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The Irish Experience

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It is perhaps not too surprising, given the many historical affinities between the two countries, that the Irish experience is seen to be of particular interest when it comes to thinking about options for Scotland. Given Ireland’s current economic woes, drawing inferences for another country might be thought of as somewhat akin to George Bernard Shaw’s advice to parents: ‘If you must hold yourself up to your children as an object lesson (which is not at all necessary), hold yourself up as a warning and not as an example.’ So what follows is not intended either as a template or as a morality tale, but rather as a reflection on some issues that have loomed rather large in Irish public debate over time. Whether or not there are any inferences to be drawn for public debate in Scotland is an open question.

In the first half of 2013, Ireland holds the Presidency of the European Union, for the seventh time since joining the EEC (as it then was) in 1973. This rotating responsibility prompts reflection on various aspects of Ireland’s political independence, on how well we have managed our economic affairs and on the quality of our democracy. The global financial crisis that started in 2007 has highlighted in retrospect many things that were not well managed during the period of sustained growth from 1994 onward. It has become clearer that there were problems in the way the economy was managed, and that many of these problems owe their origins to defects in Irish political institutions themselves. Ireland’s current experience of deep recession, and the requirement to implement painful spending cuts and tax increases under the EU-IMF loan programme it was obliged to enter in November 2010, have to be understood in
the context of the wider European framework of policy-making, and specifically in the context of the rules governing the Eurozone. There is no serious political grouping expressing Eurosceptic views in Ireland, and the great majority of people continue to support Ireland’s membership of European Monetary Union and of the European Union itself. However, as the crisis drags on, we also see new tensions emerging between what people expect of their political representatives, and what those politicians are in fact able to do.

**Managing economic policy for good or ill**

Ireland’s experience illustrates both the advantages and the disadvantages of European economic interdependence in a particularly stark way. During the 1950s, and long before it joined the EU, Ireland had begun to develop and industrial development strategy based on promoting foreign direct investment, supported by preferential tax incentives and generous grant aid. Even though this policy orientation has been debated and challenged several times over the decades, and even though tax incentives had to be modified in the late 1980s to conform with European competition law, the basic policy mix remained largely unchanged. This made it possible for Ireland to build up an export capacity from a low base of domestic economic development, and in a context where there was a limited pool of indigenous entrepreneurs and not much native venture capital.

As soon as Ireland joined the EEC (as it was in 1973), it benefited from a surge of inward investment, mostly from the US and Japan, whose firms wanted a production base in a European country from which they could easily access the wider European market. Something similar happened again in the late 1980s and early 1990s, though now based on a rather higher combination of skills, especially in pharmaceuticals and information and computer technology. The completion of the Single European Market in 1992 opened new opportunities for foreign investors, and Ireland was able to draw in a disproportionate volume of the increased US capital then looking for profitable investment opportunities.

Ireland enjoyed a prolonged period of unusually rapid economic growth from 1994 until the crisis erupted fully in 2008 – the period of the ‘Celtic Tiger’. This brought about rapidly increasing rates of employment, as previously unemployed people were able to find jobs, more women entered the labour
market, and new generations of well-educated young people readily found work. Many Irish people who had previously emigrated, and who had acquired skills and experience abroad, took the opportunity to return home. Indeed, for the first time, Ireland became a magnet for people from other countries, a country to which people wanted to move instead of an emigrant nation forever sending its own people away to look for work. Ireland, along with Britain and Sweden, were the first to open their labour markets to people from the new EU member states of East-Central Europe. Quite suddenly, the arrival of new shops selling Polish and Latvian goods testified to the presence in our midst of whole new communities and cultures.

But the kind of development path that Ireland had chosen was not unproblematic. Irish industrial policy was heavily focused on attracting foreign direct investment, but it was difficult to see how indigenous productive activity could be fostered. Many of the Irish high-tech start-ups during the years of the economic boom owed their origins to people who had gained experience in multinationals, and an Irish software development industry with significant exporting capacity grew up rapidly. But the pattern of industrial development was quite lopsided. The high-tech sector was mostly foreign-owned, and although it employed relatively few people, it accounted for the great bulk of the value of exports. Meanwhile, the large number of Irish-owned firms tended to be much smaller in size, and to produce mostly for the domestic market. The old challenge of the late-comer to industrial development persisted: Irish firms saturate the domestic market quite quickly and must export if they are to grow further, but this is difficult to do from a small base. Irish-owned firms find it difficult to grow past a certain point in order to become large players. Many of the most promising and profitable firms tend to be bought out by multinationals. The challenge of finding a sustainable mix of economic activity, with a significant domestic growth capacity, is still not resolved.

