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1 Introduction

According to Cliff Taylor, the Finance Editor of the Irish Times, you were likely to be directed to Dublin zoo, if you asked about the "Celtic Tiger" a couple of years ago. Nowadays, references to the Celtic Tiger have become commonplace in the international business press as being synonymous with Ireland's transformation in the past decade "from an ailing, virtually bankrupt economy to the fastest growing, dynamic economy in the developed world". This transformation has become to be known as the Celtic Tiger

experience. Ireland's sustained period of very rapid growth has few if any precedents not just in its own economic history but in that of the industrialised world.

It is therefore worth taking a closer look at Ireland's impressive economic performance and its turnaround from the "sick man" of the western world to Europe's "shining light". This paper will commence by describing Ireland's economic development (chapter 2) prior to the successful implementation of an innovative modern economic policy mix put in place in the late 1980s and maintained by successive governments in order to reform the nation's economy and improve its performance (chapter 3). The following chapter will set out the economic success of the last decade, while chapter 5 will attempt to underline emerging problems, imbalances and bottlenecks facing the Celtic Tiger now and in the future. Looking at these dangers and also at the possibilities which the new situation presents, chapter 6 will outline the appropriate policy responses to the changing circumstances and formulate a new policy with new strategic priorities for the first decade of the new millennium. The report will then conclude with the medium term economic projections for Ireland (up to 2010) and a personal comment on Ireland's past, present and future economic evolution.

2 Economic development and performance up to 1987

Following the foundation of modern Ireland in 1922, governmental endeavours to promote the development of the country's very weak industrial sector – made up of a small number of manufacturers, primarily in traditional sectors e.g. food, drink and textiles, producing almost exclusively for the home market – were restricted mostly to infrastructure development schemes. The early 1930s, however, saw a more inward-looking approach with protectionist measures against imports from more advanced economies. High tariffs were introduced in order to support development of new "infant industries", bolster expansion of existing native industries and promote greater economic self-sufficiency. Hence, a local industry evolved with a subsequent rapid increase in industrial employment. Growth in these early years consisted of import-substitution with manufacturers supplying mainly the domestic market as the majority of these industries suffered from low productivity and were thus unable to compete internationally. Since continued growth depended essentially on large scale imports of raw materials, components, capital goods and fuel, a chronic balance of payments crisis emerged in the 1950s, virtually stopping further growth for the rest of the decade and leading to a decline in industrial employment and a considerable increase in emigration.

In this context of disillusionment with stagnating industry and confined possibilities for expansion through dependence solely on the home market, a gradual change to a more outward-looking policy was adopted towards the end of this decade. The new strategy focused on achieving economic expansion by stimulating export-based industrial development through a programme of generous tax and financial incentive schemes. As a result, external industrial investors were lured into Ireland and established many

export-oriented subsidiaries of foreign companies leading again to rapid growth of production and employment and significant gains in export shares.

Furthermore, Ireland's protectionist barriers also began to be abandoned when the Irish economy was opened up in 1965 through the Anglo-Irish Free Trade Agreement. Linked predominantly to the UK via a unilateral monetary union, Ireland's accession to the EEC in 1973 – bringing tariff-free access to the markets of the Community for Irish commodities - marked another significant turning point in the transition to the opening-up of the country. A rapid diversification of markets beyond the EEC to the rest of Europe and to the US combined with the setting up of booming new export-oriented growth sectors such as electronics, engineering and pharmaceuticals favoured a much more open Irish economy.

On the other hand, this evolution was accompanied by important structural shifts in the composition of output and employment with the share of labour-intensive agricultural production declining constantly while that of the more mechanised, but less labour-intensive, industrial production was rising steadily. This resulted in a very high unemployment rate coupled with significant migrational outflows and relatively low living standards and showed that Ireland still lagged severely behind the economic performance of continental Europe in the 1970s. The Irish authorities then considered a more interventionist policy by launching a resolute fiscal stimulation plan with a view to pursuing an expansionary strategy to tackle these problems. This policy however proved to be badly-timed and unsustainable in the light of the oil crises of that decade. As a result of the following severe macroeconomic instability marked by very high inflation and large-scale current account and budgetary deficits the authorities began in the early 1980s a multiyear corrective process in an attempt to restore stability. Although being quite substantial over the period from 1981 to 1986, this programme of stabilisation and retrenchment did not yet succeed in stabilising the debt. Fiscal consolidation efforts in turn resulted in a severe squeeze on domestic demand, slower growth and a critical level of unemployment and emigration, in effect a deeply depressed economy. By 1987 the convergence process towards EC-levels came virtually to a halt, leaving Ireland facing its biggest challenge in recent economic history.

