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INDUSTRIAL POLICY FROM THE 1930'S TO CULLITON

By

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INDUSTRIAL POLICY FROM THE 1930'S TO CULLITON

Introduction

In this paper I want to set industrial policy in Ireland within a historical framework. The main conclusions of the paper are that the direction of industrial policy outlined in the late 1950's was correct; that the early success with attracting overseas firms distracted attention from the weaknesses of domestic firms and domestic policy; and that both the Telesis and the Industrial Policy Review Group (IPRG) reports can be seen as attempts to reassert the principles laid down in the late 1950's.

The structure of the paper is as follows. First the historical background which led to the adoption of outward looking industrial policy in the late 1950's is described briefly. Then the successes and weaknesses of the outward looking strategy are considered. Third the period from 1973 to the Telesis Report is examined. Fourth, the New Industrial Policy that evolved from the analysis of the Telesis Report is discussed, and finally the logic of the IPRG is analysed.

Section 1. THE PRE-OUTWARD LOOKING ERA

At independence there was a deep commitment to free trade to maintain competitive prices for farm inputs and to maintain the real value of farm incomes. The emphasis on farm incomes reflected not just the political base of the new administration, it was based on the fact that the majority of the population was dependent on agriculture. In a free trade world it could have been expected that the economy would
develop on the basis of the natural advantage enjoyed in grass growth – initially in the production of cattle and milk, and thereafter in the processing of these primary inputs by the beef and dairy industry for the UK market.

In the event this development did not take place. The world economy experienced the Great Depression and the spread of protectionism across major industrial countries. This created an environment that was favourably disposed to protectionism within Ireland. Indeed it has been argued recently that the introduction of protectionist measures at home at the time was the correct response to protectionism abroad. The Economic War with Britain not only disrupted trade with Britain, but gave a further fillip to domestic protectionist measures. The Second World War, with its attendant shortages of imported goods, made domestic production essential.

While it is clear that special circumstances could be used to justify the introduction and maintenance of protectionist measures, protectionism was continued too long after the end of the war. The post war reconstruction period in Europe could have provided the necessary favourable climate for industry to experience lower protection and to learn to respond to competitive pressures, since much of post-war industry in Europe was more supply constrained, because of the destruction caused by the war.

In fact protectionism was continued beyond this, and this resulted in a high cost industrial sector, which was not only not in a position to benefit from high growth in Europe, but required further measures to stay still. The 1950’s were characterised by low growth, high emigration, high unemployment, balance of payments and fiscal imbalances. Even by the mid 1950’s industrial policy was still geared towards the domestic market. In 1956 the IDA was empowered to grant aid outside the “undeveloped areas” - the objective being to increase industrial employment via import substitution. However a first tentative step was taken to encourage exports - tax concessions were given for increased profits from
exports. Overall, policy was still inward looking. Within a very short period there was a significant change in emphasis. The Programme for Economic Expansion 1958 recognised that a more outward looking strategy was needed if the economy was to develop. Industrial growth needed to be based on export growth, as the domestic market was too small to allow firms to realise economies of scale. In order to achieve export growth a dual approach was adopted:

(i) new industry was to be promoted
* Foreigners were allowed to set up business
* Export sales relief adopted

(ii) Existing industry was to be made more competitive
* by the application of grants for rationalisation
* by reductions in tariffs which would force firms to face competitive pressures

Once existing industry was more competitive, then it was expected that domestic firms would sell in export markets. It is this distinction between the promotion of new industry and improved competitiveness of existing industry that has been at the centre of the industrial policy debate over the past 20 years. It lay behind the concerns that resulted in the Telesis Report, and indeed many of the recommendations of that report, and it also informs much of the IPRG Report.