Relying on multinationals as the engine of growth has worked well for Ireland, for as long as they are willing to invest. But it leaves the Irish economy vulnerable to swings in the international economy, and this helps explain why the Celtic Tiger period should really be understood as falling into two time-
periods. From 1994 until about 2000, investment by foreign firms generated a great deal of extra domestic economic activity. Large numbers of new jobs were also created in the domestic economy, very many of them in service-related activities, in high-value-added areas as well as in lower-skill personal service activities. But the collapse of the dot-com bubble in the US in the early 2000s had unfortunate consequences for Ireland, where information and communications technology firms were so important. From 2000 until 2007 or 2008, the emphasis switched away from export-oriented economic activity and toward construction as the main source of growth. The government recognized that a property price bubble was developing, but it was unwilling to intervene too actively. This provided a great many new jobs in construction, and new opportunities in property speculation that benefited developers, the banks that lent the ever-increasing sums of money, and the lawyers and accountants who supported the deals. Employment in construction came to account for some 15% of all jobs, twice what is generally regarded as common in a normal growth context, and the revenues generated by construction-related activities (sales transaction taxes, capital gains taxes and so on) provided a buoyant source of tax buoyancy to government. Once the crisis hit, therefore, Ireland was particularly vulnerable to the sharp collapse of house prices and the sudden cessation of activity in the construction industry. Large numbers of men, mostly with relatively low skills, were suddenly made redundant, and the job losses quickly extended to many areas of service activity such as retail and personal services, many of which were jobs filled by women; over time, ongoing recession destroyed jobs in many other sectors.

In an economic downturn, it might be thought that there may be scope for government to step in to stem the worst effects of the downturn with additional spending. Indeed, a number of other European governments undertook some stimulus measures in 2008 and 2009 to prevent the recession turning into a new Depression. However, the Irish government did not take part in this recovery effort, but turned fairly quickly toward prioritizing the need to stabilize the public deficit. The reasons for this are complex, and owe something to the lessons they believed needed to be learned from an earlier period of fiscal
consolidation in the late 1980s, when getting the public finances in order, it was argued, helped to create the conditions for making Ireland a credible destination for new investment.

Indeed, the Irish public finances, which had seemed quite stable and buoyant during the 2000s, concealed some problems that were only exposed by the onset of crisis. Tax had become dangerously reliant on revenues from construction, and other sources of revenue had been weakened. Personal income tax rates were cut, and up to 40% of low-income employees had been given complete exemption from income tax. This followed from the preferences of centre-right Fianna Fail-led governments, which were in power from 1997 until 2011, for a low-tax, low-welfare-services policy mix, which they believed was most conducive to job creation. Electorally, this proved popular. People welcomed the increases in disposable income that resulted, and lower taxes helped dampen demands for higher pay. The trade unions, although not very keen on this approach, went along with it, because as long as total tax revenues were buoyant, lower income taxes did not result in any worsening of public service provision. Indeed, total public spending was on an upward curve, as government committed extra funds to more jobs, higher pay, and higher rates of welfare payments and other transfer spending. For a time, it seemed as if Irish people could have it all: we could have both the penny and the bun. But the combination of a narrowing revenue base and increasing spending commitments proved to be a fragile and contingent combination. This is why the deficit gap widened so sharply during 2008 and 2009.

In hindsight, it is easier than it was at the time to recognize the dangers of having a budget mix that was so susceptible to crisis, particularly because Ireland had, since the turn of the millennium, been part of the Eurozone, which greatly altered the scope of domestic policy choice. The logic of European Monetary Union (EMU) meant that no member state could alter interest rates to help its own economy, nor could they devalue or otherwise change their exchange rate to gain competitiveness or boost jobs and exports. This placed all the pressure of managing the domestic economy in a stable manner onto the control of relative costs within each country. If a country let its cost base worsen relative to other
Eurozone members, it would pay a price, mostly in the form of higher unemployment. In order to keep governments from spending their way out of trouble, and thereby undercutting the cost-containing efforts made by other countries, the Stability and Growth Pact (SGP) put strict limits on the size of the deficit governments could run (3% of GDP), and the scale of debt they could incur (60% of GDP). Because so much decision-making was now run centrally, market lending to Eurozone member states came to be seen as more or less risk-free, and countries like Ireland, Spain, and Greece were able to borrow on international markets at rates that were very close to those of the largest and strongest economy, that of Germany. There was a strong expectation that even though member states of the Eurozone had very different sorts of economy, they would converge in the way these functioned under the rules of EMU.