3 What then turned Ireland around?

Against this setting of demoralisation and despondency, a new government in 1987 re-intensified efforts at fiscal consolidation and adopted supply-side reforms to the economy, directed at enhancing the attractiveness of Ireland for both domestic and foreign investors and increasing the international competitiveness of Irish-made goods. This new consistent macroeconomic policy mix, based on a broad social consensus agreement, geared primarily towards lowering unemployment and raising average living standards, although income redistribution, social cohesion and regional development also played an important role. The implementation of this strategy, combining a wide scope of elements including prudent fiscal and monetary management, institutional reforms, social consensus on wage moderation, investment in physical and human capital, labour market flexibility, a favourable tax regime, trade openness, etc., together with a benign international

environment and a conjuncture of other exogenous factors were to help lay the basis for the outstanding economic performance of the 1990s. Widespread recognition of macroeconomic stability being the key factor underpinning sustained economic growth and the willingness to accept its consequences led to the emergence of a social consensus making it easier that this economic policy shift has been maintained by successive governments to date and has always been supported on the microeconomic level by employers and employees.

There is unrestricted assent among business experts that one outstanding feature has been responsible for the fiscal consolidation and the economic recovery of Ireland: the so-called ***Social Partnership Agreements***. In 1987, the incoming government took the opportunity to bring previously excessive costs in the domestic economy under control. The government, employers and trade unions agreed on a three-year Programme for National Recovery (PNR) linking moderate wage increases negotiated in a centralised setting to targeted tax reductions on labour and improved social services. This de facto incomes policy thus stressed fiscal and monetary restraint, tax reform, pay moderation and sectoral development on the basis of social consensus as main targets. This policy hoped to ensure improved competitiveness of Irish goods internationally, as well as securing enhanced foreign investment, greater job-creation, higher take home pay and the avoidance of inflationary pressures that might undermine the stabilisation programme. As the terms of the concluded regime were complied with to a high degree, the PNR proved to be successful and was followed by a series of multi-annual agreements. The successors to the PNR, the Programme for Economic and Social Progress (1990 to 1993) and the Programme for Competitiveness and Work (1994 to 1996), provided for the award of additional wage increases to facilitate specific local circumstances. Moreover, they also implemented wage freezes, wage cuts and the recruitment of new employees on lower entry pay scales, representing a pragmatic response by the social partners in the face of intensified competition and an inhospitable labour market. The latest contract, Partnership 2000 for Inclusion, Employment and Competitiveness, builds on its predecessors and is due to expire at the end of March 2000. This sequence of national wage agreements has been decisive in impeding both social discord resulting from indispensable changes in work practices and excessive wage increases from setting in motion a severe squeeze on traditional, labour-intensive industries.

Closely linked to the social partnerships described above, was the marked consensus that ***fiscal rectitude*** was necessary in order to correct significant imbalances in the government finances. Therefore, beginning in 1987, fiscal adjustment emphasised more on the expenditure side by tightening control over public spending and reducing the national debt needs. This strategy combined with enhanced exchange rate stability on the monetary side alleviated concerns for the longer-term sustainability of stability-oriented fiscal and monetary policies, thus improving macroeconomic stability.

As a small economy, Ireland is extremely dependent on ***economic and trade openness***. By applying an international economic integration approach, combining active promotion of

foreign direct investment (FDI) with expansion of exports markets, Ireland has been able to position itself as a "hub" between Europe and the global marketplace. Ireland's FDI-policy has contributed vitally to economic progress by exploiting the so-called "first-mover advantage": once the first foreign investor in a certain sector had set up production facilities in Ireland, it has been usually easier to attract its competitors. Generous financial incentives and considerable industrial support centred on a small number of key dynamic sectors with spin-off potential, have also been crucial in persuading major export-oriented multinationals to locate in Ireland in order to serve the EU market. Ireland demonstrated to be very innovative and successful in luring FDI and has served as a role model in this respect for many other countries. Another manifestation of openness can be seen in Ireland's modified approach to competition policy, recognising that free and fair competition and trade stimulate demand and economic growth. Strengthened domestic competition legislation has been installed eliminating obstacles to competition such as entry requirements for professions and licensing systems. Institutional reforms and a conducive and transparent regulatory framework have consequently been the main impetus of greater competition and liberalisation in the economy. By reducing the size of state-owned industries through privatisation, especially in the provision of transport, energy and communications services, the Irish government has favoured a much more proactive opening up of hitherto protected activities. In addition, developments in EU competition law have had a remarkable and growing impact in the public utilities area.

Central to the pickup in the economic performance of Ireland has been the identification of the need for ***tax reforms***. The recognition of the incentive power of taxation has made the new government cut tax rates on a large scale, mainly on corporation tax, capital gains tax and income tax, in order to stimulate economic activity. As the domestic economy has responded rapidly and positively to this new strategic approach of lowering taxes, this has led to the creation of new companies and new jobs. As a result, the tax receipts needed to fund additional government expenditure on social services have been generated, thus refuting the thesis that tax cuts can not be followed by improved social services. A long-standing auspicious tax regime with a 10% corporate tax rate applied to international manufacturing and service companies has also consistently been pursued. Apparently, this has not only boosted significantly FDI but also has had a very positive impact on the non traded sector.

