tended to cluster round a model of "competitive corporatism", combining a "search for elaborate equity-based compromises and trade-offs" with "new market-conforming policy mixes".⁴⁹ But the balance between the "equity" and the

“market-conforming” aspects may be struck at many different points.

As has already been noted, social partnership in Ireland went hand-in-hand with rising real disposable income and living standards, alongside significant growth in participation rates. But in view of the pronounced growth in profitability, especially in the foreign sector, during the 1990s, this is consistent with a forced adjustment to new parameters in which equity or collective consumption issues get short shrift. Two such issues might be considered. The first is the pattern of income distribution; the second is the trend in welfare provision.

Income inequality increased during the 1990s. The principal reason for this was the growth in returns to education which, combined with shifts in the composition of the workforce, contributed to pulling the top portion of the income distribution scale away from the median.⁵⁰ Tax cuts also played a part in boosting disposable incomes: the emphasis was on cutting rates and reducing the number of bands, so the effect was invariably regressive.⁵¹ At the bottom of the income distribution, relative income poverty showed an increase. Although the lowest incomes rose in real terms, they rose less rapidly.⁵²

But even if the trade union movement accepts market-conforming outcomes in income distribution, the scope may exist for seeking an increase in social equity by other means. The social partnership agreements formed part of the government’s Anti-Poverty Strategy. The incidence of severe poverty declined steadily, from about 15% in the early 1990s to below 10% in 1997, and about 6% in 2002.⁵³ Yet the evidence indicates that the distributive effects of welfare payments fluctuated over time across different categories of recipients; and in general, living standards rose most slowly of all for those dependent on welfare.⁵⁴

When considering welfare “effort”, the very rapid growth in national income complicates matters. General government spending – 36 per cent of GNP and 30 per cent of GDP in 2001 – is below both the EU average of 45 per cent and the OECD average of 37 per cent. The share of public spending devoted to health, education, and housing also fell during the 1990s, whether considered in terms of GNP or GDP. Yet

public spending rose steadily in real terms, especially toward the end of the decade – just not as rapidly as the overall economic growth trend.⁵⁵ Years of under-investment in economic and social infrastructure and in social and health services had left a big deficit to make good. Despite the fact that per capita income outstripped EU averages within recent years, and despite real spending increases, per capita public spending on many welfare issues continue to trail EU standards by a significant margin, and the quality of the services reflects this. Moreover, the surge of growth and of labour market participation created huge shortages of infrastructural provision in housing, transportation, schools, health care, and so on. Real increases in spending took place in all these areas, but demand greatly outstripped provision.

In conclusion, the verdict on social equity performance is mixed. A key feature of the social allocation of resources during the 1990s must surely be that, for a short while, Irish people could have it all – rising living standards, and tax cuts, and growing public spending on social services. On balance, the public preference – certainly the preferences of every government that held power during the 1990s (and every major party has held a share of power during that time) – appeared to be biased toward the liberal and individualist pole of tax-cutting over building up collective consumption.⁵⁶ As Ireland moved further towards the low-tax, low-services end of the scale, public expectations of high-quality services became increasingly vocal. Yet survey evidence suggested that popular opinion showed little appetite for the higher tax levels required to meet these standards.⁵⁷

5. Sustainable? Exportable?

What policy lessons, if any, can be learned from the Irish experience, for Ireland and for other countries?

The advantages that Ireland enjoyed during the 1990s are now no longer as readily available or as appropriate to sustain the forward momentum of the economy. The downturn in the international, and especially the American economy, in the early 2000s changed the global context of domestic economic policy. Some of the conjunctural factors also changed irreversibly: Ireland no longer has an abundance of

well-educated but relatively under-utilized and therefore relatively cheap labour.

Ireland's industrial policy has been based on catching a wave of international capital investment. Rising living standards will price Irish labour out of lower-value-added employment. The economy must shift toward creating more highly skilled, higher-quality employment. For some commentators, the volatility inherent in this strategy is argument enough against depending so heavily on the foreign sector.⁵⁸ And the hazard of attempting to upgrade the quality of industrial investment lies in the risk of losing too many low-skilled and low paid jobs before gaining much in the higher value-added end of the market.