Section 2. THE SUCCESS OF OUTWARD LOOKING POLICIES

There can be little doubt that in the 15 years to 1973 outward policies were hugely successful. The "Survey of Grant Aided Industry" published in 1967 revealed that total employment in grant aided industry in 1966 was 17,000 (including 3,000 employed in Shannon), of whom it was later estimated 13,600 were in new overseas firms. There were also about 4,000 employed in non-grant aided overseas firms that had set up in the previous decade. These firms were mostly engaged in selling to the domestic market, in contrast with foreign grant aided firms whose focus was exports. Thus in 1966 there were 17,600 employed in overseas firms in industry in Ireland,
amounting to 9.5% of manufacturing employment. Irish industry employed 167,400.

It was in the period from 1966 to 1973 that the greatest expansion of overseas firms occurred. By 1973 there were 576 overseas firms, employing 68,500 in manufacturing. This compares with 3,994 Irish firms employing 150,200. **Employment in overseas firms had quadrupled since 1966 while employment in Irish firms fell by one tenth.** Overall employment in manufacturing increased by about one sixth, or 30,000. By 1973 the economy was effectively fully employed, and had experienced what is now seen as its fastest period of sustained growth.

<table>
<thead>
<tr>
<th>GNP % change 1960-1973</th>
<th>4.4</th>
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<tbody>
<tr>
<td>Industrial Production</td>
<td></td>
</tr>
<tr>
<td>% change 1960-1973</td>
<td>6.5</td>
</tr>
<tr>
<td>Industrial Exports £mn</td>
<td></td>
</tr>
<tr>
<td>1963</td>
<td>54.7</td>
</tr>
<tr>
<td>1973</td>
<td>512.7</td>
</tr>
<tr>
<td>Employment</td>
<td></td>
</tr>
<tr>
<td>Change 1958-1973 000's</td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>-174</td>
</tr>
<tr>
<td>Industry</td>
<td>+ 53</td>
</tr>
<tr>
<td>Services</td>
<td>+ 57</td>
</tr>
<tr>
<td>Total</td>
<td>- 84</td>
</tr>
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In the period from the late 1950's to the early 1970's the economy underwent a remarkable transformation. There was a major shakeout in agriculture, as low agricultural incomes forced people off the land, while industrial and service sector employment increased rapidly. By the end of the period net immigration was being experienced in contrast to average net migration of 42,000 per annum in the years 1956-1961. Participation rates in education had increased, real incomes had risen consistently and the state had set in place increased social expenditure in education and health, designed to improve entitlements. It is in this sense that the outward looking policy proved remarkably successful.
There was insufficient attention given to the nature of the success, however. With hindsight, it is possible to identify those factors that were important.

First, the industrial world was fully employed. There were shortages of labour and capacity in the OECD area. This had the effect of encouraging inward migration to the OECD area, and of encouraging industry to locate outside traditional areas. Ireland had the advantage of location within the European region of a plentiful supply of labour, and with the introduction of outward looking policies, a favourable climate for industry.

Second, there was ready access to the UK market, and the completion of the Anglo-Irish Agreement encouraged firms who were servicing the UK market to locate in Ireland.

Third, the grant system, and the existence of Export Sales Relief represented more favourable incentives than were available in other countries. The "Survey of Grant Aided Industry" concluded that the tax and grant incentives were more important than any inherent attractions offered by the country. This point is important when considering the subsequent period. It should also be noted that for most overseas firms the ESR was much more important than the grant system in influencing location. This can be seen by considering the present value to firms of ESR as opposed to the once-off payment of a grant.

Employment in domestic manufacturing declined over this period. The reality was that many firms proved uncompetitive in the face of the operation of the Anglo-Irish Free Trade Agreement. Even within a supply constrained industrial world these firms were marginal. The growth in the overseas sector, and the fact that the economy was fully employed, distracted attention from the problems of indigenous firms.
Section 3. THE OIL RECESSIONS

The oil price rise of 1973/74 and the further increase in 1979/80 marked the end of the fast growth era in the industrial world. That world was now characterised by lower growth in output, and high unemployment, particularly in Europe. Industrial investment weakened, and there was much less need for locations for residual production. There was much greater competition between industrial countries for investment by multinationals.