The increased recognition of the role of education and training as a key to prosperity in a fast moving and increasingly knowledge-based and globalised economy, has led to major long-term ***investments in human capital and physical infrastructure***. Generous EU transfers have played a considerably supporting role to this framework of domestic policies in up-grading the nation's human resources and improving its physical infrastructure. Investment aid from the EU Structural Fund has substantially financed the infrastructural needs of the economy while the EU Social Fund has vitally provided for higher levels of expenditure on education and training. The availability of these funds has not only had beneficial short-term macroeconomic effects by boosting domestic demand, but has also

eased budgetary pressures, especially at the beginning of the 1990s, and have helped to alleviate the fiscal adjustment process.

Another crucial element in Ireland's economic turnaround has been the remarkably growing ***labour market flexibility***. As Ireland was at the forefront of the paradigm shift of changing the economy's structure with resources, labour and capital moving from relatively low-productive agricultural and industrial sectors into high-productive high tech industry and services, the nation's labour supply had to respond quickly to the new situation. With the standard factors of production becoming lighter and, hence, more mobile, labour supply has become absolutely crucial among factor inputs. Due to sharp improvements in the supply of skilled workforce and favourable demographic factors generating a strong labour force growth, Ireland has been able to face this challenge and respond to rapid growth in demand. In essence, Ireland's appeal to foreign investors has therefore been based on the quality, price and availability of its labour.

Finally, a ***benign international business environment*** has also helped Ireland to recover economically. Undoubtedly, the robust and prolonged expansion of the US economy – the source of most of the FDI – as well as Ireland being an English-speaking nation have had a beneficial impact on the Irish economic performance. The pledge to the single European market and to Irish participation in EMU has permitted Ireland to position itself seemingly nicely balanced between the different business cycles of the United States on the one hand and the EU on the other.

4 Economic performance in the 1990s

Since the implementation of a consensus approach to economic management in 1987, based on the elements set out in the preceding chapter, Ireland has experienced a significant and sustained process of catching up to average EU-levels which, however, has only been translated into a convergence in income levels and living standards in the 1990s due to the "bad" timing of German unification and its consequences for European monetary policy. A renewed stable macroeconomic background - price stability had been restored - led to strong credibility effects providing the conditions for Ireland's remarkably strong and impressive economic and budgetary performance over the last decade. As a result, no other country has been able to match its outstanding outcomes in a variety of dimensions, and in 1999, Ireland's "Celtic Tiger" economy is expected to have had the fastest growing economy in the industrialised world for the sixth consecutive year. Fortunately, the Asian crisis of 1997 and the Russian crisis of 1998 appear to have been having only a relatively small impact on Ireland's growth rate. Ireland's vigorous export-led growth has resulted in a rapidly declining unemployment rate, impressive labour productivity gains, a substantially strengthened fiscal position, low inflation, lower taxes and rising disposable incomes. Altogether this has lead to historically-high levels of business and consumer confidence.

Looking closer at the economic expansion of the past decade, averaging more than 9% in the past five years and totalling more than 60% over this period, it has undoubtedly been most visibly reflected in the employment situation. With a record employment rate increase

of close to 50% over recent years (annual increases averaging more than 5%) and an unemployment rate steadily falling from almost 18% in 1987 to 5.1% in November 1999, Ireland is now approaching full employment. 61% of the working-age population is in employment at the moment, a number similar to that of the EU as a whole. Private sector services have been the major source of this development with manufacturing employment expanding rapidly in the 1990s and employment in agriculture declining further, reflecting the changeover in the economy's structure. This has been achieved notwithstanding substantial natural increases in the labour force due to a steady acceleration in the working-age population resulting from Ireland's particularly favourable demographics (baby boom of the 1970s), an endogenous reversal of traditional net outward migration and rising female participation associated with changing social attitudes to women working. Finally, following the upgrading of human capital and higher educational attainment among young employment market entrants due to, in essence, the introduction of free third level education a few years ago (Ireland was ranked first in the world in terms of its educational system meeting the needs of a competitive economy in the most recent IMD World Competitiveness Report), the average quality of Irish labour force has risen sharply entailing significant positive effects on long-term and youth unemployment through 50%-cuts.