Notwithstanding significant profit repatriation, though, the benefits to the Irish economy from the presence of the foreign sector strengthened during the 1990s. Nor has the decline in the number of international projects available since 2001 affected Ireland disproportionately: "Ireland is now ranked as the number one location for software and shared services operations in Europe, with top five rankings in... three other sectors" (pharmaceuticals, ICT, research and development).⁵⁹

But the policy instruments that proved so successful hitherto – especially the advantages of low corporation tax – may be less well suited to promoting the next phase of industrial renewal. For example, Ireland trails behind most OECD countries on the principal measures of R&D investment.⁶⁰ Successful as it has been in the past, Ireland's industrial development strategy will have to mutate to continue to reap comparable benefits in the future.

Equally, it can be argued that the social partnership process must adapt if it is to continue to be relevant to successful economic management. The future of social partnership as a cost containment mechanism is challenged by rising expectations, lower labour supply, and the diminished scope for tax concessions. Yet increased government spending – including sizeable public sector pay rises from 2003 onwards – further constrains fiscal "wiggle-room". A new conception of how best to reconcile diverse economic and social interests seems called for. However, despite the stresses caused by wage drift and price inflation, the social partnership process itself remained

intact at the time of writing.

Strategic policy choices pulled elements of Irish economic and social structure into alignment with favourable international conditions to produce good economic performance. Is there anything of a generalizing nature to be gleaned from this experience?

The countries to which such lessons might be of greatest interest are those of East-Central Europe and the Baltic region who are about to become EU members – especially the smaller states such as the Czech Republic, Hungary, Estonia. Like Ireland in the late 1980s, they typically have a ready supply of labour, good standards of education especially in technical subjects, a relatively low general cost base, and a shortage of domestic capital. The EU accession countries are likely to be able to attract the jobs that Ireland can no longer retain.⁶¹

Two themes have emerged that may have a bearing on the policy mix they adopt. The first is that tax incentives and an open-door policy toward FDI is unlikely to be successful by itself, quite apart from the damaging effects of a “race to the bottom”. Attending to supply-side conditions in areas such as educational investment, transport and communications is likely to be a necessary but not sufficient condition. Ireland’s experience suggests that deliberate targeting by state agencies plays an important role in creating agglomeration or industrial clustering and the spin-off advantages that follow from this.

The second theme is that the cost base of the economy, including crucially the cost of labour, must be managed successfully. Ireland’s manner of doing this during the 1990s entailed embedding wage bargaining in social pacts based on tax cuts and some social policy improvements. The means whereby cost competitiveness is achieved will be contingent upon the profile of economic activity and the structure of societal interests in the accession states. Conflicting interests can be played out through purely market-based encounters. But this is likely to be costly in both economic and political terms. So managing economic and social conflicts is likely to involve not only the development of a formal industrial relations framework, but also consultative

networks with government. Besides, the EU itself provides strong support for “social dialogue”. Whether or not such networks result in formally negotiated pay deals, they facilitate the flow of information about how the economy functions, and provide a forum within which competing interests and priorities can be articulated.

6. Conclusions

The Irish “Celtic Tiger” period was a remarkable phase of growth, employment expansion, and rising living standards. The argument of this paper has been that while some of the elements that went into its making were simply the result of good fortune and a useful policy inheritance – chance and coincidence – important elements of choice, that is, deliberate policy adjustment, also played a vital role. Good policy choices were central to making the most of the institutional, economic, and conjunctural opportunities available.

The sustainability of the policy mix of the “Celtic Tiger” phase is under challenge in changing economic conditions. There are still considerable advantages to be reaped from a strategy of seeking direct foreign investment to drive economic development in a small economy. But the mix of skills and activities must change to be viable. This may entail changing the incentive structures for foreign investors, and actively targeting new sectors and firms. Similarly, cost containment becomes more not less important to competitiveness within the Eurozone. It is difficult to envisage how this could be secured in the Irish context without engaging in structured consultative processes. So while the model of tax-cutting pay deals may be close to the end of the road, some model of social partnership seems likely to retain its importance in facilitating the next phase of domestic economic adjustment.