However, it became clear quite quickly that the Eurozone had a number of unanticipated consequences. Not only were the SGP rules too weak to enforce, but the low cost of borrowing had the paradoxical effect of creating a surge of capital inflows into Ireland and other peripheral countries, where growth potential seemed strong. But the most common outlet for all this lending was in property. This was the source of the uncontrolled property boom, which peaked between 2005 and 2008. Inflationary pressures mounted in the Irish economy, as employees pushed for higher pay to enable them to meet rapidly rising house prices. It was not possible for government to raise interest rates to dampen the rate of borrowing, because interest rates were set centrally, by the European Central Bank, and were most responsive to the needs of the strongest core countries; and as German growth was sluggish, interest rates were kept low to help prevent job losses there.

Ireland was accumulating many problems of sustainable growth by the time the crisis broke. But what proved to be the biggest catastrophe of all centred on the financial sector. Irish governments had followed the British lead in adopting a light-touch regulatory stance toward the banking sector. This followed from its efforts to build up a tax-incentivized centre for internationally traded financial services in Dublin from the late 1980s on. It was also consistent with a more general view, widely held in Irish political circles, that the main banks lending
into the Irish economy could be trusted to regulate themselves such that their own profitability would not come at the expense of excessive risk or of damaging their own shareholders’ interests. Unfortunately, intensifying competition for business in a runaway property boom meant that the main banks made ever larger and risker loans, and the structure of incentives for the top managers, similar to the experience of the large British banks, placed few restraints on their willingness to gamble recklessly with their own institutions’ viability. Adverse market assessment of the performance of the main Irish banks had already caused their share prices to slide by the time Northern Bank collapsed in Britain. By the end of September 2008, they faced imminent collapse. In an event that is still not fully understood or explained, an emergency all-night meeting between senior bank officials and government ministers resulted in the Irish government providing guarantees to the main Irish banks, without any full assessment of the scale of the liability they were undertaking.

The total cost to the public purse of bailing out the banks is estimated at almost €63bn. To put this in context, total GDP in 2011 was €159bn. The scale of this public responsibility for private sector bail-out is considerably larger in any other OECD country. The politics of how this is to be managed is the subject of ongoing contention between the Irish government and the European authorities.

The scale of the banking crisis in Ireland compounds the crisis in the public finances. It is now all too clear that under-regulation of the financial sector has had devastating consequences. Not unlike the Icelandic case, the Irish banks competitively goaded one another into ever-risker lending practices. In the absence of strong domestic oversight, and with no controls on European lending practices, they exposed their businesses, their shareholders, and ultimately the whole Irish economy and Irish society to devastating losses, and to crushing recovery efforts into the foreseeable future.

Large countries that control their own currencies, or large countries with large internal markets for their goods and services, need not worry so much about vulnerability to international fluctuations: they have a wider range of policy options they can deploy in the bad times. Small countries are much more
vulnerable in the international economy. The implications for a small country such as Ireland are much the same as those learned over time by the small Scandinavian countries. Public spending must be solidly underpinned by a solid tax base, and public deficits in small economies are judged harshly by the international markets. Furthermore, regulations of banks must be taken a great deal more seriously than Irish governments believed was necessary. The belated lesson for Ireland is, as US political scientist Herman Schwartz has noted, that ‘small states must behave more prudently than large ones, not because it is the right thing to do, but because it is the only thing they can do’ (Schwartz 2011).

Institutional design and political accountability

Economic policy decisions are made by a whole range of policy actors, so it is appropriate to reflect on the features of institutional design and political practice that may have generated some of propensity to make the kind of decisions that, as we have seen, have contributed to the origins and management of the crisis.

We might think of this as a problem of how to generate good policy decisions to try to avoid things going wrong; and if things do go wrong, how to find out what happened to the right people can be held to account, with a view to ensuring that similar problems to not arise again. In other words, these are issues to do with the quality of policy formation on the one hand, and ensuring appropriate political accountability on the other.

As in other democratic societies, elected governments set the policy agenda, and the programme for government constitutes much of the work of the public service for the following four or five years. A recurring issue in discussion about Irish politics concerns the quality of debate informing the way government goes about implementing its declared policy priorities.