In pondering on Irish economic performance it is vital to note that Ireland is one of the most trade dependent economies in the world. With total trade now amounting to almost 200% of GNP due to double-digit increases in imports and especially in exports of goods and services over the last decade, it is small wonder that Ireland has registered consecutive annual balance of trade surpluses exceeding 10% of GNP on average over the last 10 years and that it has maintained a trade surplus with the rest of world since 1985. FDI has been the major impulse to Ireland's trading performance with exports having primarily been generated in the high-tech sectors of electronics (the potential of the IT sector as a powerful instrument of employment and wealth creation had been identified by the Irish Government more than 20 years ago), software (55% of Europe's FDI software projects are located on the "Emerald Isle" making Ireland the second most important exporter of software in the world), chemicals and pharmaceuticals/healthcare (Ireland is the absolute European market leader in this sector). With the Dublin International Financial Services Centre Ireland, as the most successful FDI location in Europe relative to size, can now offer the second largest off-shore financial centre in Europe. Ultimately, to date, one job in four is directly dependent on exports and, taking indirect influences into account, this rises to almost one job in two.

Side by side with considerable economic progress and following buoyant tax receipts, sound budgetary management - since 1993, public sector spending has fallen from 44.5% of GDP to less than 36% - has allowed the fiscal position to improve from runaway public deficits averaging over 12% of GDP before 1987 to consecutive substantial surpluses in the last three years. This mirrors mainly the cyclical strength of the economy and lower interest payments. The elimination of public deficits has entailed a large reduction in the national

debt, falling from a peak of 125% of GDP in 1987, the second highest in the OECD, to 47% by 1999. This has brought down the burden of debt service, freeing resources for other purposes.

Albeit strong economic growth in recent years, inflation has remained moderate. In contrast to characteristic annual increases in inflation of more than 10% before 1987, consumer price inflation has remained below 2% over the last decade even though it is no longer among the lowest in the OECD. Consequently, having fulfilled price stability as well as all other Maastricht convergence criteria, Ireland was confirmed, in 1998, as a starting participant in the final stage of EMU. Finally it is worth mentioning that, since 1993, after-tax incomes have increased by almost 40% due to Ireland exhibiting the highest measured productivity in the EU over the last decade.

5 Emerging dangers and bottlenecks

However, despite the current economic success, domestic business experts from the ESRI as well as outside observers such as the OECD and the IMF caution that the macroeconomic balance in the economy has shifted since 1998. The tenacious expansionary supply shocks have propagated to factor and domestic goods markets, consequently giving rise to signs of excess demand pressures and overheating. It has become obvious that the continuation of rapid economic growth is entailing pressures and tensions which have the potential to stop growth and possibly to cause severe imbalances. Although imbalances can exist for quite a long period without causing much harm - especially in the case of an extremely open economy such as Ireland's - experts seem to have detected certain areas of concern which could probably, albeit temporarily, halt economic progress. Thus, a series of emerging internal short- and longer-run bottlenecks - including infrastructural problems, labour shortages, social disadvantages and inflationary pressures caused by excessively large increases in house prices and the danger of an explosion of expectations with regard to wage levels, public spending and tax cuts - has been identified which could undermine prospects for continuing stable growth. Moreover, negative effects of external shocks could add to vulnerability and magnify the threats.

Despite very substantial investment in recent years, including EU-assisted activity, Ireland still has a major ***infrastructural deficit*** in relation to many of its EU partners. Public infrastructure has failed to keep up with the phenomenal economic growth because of investment constraints by Ireland's relatively low per capita income. As a result, the depth and quality of Ireland's physical infrastructure is several sizes too small and well below the requisite standard for an economy developing as fast as the “Celtic Tiger's”. The economy could choke through congestion originating from past underinvestment especially in the domain of public transport, rail and road infrastructure, environmental services (water and drainage services; waste management system) and a range of other publicly provided infrastructure such as telecommunications and electricity transmission. While bottlenecks in the housing market (demand pressures due to sharp rises in incomes, employment and household formation) are as much a sign as a cause of this congestion, they are closely

linked to these other infrastructural limitations. These shortages are beginning to impact on the growth potential of the economy, both directly and indirectly, through their macro-economic spill-over effects on the supply of labour or on price levels.

The higher-than-expected demand for Irish labour over the 1990s was met, in essence, by a very flexible and steadily increasing labour supply. However, as this period of rapid growth in labour supply is reaching an end, the labour market conditions have lately tightened extremely and ***labour shortages*** have loomed in crucial sectors such as high-tech industry or construction. This development is due to a lack of additional domestic labour resources in view of a falling number of young labour market entrants and a decline in women participation growth, and to a limited supply of immigrant labour force in the light of excessive accommodation costs. Labour scarcity has moved beyond the realm of specific skills to a general lack of even unskilled labour bringing about difficulties filling vacancies. This situation is now giving rise to upward pressure on wage rates with increases observed or in the pipeline which were at the upper end of economic sustainability or which ran ahead of productivity growth thus seriously threatening Ireland's competitiveness. Public services have been identified as the other major source of overshooting wage levels. As sheltered sectors such as health, education and security are not exposed to market disciplines or international competition, wage demands are substantially pushed up. Altogether, this evolution will make a new broadly-based national agreement, as a successor to Partnership 2000, very difficult to achieve.