In spite of this unfavourable international climate there was continued growth in output and employment in overseas firms:

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of foreign firms</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>576</td>
<td>66,500</td>
</tr>
<tr>
<td>1978</td>
<td>775</td>
<td>82,500</td>
</tr>
<tr>
<td>1983</td>
<td>939</td>
<td>87,600</td>
</tr>
</tbody>
</table>

The employment figures understate the extent to which new firms were attracted to Ireland as overseas firms were also experiencing the effects of the two world recessions. This point can be better appreciated when the record for domestic firms is considered:

<table>
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<tr>
<th>Year</th>
<th>Number of Domestic Firms</th>
<th>Employment</th>
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<tbody>
<tr>
<td>1973</td>
<td>3994</td>
<td>150,200</td>
</tr>
<tr>
<td>1978</td>
<td>4691</td>
<td>150,900</td>
</tr>
<tr>
<td>1983</td>
<td>6336</td>
<td>135,700</td>
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There was a sharp contraction in employment in domestic industry, even though there was a dramatic increase in the number of firms. The reasons for this poor performance by indigenous companies are complex. They include the pure recession effect, but there was also the failure of industry to adapt to EEC entry and the set of fiscal and incomes policies pursued throughout the period had the effect of increasing costs.
Over the same period there was a very significant increase in the labour force. The principal reason for this was demographic i.e. the increase in the numbers in the relevant age groups. There were also major changes in participation in the labour force by married women following the removal on restrictions on their employment, but this was more than offset by reduced participation by males.

The combination of the weakness of domestic firms, and the growth in the labour force, led to a reconsideration of industrial policy, and there was a greater awareness of what could legitimately be expected from overseas firms.

Overseas firms generate employment initially in the construction phase. Thereafter, once they reached their target level of production, they rarely increased employment. Indeed, with process development, and as products matured, employment in each individual plant could be expected to decline. Furthermore, plants tended to be production units, not decision units, so that the location here of overseas firms was unlikely to provide the country with entrepreneurial skills - one of the original constraints identified in the Irish industrial sector. Foreign plants also tended to be very capital intensive, and as Ireland lacked a capital goods, machinery and equipment, sector, the induced effect from the initial investment were weak. There were also poor backward and forward linkages, as overseas firms did not find domestic raw materials sources - indeed, it was never expected that they would be competing for these materials with domestic firms; had low domestic expenditure once plants were in operation; exported output directly, rather than integrating with other overseas and domestic firms.

These characteristics were seen as a weakness in industrial policy and as industrial policy was identified with the first strand identified earlier viz. the promotion of industry, mainly foreign industry, overseas industry was "blamed" for the failure to reach full employment. In fact the real
The failure of industrial policy in Ireland was that of indigenous firms to develop, i.e. the failure was in the second of the strands. Even this must be qualified by the failure of general economic policy to provide a consistent framework for domestic firms to operate under. The failure of general economic policy, particularly in the 1970's, makes it difficult to see how industrial policy could have been successful. Industrial policy was only partly successful in counteracting the adverse effects of poor general economic policy. It is no accident that in these circumstances there was continued decline in employment in indigenous firms, in spite of the very significant level of support by way of grant. It remains surprising, however, that domestic firms did not perceive the opportunities created in the sub-supply sector to a much greater extent.

Section 4. THE TELESIS RECOMMENDATIONS

The Telesis report arose out of dissatisfaction with the industrial policy outcome, as indicated above. There was a curious apparent paradox in the Telesis analysis. On the one hand, Telesis claimed that industrial policy had been very successful, yet its recommendations represented a fundamental shift in policy. This paradox can be explained by reference to the dual approach outlined in the late 1950's. The promotion of overseas industry had indeed been very successful, but the second aim of policy, viz. to make indigenous firms competitive, had not. Telesis recommended a shift in policy towards indigenous firms.