The EU accession states face adjustment challenges that are in some respects very similar to those that Ireland faced when it joined in 1973. Strategic positioning of industrial policy on the one hand, and the construction of domestic mechanisms to manage cost adjustments on the other hand, are likely to be among the principal challenges they face. Inevitably, however lucky a country may be in terms of the opportunities and coincidences it encounters, there will be no substitute for intelligent policy design and institutional adaptation – that is, for choice.

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Table 1. Ireland's Economic Performance in Comparative Perspective

	1. Real GDP Growth %, 2002	2. Real GDP growth, % change 1997- 2002	3. Employment Growth, % change 1997-2002	4. Standardized Unemploy- ment % 2002
Czech Republic	2.0	-	-	7.3
Denmark	1.6	12.1	4.4	4.5
Finland	1.6	17.9	8.0	9.1
France	1.2	11.9	7.9	8.7
Germany	0.2	9.1	3.8	8.2
Hungary	3.3	-	5.7	5.6
Ireland	6.0	44.8	25.3	4.4
Italy	0.4	9.9	6.3	9.0
Japan	0.3	-	-2.7	5.4
Korea	6.3	-	0.4	3.0
NL	0.3	14.8	10.5	2.8
NZ	4.6	-	9.3	5.2
Poland	1.3	-	-4.2	19.9
Spain	2.0	16.6	14.5	11.3
Sweden	1.9	13.3	7.2	4.9
UK	1.8	13.5	4.5	5.1
US	2.4	-	3.3	5.8
Euro area	0.9	-	-	8.3
EU	1.0	12.1	6.65	7.6
OECD	1.8	-	-	6.9

Sources: Columns 1 and 4: OECD Economic Outlook No. 73, Summer 2003, Statistical Annex. Columns 2 and 3: Forfás/National Competitiveness Council, *Annual Competitiveness Report 2003* (Dublin: Forfás, 2003).

Table 2. The Transformation of Ireland's Economic Performance:
Annual Average % Change in Key Macroeconomic Indicators 1983-2002

	1983-1987	1988-1993	1994-2000	2001	2002
GNP	1.0	3.9	8.4	4.6	1.8
GDP	2.2	4.3	9.2	5.7	4.5
Non-agricultural Employment	-0.6	1.8	5.9	4.1	2.0
Unemployment as % of the Labour Force	16.4	15.0	9.6	3.6	4.2
Inflation	6.3	2.9	2.5	4.9	4.6
Tax revenue, % GNP	40.1	38.6	36.0	34.2	33.7
Gross Current Expenditure, % GNP	52.5	43.7	35.7	30.9	31.8
Debt, % GNP	115.2	102.9	65.6	37.4	35
Exchequer balance, % GNP	-9.4	-2.3	+0.2	+0.7	+0.1

Source: Calculated from *Budgetary and Economic Statistics 2003*, Department of Finance.

Table 3. Corporate Income Tax Rates in Selected Countries, 2002.

EU States:	
Denmark	30
Finland	29
France	34.3
Germany	38.4
Ireland (a)	16
Italy	40.3
Netherlands	34.5
Spain	35
Sweden	28
UK	30
Accession States:	
Czech Republic	31
Estonia (b)	0
Hungary	18
Poland	28
Slovak Republic	25
Other OECD States:	
USA	40
Australia	30
New Zealand	33
Korea	29.7
EU average	32.5
OECD average	31.4

Source: KPMG Corporate Tax Rate Survey, January 2002 (KPMG International, 2002). http://www.kpmg.com.sg/services/sg_tax_pub/corp_tax2002tax.pdf

(a) 12.5% from January 2003.

(b) “The Balts and the EU: Welcome Aboard”, *The Economist*, 12 December 2002.

Table 4. Performance of Irish, US and All Foreign Manufacturing, 1991 and 2000.