Albeit significant progress in recent years, the Irish society encounters many pressing ***social problems*** resulting mainly from regional imbalances due to a different regional growth performance. Assessment of the distributional effects of Ireland's economic and, in particular, labour market success reveal that sections of the Irish community have been, to a greater or lesser extent, bypassed by the economic boom. Issues of social exclusion, marginalisation, equality and poverty will have to be addressed. The number of people falling below poverty line has remained high as social welfare payments have not kept up with the rapid increase in average incomes. Long-term unemployment is still problematic as well as access to appropriate and affordable accommodation with waiting lists for social housing having risen rapidly in recent years. In the educational sector human capital development is still in need of further upgrading in order to tackle early school leaving and adult illiteracy ensuing from a lack of adult education and training schemes. Finally, drugs problems, inadequate health care, leisure and recreational facilities as well as obstacles to entering paid work for lone parents, and especially for women, such as disincentives in the taxation and welfare systems or the lack of state support for child care continue to threaten social inclusion.

The biggest domestic threat to a sustained economic progress lies in ***inflationary pressures*** and an ***inappropriate fiscal policy*** in the new policy framework of EMU. In recent months, Ireland’s inflation rate has deteriorated drastically from one of the lowest in the EU to the highest, averaging over twice the euro zone average. The pick-up has essentially been driven by significantly easing monetary conditions resulting from a sharp fall in interest

rates due to the convergence to EMU levels. This monetary situation is absolutely inconsistent with Ireland's business cycle and, combined with surging prices for international commodities such as crude oil and price increases in the domestic services sector, has intensified the demand and wage pressures mentioned above. In this context a tightened counter-cyclical fiscal policy is the key tool for macroeconomic stabilisation. However, assessments of past fiscal policy corroborate that it has been fairly consistently pro-cyclical, wrongly accentuating both booms and recessions. Furthermore, given the sizeable fiscal surpluses generated over the last three years, this need for fiscal restraint is difficult to justify, as the vast majority of the population expects massive tax reductions, higher pay and spending increases or improved public services. Lastly, issues of competition, efficiency or regulatory policies, financial supervision and public utilities come to the fore because structural barriers, restrictive practices, excessive regulation and rigidities in various spheres hinder free competition.

As a small and highly open economy, depending predominantly on exports and inward investment, Ireland's economic performance is crucially vulnerable to conditions elsewhere. Such is the integration in the global economy that a crisis commencing on the far side of the globe could severely affect Ireland's economy. The impact of negative effects resulting from external shocks, similar to German reunification or the oil crises of the 1970s, combined with the current potential bubble in the housing market and rising pressures in the labour market could turn a temporary slowdown elsewhere into a recession in Ireland. Potential external shocks include in particular the prospect of a serious correction in the US equity market triggering off a chain reaction in the world. Considering Ireland's rising dependence on FDI from across the ocean, a major fall in the US equity market could hit US-owned companies in Ireland and cause their closure due to mounting pressures to move them to cheaper locations. In the event of the economy being hit by a sudden sharp increase in euro zone interest rates - fuelled by the current rise in oil prices, for example - or even the break-up of EMU, Ireland would experience a sharp decline in production and employment. Moreover, because of a distinct pick-up in private sector credit growth, the bubble in the housing market could burst causing a major trauma in Ireland.

6 Policy measures and strategic priorities for the next decade

Having identified the dangers that face the economy, and also the opportunities which the changing circumstances present, there is now a new basis from which to formulate the appropriate policy responses for the next decade. In the new conditions which now prevail the first objective of economic policy, namely to manage the current economic success and safeguard the accomplishments to date, will necessitate that the tensions be dealt with through a newly designed approach to economic and budgetary policy. Secondly, the rapid rise in incomes and living standards makes feasible many desirable objectives, all of which seemed beyond Ireland's reach a few years ago, and raises issues about the longer-term strategic priorities for the country in the next decade. Therefore, a series of documents such as the Stability Programme or the National Development Plan 2000 - 2006 outlines the Irish

Government's set of goals and objectives for the beginning of the new millennium while reflecting its current assessment of the situation. However, in the years ahead, priorities may change in line with economic and social circumstances. The overall vision of the Irish Government is to implement public policies which will provide the groundwork for future strong and sustainable economic progress, make the economy more competitive in the global market place, foster balanced regional development and promote social inclusion. Hence, structural reform measures and initiatives contrived to promote labour supply, maintain wage moderation and increase the efficiency of the economy through large scale public and private sector investment are being undertaken. Furthermore, the Government intends to improve product, capital and labour markets, tackle social priorities and prepare the public finances for the longer-term costs arising from the ageing of the population in the early decades of this century. Altogether, as there is no single "right" answer to address these challenges, this implies striking the right balance between wage costs, taxation and other State imposed costs, and productivity.