There were many elements in the Telesis strategy. The most important was the recognition that the correct approach was to identify the constraints confronting indigenous firms, and applying resources to deal with these specific constraints. Capital grants are an inappropriate instrument where the
problem is management, or marketing, or lack of product development. In many respects the Telesis recommendation is that firms should be encouraged to adopt a strategic approach to their business. Once this is done realistically, rather than as a means of obtaining grants, firms are already on the way to developing successfully. Grants, if necessary at all, can then be applied to overcome constraints.

The Telesis Report also recommended that there should be a concentration on a small number of firms, in order to build strong indigenous companies that could compete internationally. These firms would become a focus for other local supply industry. The principal difficulty remains the concern that concentration, which almost certainly will produce strong firms, may inhibit the development of other potentially successful companies.

Perhaps the feature of the Telesis Report that overseas firms were most concerned with was the recommendation that grants for foreign firms be cut. The Telesis recommendation was based on a recognition that the tax incentive was the dominant element in the location decision of multinationals, but it was not sufficiently sensitive to the concerns of overseas firms about the commitment to overseas firms. Cutting grants could be seen in a negative light.

Section 5. THE POST-TELESIS ERA

During the 1980's there were significant changes in the operation of industrial policy. For domestic industry new programmes were instituted (Company Development Programme, National Linkage Programme, Management Development Programme, and the Business Partnership Programme). The objective was clearly to develop the capacity of indigenous industry to operate by encouraging firms to think strategically about their business as a whole, rather than seeking capital grants for new investment. Out of this analysis, appropriate assistance could be given to deal with identified constraints. The practice of industrial policy in the 1980's in relation to
indigenous firms is close to the type of measures that should have been taken three decades earlier. The most significant change in relation to foreign firms was the extension of the 10% tax on profits to the year 2010. This was introduced at a time when there has been some fall off in new foreign investment. Such investment is still taking place, however. By end 1991 it is estimated that some 94,000 were employed in overseas companies in the manufacturing sector, while indigenous sector employment has declined further to 120,000.

Section 6. THE INDUSTRIAL POLICY REVIEW GROUP

The Industrial Policy Review Group (IPRG) was set up in a period of crisis, when after a short period when unemployment had declined, the economy experienced a rapid increase in the level of unemployment. There was also some concern that associated with the growth in the economy in the late 1980s employment growth had been very slow. In particular employment growth in manufacturing lagged well behind previous experience as productivity growth remained very high. The underlying philosophy of the IPRG is as follows: growth in output is the key to growth in employment, output is determined by efficiency and competitiveness. As a consequence public policy must have the achievement of these as the prime aim of policy! The IPRG then proceeded to list policy changes designed to achieve these objectives. These recommendations cover Taxation, Infrastructure, Education and Training, Support for Industry, and Institutional change. The important point is that the recommendations cover all aspects of economic policy. There is a clear recognition that industrial policy cannot be undertaken independently of general economic policy. The IPRG recommendations are an attempt to set a framework for better general economic policy, within which industrial policy can operate more efficiently.
The recommendations are primarily designed to improve the environment for domestic firms. They represent the set of policies that three decades ago, if coupled with the most recent initiatives of the IDA referred to in Section 5, would have provided the correct policy mix for domestic firms, facing an open trading future. In this respect the IPRG report lies well within the tradition set by the Programme for Economic Expansion and the Telesis Report.

As a general comment it must be clear that the emphasis of the IPRG is to welcomed. The overhanging issue of Irish Industrial Policy for more than thirty years has been the second strand of outward looking policies viz. to make domestic Irish firms more outward looking. Policy has only very slowly been focused on this issue, in spite of the direction set out in the Programme for Economic Expansion, and later taken up in the Telesis Report. There may have been very good reasons for this, particularly the early success with overseas firms. The overseas sector should however have always been seen as supplementary. Hence, more and different resources, should have been devoted to the development of indigenous firms.