	Output %		Exports %		Employment %	
	1991	2000	1991	2000	1991	2000
Irish	46.5	21.8	26.1	9.2	55.9	51.9
US	31.1	64.1	48.2	76.9	19.8	30.2
Total Foreign	53.5	78.2	73.9	90.8	44.1	48.1

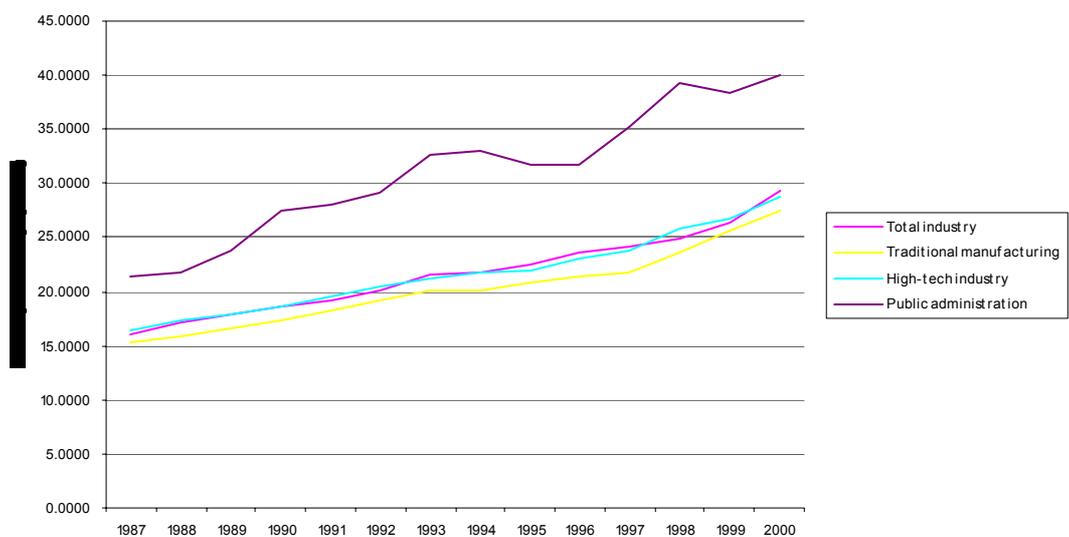
Source: CSO *Census of Industrial Production*, 1991 and 2000.

Table 5. Contribution of Selected Sectors to Economic Performance, % change 1995-2000

	Output	Employment
ICT	35	76
Chemicals	55	15
Food and Drink	4	0
Other Domestic	6	9

Source: *Central Bank Quarterly Bulletin*, Autumn 2002, Table 1, p.22.

Figure 1. Wage trends 1987-2000



Source: ESRI Databank (Economic and Social Research Institute, Dublin;
www.esri.ie)

Notes

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⁵ See *OECD Economic Surveys: Ireland 2003*. (Paris: Organization for Economic Cooperation and Development, 2003), p.5.

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⁹ Department of Enterprise, Trade and Employment, *Review of Industrial Performance and Policy 2003* (Dublin: Stationery Office, 2003), p.47.

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¹³ See also Herman Schwartz, “The Danish ‘Miracle’: Luck, Pluck, or Stuck?”, *Comparative Political Studies*, 34, 2, March 2001, 131-55.

¹⁴ See Ó Gráda, “Is the Celtic Tiger a Paper Tiger?”, pp. 56-9.

¹⁵ Figures from Forfás. For the insider-view story about the establishment of the IFSC, see Ray MacSharry and Pádraic White, *The Making of the Celtic Tiger: The Inside Story of Ireland’s Boom Economy* (Dublin: Mercier Press, 2000).

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²⁰ The story is told in considerable detail by MacSharry and White, pp. 198-308.

²¹ Mac Sharry and White, pp. 219-220.

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⁴⁶ Ó Riain, “The Flexible Developmental State”.

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⁴⁸ See, for example, Kathleen Thelen, “Varieties of Labor Politics in the Developed Democracies”, in Peter A. Hall and David Soskice eds., *Varieties of Capitalism* (Oxford: Oxford University Press, 2001), 71-103.

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