Over the next decade, the public sector should be able to simultaneously run fiscal surpluses, fund a sizeable increase in investment, accomplish confined improvements in public services, and a limited reduction in the burden of taxation. Consequently, despite the Irish Government's commitment to restrict annual growth in public expenditure to 4 %, it will provide the necessary resources for an ambitious programme of infrastructure improvement designed to tackle the deficit in public physical infrastructure. In this respect, specific measures attempting to restore an equilibrium between housing supply and demand, are of crucial importance. In order to ease the constraints on supply and maximise housing output countrywide, in particular the availability of affordable housing for young people and low-income households, steps have been taken aimed at expanding the supply of serviced land, precipitating the planning process and increasing housing as well as urban densities. Certain experts even recommend that the State's direct involvement in the housing sector should be confined to social housing, that fiscal incentives to investment in housing should be removed and that the implementation of a property tax would be desirable in order to moderate prices. In this context, the provision of a greatly expanded, much more sophisticated and more reliable system of public transport by different modes (rail and road), which will assist greater mobility within cities and between them, could further relieve congestion. Lastly, a substantial investment in the implementation of high-standard environmental services, including a modern waste management/recycling system and adequate water and sewerage services, will help to deal with deficiencies in Ireland's environmental outcomes and further ease the problem of housing supply.

In order to avoid further overheating of the economy and offset the injection of demand arising from this investment programme, the Irish Government is likely to tighten fiscal policy elsewhere. As "festina lente" (make haste slowly) seems the appropriate motto for fiscal policy, the Government considers to postpone partially its comprehensive programme of tax and welfare reform initiated in 1999 and aiming to improve the efficiency of the economy through a balanced strategy of removing more of the low-paid from the tax net

altogether, by ensuring that a large majority of taxpayers are subject to no more than the standard rate, and by completing the transition to a more progressive system of tax credits. Considering that decisions taken in relation to public spending and taxation tend to become permanent commitments that cannot easily be reversed, experts have cautioned against further tax reductions projected for the Budget 2001 and 2002. They recommend placing the tax reform in a medium-term context and building up a budgetary buffer by connecting the planned tax cuts with a revenue-neutral broadening of tax bases. Moreover, their proposals include the introduction of a wide range of revenue-raising environmental taxes and charges such as carbon taxes and road pricing in order to comply with the EU Stability and Growth Pact and ensure that the environment is not overused. Finally, the Irish authorities have seized the opportunity, created by the present buoyant economic and budgetary conditions and the unusually favourable demographic situation, to prepare public finances to meet future pension liabilities resulting from a progressively ageing population. By establishing a Social Welfare Reserve Fund and a Public Service Pensions Fund in 1999 authorities aim to promote inter-generational equity by partially pre-funding the government's future pension liabilities. The provision of resources on a planned basis through a sizeable annual set aside amounting to 1 % of GNP will make sure that no single generation will have to carry too heavy a burden of caring for the aged.

The recent changes in taxation intend also to meet the needs of the labour market by improving work incentives, especially by encouraging the take up of employment by the lower paid with the purpose of inciting a further increase in labour supply and addressing existing labour market pressures, by maintaining general wage moderation, by addressing unemployment and poverty traps and by ameliorating the interaction of the tax and social security systems. In this context, the Irish Government adopted in 1999 the so-called National Employment Action Plan focusing mainly on upgrading the quality of labour programmes rather than on expanding their quantity. It is made up of a two-pronged approach, targeting on the one hand exclusively and intensively on the long-term unemployed through increased expenditure on highly effective reintegration programmes, and on the other hand on youth unemployment through a more "preventative" strategy. The State has been taking active labour market policies in order to assist the most disadvantaged groups in accessing employment. By sponsoring job creation projects and enhanced training opportunities for the disabled and lone parents with children, and by fostering the development of child-care and pre-school facilities, as well as by strengthening the conditionality of unemployment benefit payments through the introduction of interviews - which has led to a sharp drop in the number of claimants - authorities have succeeded in increasing labour supply. The Government is also expected to introduce a National Minimum Wage with effect from April 2000 whose conditions have been a key subject in the ongoing negotiations between state authorities and social partners on a renewed social partnership programme adapted to the new circumstances. Since November 1999 the Government has been acting to preserve social partnership and trying to conclude a satisfactory successor agreement to Partnership 2000 which will guarantee a significant

dividend from present economic buoyancy to all citizens, while maintaining the country's competitiveness. Therefore, it has argued strongly for significant profit-sharing options through a more extensive use of performance-related wage increases based on local bargaining in order to foster greater wage flexibility - including the public sector - and has committed itself to bring about more flexible working conditions in general. While the level at which the proposed minimum wage will be introduced has not yet been determined, a suggested reduced rate of 70 % applicable for youth, job entrants and trainees up to 21 years has been welcomed in order to limit the negative impact on youth employment.