Second, the emphasis on good general economic policy is to be welcomed, and not just in relation to domestic firms. While it might appear that domestic costs are relatively small in relation to total revenue in the overseas sector, it cannot be assumed that firms are indifferent to costs in Ireland relative to costs in other locations, even where tax advantages outweigh adverse costs. Many plants in Ireland represent just one location for the parent company, and the parent company will be aware of relative costs. This will influence strategic decision making, both with regard to current production, but also with regard to the location of investment. A more competitive domestic environment will affect the domestic input costs of materials, and could influence purchasing decisions, as well as lowering the real cost of labour. The income increases of the early 1980’s did lead to the substitution of labour and while this will not be reversed, the maintenance of good economic policy will prevent
such substitution, driven by tax and excess wage inflation.

(For domestic companies competitiveness is a necessary, but not sufficient condition, for development. Companies need access to markets.) This is not simply a question of tariff reduction or removing non-tariff barriers to trade, or freeing up public procurement in other countries. The limiting factor in gaining access to markets is the cost. Policy to deal with this is not obvious, but links with firms located abroad, acquisition abroad, mergers or reverse takeovers, are potential strategies.

The IPRG addressed a series of micro issues – some of which are analysed in other papers at this conference. By training, and to a lesser extent by inclination, Irish economists have been diffident about their contribution to micro analysis – and as a result their recommendations seem to emerge on an ad hoc basis, rooted in the specifics of the case rather than derived from a clear theoretical framework. This applies in particular to the proposals on energy, waste disposal, education and training, and taxation. Rather than attempt to add to what others might say in these areas, I will address the single issue of the two agency structure proposed by the IPRG. While the issue might seem to have been resolved by Government the debate has been almost entirely political, and this has both obscured important issues and made it difficult to comment.

The issues raised by the two agency proposal are important for future industrial development and will be considered below.

The IPRG report argues that two agencies are needed on the basis of the need for the integration of the development functions of the IDA, ABT, and BOLAS, and as a result of the recognition that the promotion of overseas industry is different in a real sense from the promotion and development of indigenous industry. Clearly there are benefits from the integration of development functions, and, equally clearly, the promotional requirements of domestic and foreign companies are different. It does not follow that separate agencies are required as a consequence. The critical point is that the
need for integration of functions, and differences in approach be recognised. A single agency which considered the needs of both foreign and indigenous companies is likely to develop * coherent measures that do not conflict with other. In particular the recent emphasis on the promotion of overseas firms with marketing and science and technology aspects could be lost if EOLAS functions were subsumed within an agency geared towards the domestic sector.

The issue of integration is not as clearcut as the IPRG suggest. EOLAS has functions which are not obviously related to industrial policy except in the very long run. This applies in particular to its support for basic research. An industrial promotions agency is not the correct body for supporting basic research. It is unrealistic to think that only those elements which impact on industrial policy can be abstracted from EOLAS without losing an important dimension of interaction between all elements of science and technology.

The classification used by the IPRG in distinguishing between the promotion of overseas industry and the development of indigenous industry is too simple and is consequently misleading. There are in reality three groupings: indigenous Irish Companies, existing overseas companies, and overseas companies that might locate in Ireland. The two agency approach ignores existing overseas companies, although almost half of manufacturing employment is in these companies.

Furthermore

- (existing overseas are a major source of new investment. These firms are already familiar with Ireland, and the IDA has well established contacts with both the parent companies and local manufacturing plants. These contacts should be built upon, not downgraded.)

- (there is a need for interaction between indigenous and overseas firms by strengthening the National Linkage Programme.) This can best be done by an agency familiar with both domestic and overseas firms.

- (there is a need for positive action in relation to existing overseas firms to encourage an increase in the scale of their activities in Ireland.)
The attention given to institutional change has distracted attention from the more important policy recommendations made by the IPRG. It would be a grave disappointment if the other very positive measures were not put in place.

In spite of these reservations the overall thrust of the IPRG is correct, and one that should be run with. (The indigenous sector needs to develop and this can best be achieved by addressing the specific constraints that confront individual firms, and by ensuring that policy over all areas of the economy do not add further constraints.)