Considering the "dependency culture" of Ireland's distorted industrial sector ensuing from massive tax incentives on FDI the Irish Government has decided, in response to European Commission criticism, to harmonise corporate taxation. Thus, a new uniform rate of corporation tax of 12.5 % will be introduced to all sectors of the economy with effect from January 2003, thereby eliminating the differential treatment between indigenous and foreign companies. Authorities are also committed to continue the transformation of the economy by repositioning Irish industry higher up the economic value chain. Therefore, in order to cope with the information society, they will actively pursue the positioning of Ireland as a global leader in electronic commerce, teleworking and next generation internet technology. Substantial investment in R&D, IT and an Education Technology Fund is supposed to provide Ireland the competitive edge in this regard. In addition, measures to enhance competition in all sectors of the economy through increased enforcement of competition law and the reduction of regulatory burdens focus also on restructuring the economy and making it work more efficiently. The recent successful deregulation of both the telecommunications and aviation sectors, the sale of state-owned banks as well as the forthcoming liberalisation of the electricity and gas sector visibly prove that the government is on the right track. However, authorities have taken steps to strengthen supervision in the most vital area of the economy, the financial sector, in the view of its vulnerability to external shocks. Finally, as social inclusion remains the key objective of the current government, additional resources have been made available to ensure the provision of modern and efficient education, health and social services. As to a more balanced regional development a nodal strategy is likely to be implemented concentrating on investing in selected regional centres which will provide a development focus for their surrounding hinterland.

7 Economic outlook

This chapter presents the key points of detailed forecasts for the Irish economy out to 2005 and of a more limited set of projections out to 2010 carried out by domestic (ESRI) as well as foreign (IMF; OECD) economic research institutes. Their studies suggest that the economy is currently like a clockwork mouse - it is fully wound up and moving very fast i.e. it is temporarily growing at an unusual rapid pace as it catches up with EU average income levels. However, as the demographic effects taper off, capacity constraints become increasingly binding and income levels converge, the economy is expected to unwind

gradually over this decade, eventually slowing from its present gallop to more sustainable, albeit still significantly above EU-average rates of growth. The average growth potential over the next five years is predicted at 5 % or more, with Irish income per capita reaching EU average levels by 2005 and growth returning to a "more normal" European growth rate after 2010. Although the international outlook appears quite favourable for Ireland for the immediate future (recovery in the OECD; pick-up in Japan and in the EU; continued strong growth in the US) the government is likely to continue running substantial budgetary surpluses until 2006 in order to give Ireland the leeway to meet any future crisis. This development will lead to declining debt ratios and culminate in the full repayment of the national debt by 2010. Consequently, the scenarios stress the underlying strength of the economy and suggest that Ireland is reasonably robust to offset some of the worst effects of asymmetric shocks through counter-cyclical fiscal policy. Thus, external shocks need not cause lasting damage - although they could reduce growth by 3 % or more for a limited period, giving rise to a severe but temporary recession - and the economy would respond resiliently to them and quite rapidly return to its previous growth path. Inflation is forecast to increase to 3 % on average between 2000 and 2005 in response to external and internal pressures combined with indirect tax increases on tobacco, and to moderate again in the period to 2010. Ireland's inflation rate will therefore remain above the average inflation rate of the euro area, mainly due to stronger wage growth and higher productivity growth reflecting a continued gradual upgrading of human capital (third-level education will rise from 30% in 2001 to more than 40 % in 2010) and a fall in labour supply arising from a sharp decline in the birth rate after 1980. While Ireland will have one of the lowest dependency ratios in the EU with most adult women being in the paid labour force by 2005, labour supply growth, whilst remaining high relative to that of the EU, will progressively moderate over this decade. As long-term unemployment is predicted to be eliminated by 2005 and unemployment in general to continue falling substantially, the Republic will effectively be left in a position of full employment in the medium term. However, as Ireland will become one of the most attractive labour markets in the world over this decade, one major difference between the 1990s and the near future is that the benefits of economic progress will increasingly be mirrored in rapidly rising wage rates. Private consumption is projected to rise significantly as unemployment falls, wages rise and personal taxes are likely to fall by 0.5 % annually to 2010. For those still relying on social welfare payments the welfare rates will be fully indexed to the growth in average earnings in order to guarantee that their standard of living will also rise. In this context, experts believe that the introduction of the minimum wage, while it should improve work incentives, is not likely to have a major direct impact on household poverty since the overlap between low pay and household poverty is not as great as it is thought to be. As a result, simulations suggest a fall in employment of 0.9 % and a rise in unemployment of 0.5 % through its implementation. Investment will remain high over the period to 2005, reflecting the fact that, while Ireland will enjoy an EU standard of living, it will not yet have attained the average EU stock of wealth, particularly in terms of infrastructure. Albeit a predicted total

of 225.000 dwellings over the next five years should alleviate the housing constraint, the rate of inflation in house prices will continue to be very high. Thus, due to extraordinary high accommodation costs net immigration will be lower during this period and is expected to rally after 2005 as the cost of accommodation should have returned to the EU level. Overall, experts assume that the most likely outcome for the housing market is a "soft landing", with house prices stabilising, and eventually falling slowly in real terms. The growth rate of business investment including FDI will decrease as corporation tax is forecast to rise post-2003, when the single 12.5 % rate will be in place, to an estimated rate of 17.5 % in 2010. Finally, the structural evolution of the Irish economy will continue with a gradual shift from high-tech manufacturing to market services, especially internationally traded services, as the engine of growth over the course of the next ten years.

8 Conclusion

"At first glance it is astonishing that a nation could have moved all the way from the back of the pack to a leading position within such a short period" said the Irish Taoiseach Bertie Ahern during a speech on 2 July 1999. However, I would argue that Ireland has broken free from the vicious circle of falling employment, reducing living standards, emigration and fiscal crisis because the Irish people have identified how all of these different aspects of economic and social life are connected. "Like the apocryphal butterfly that flaps its wings in China and causes a hurricane on the other side of the globe", neglect of any one of these systematically interrelated factors can severely harm the Irish economy. On the other hand, when pursued in a determined and concerted way it is possible to create a virtuous circle transforming a relatively insular society, with a protected economy, into a "Celtic Tiger" whose economic outcomes, while having clearly surpassed those of its etymological rivals in Southeast Asia, are the envy of countries around the world. Ireland is now reaping the benefits of the shift in economic policy as the prosperity of recent years has transformed the economy, bringing greatly improved opportunities and higher living standards to most of the people. A prudent consensus approach adopted by the social partners has significantly contributed to this result and the lessons of this experience remain highly relevant for the future. However, in many regards, the policy challenges of this decade will be radically different from those of the recent past. Old problems which have now been entirely or mostly solved will give place to new ones - and different solutions and new thinking will be needed. To realise the economy's full potential in the years ahead will, to a large extent, be determined by how quickly the well-known bottlenecks are overcome. Irish policy-makers, so long used to dealing with economic under-performance, must now grapple with the problems created by success, if the recent strong economic record is to be sustained. But over the medium-term, while the economy will mature, some traditional, fundamental challenges will remain - even if ways of meeting them will change. In this era of unprecedented structural change it is crucial that Ireland maintains its international competitiveness, its attractiveness as a location for foreign and domestic investors and the confidence of international markets in the long-run sustainability of public finances. Ireland

cannot afford to treat its current economic performance as inevitable, or its continuation assured. Therefore, it would be prudent to lay the groundwork for the day when growth slows - as it inevitably will.

Ireland today is a society of unprecedented opportunity to which the government is determined to ensure equal access for everyone. It is the authorities vision to assure that the fruits of Ireland's economic progress over the last decade will not be frittered away, but built upon, and to guarantee that nobody will be left behind in order to improve the quality of life for everyone. Furthermore, as Ireland moves from being a net recipient of EU funds to a net contributor to the EU budget, a shift in the perception of Ireland's strategic role in the EU and in the wider world seems appropriate. For the future, Ireland will be expected, like many other EU countries, to shoulder the responsibilities of rising incomes through a substantial increase in overseas development aid. Considering developments such as the introduction of the new single currency in 2002, the expansion of the EU to Central and Eastern Europe, the continuance of rapid technological change, the globalisation of the world economy through continued trade liberalisation, the ongoing process of restructuring markets and enterprises, and the demographic evolution of Europe's population, Europe will undergo a period of unprecedented transformation over the first decade of the new millennium. Irish authorities believe that the positive trade benefits arising from this new situation are likely to outweigh the effects of increased competition. The Irish Government is confident that the country's internal market dynamism will allow Ireland to achieve a sustainable competitive advantage in this wider global marketplace and to reap the benefits of an era of open markets bringing more jobs, consumer choice and general prosperity. It also seems certain that, as long as the varying economic tides between Europe and the US remain favourable, Ireland's good times may last a little longer yet. Consequently, Ireland in 2010 will be a very different economy and society from today, however not the "heaven on earth" promising a golden age of BMWs, yachts and heated swimming pools as Séan Mac Cárthaigh wrote in an Irish Times article.

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