One such issue has to do with a persistent tendency of economic policy to be procyclical in character. Governments tend to spend heavily during the good times, then when a downturn comes, they have little choice but to engage in harsh retrenchment – the opposite of what prudent fiscal management might suggest. It is perhaps all too easy to blame the voters for letting politicians play too personalized a role in Irish public life, such that they put the need to attend to
constituents’ requests over the need to be responsible for making sure public policy is coherent and consistent. But it is also true that the incentives in the political system as it is currently constituted have encouraged these tendencies. There is little scope for serious policy debate in parliament, and most politicians therefore see little need to become more expert on policy issues.

The civil service, run on generalist principles, often lacks specialist skills, especially in economic policy analysis. These deficiencies have started to be addressed under the watchful eye of the ‘Troika’ of lenders (the European Commission, the European Central Bank, and the International Monetary Fund). A new specialist Department of Public Expenditure and Reform has been created, closely linked to the Department of Finance. In line with new Eurozone rules, Ireland has created a Fiscal Council to provide expert commentary on policy. Irish voters endorsed a referendum to give effect to the European Fiscal Pact, constraining the scope of discretionary domestic choice in future. Domestic policy expertise has been strengthened. But this has come about as a result of the extension of the scope of EU oversight, and a consequent narrowing of the scope of domestic policy discretion.

The Irish parliamentary system has provided relatively little effective legislative counter-weight to executive preferences. The Irish system, designed on the Westminster model, affords a relatively weak role to the political opposition and indeed to government party backbenchers. In Britain, many reforms have been undertaken to permit parliament not only to scrutinize and amend new legislative proposals, but also to conduct specialized inquiries. But in Ireland, a constitutional case in 2002 made it impossible for parliamentary committees to undertake many kinds of inquiry. Compared with the British government in Westminster, Irish governments face much weaker institutional constraints that would expose their policy priorities to scrutiny and debate. Indeed, corruption scandals in the 1980s, 1990s and 2000s often centred on cases in which domestic business interests gained preferential treatment or favourable government decisions in exchange for financial support, paid either to the party or in some cases to individual politicians themselves. Yet it proved extremely difficult to hold politicians to account. Similarly, some high-profile cases in which
politicians have overseen policy mistakes, or where poor administrative oversight has resulted in damaging outcomes (in managing the costs of care in nursing homes, for example, or in blood contamination scandals), it proved very difficult to establish responsibility or accountability. For a time, Ireland resorted to public Tribunals of Inquiry to investigate such problems. But their extraordinarily high cost and the indeterminate findings they produced led to their falling out of favour, without any clear alternative in sight.

Compared with other European countries, the spectrum of political debate in Irish public life is quite narrow. The main political parties have not been very clearly differentiated in their presentation of the policy choices facing Irish voters. The two historically largest political parties, Fianna Fail and Fine Gael, have been the principal rival contenders to lead government formation, but they have clustered close to each other on the centre-right of the political spectrum. The left or centre-left attracts much weaker support. The Labour Party has found it necessary to compete on policy platforms that would make it possible to form a coalition with one or other of the major parties.

The aftermath of the crisis has challenged much of this, with consequences that are as yet unclear. Fianna Fail bore the brunt of voter anger over the scale of the crisis and the mismanagement that had preceded it: this historically dominant party was reduced to a rump in the 2011 elections. The governing coalition of Fine Gael and Labour has a commanding majority, but has little discretion in policy choice under the terms of the loan agreement. Political opinion is still in flux. It will be some time before it becomes clear whether the lines of political competition re-form on familiar tracks, or whether some more far-reaching realignment may yet be in store.

Economic government and democratic debate in an interdependent Europe

Among the issues that will decide the future direction of Irish political life is the prospect of economic recovery, not just the resumption of employment opportunities, especially for younger people, but also relief for the many households experiencing severe mortgage pressure in the aftermath of the property crash.
One interpretation of Ireland’s current situation is that although it has experienced an economic disaster, it is better placed to deal with this inside the EU, and specifically inside the Eurozone, than if it were obliged to go it alone. After all, the yawning gap between expenditure commitment and revenue flow has to be met somehow: better therefore to manage this through a structured loan agreement. Some economic commentators have pointed to alternative options, for example to the benefits Iceland has gained through bank debt repudiation and a sharp currency devaluation, even if at the expense of the collapse of national living standards. There is virtually no constituency of support in Ireland for either default or devaluation though. Harsh and unpleasant as it is to engage in ‘internal devaluation’, a departure from the existing policy framework is generally seen as incurring the risk of immense economic dislocation and the probable destruction of recovery prospects.

This is not to say that there is uncritical acceptance of the view that ‘there is no alternative’, for there is considerable disagreement about the terms of the EU-ECB-IMF loan, about the funding of bank recapitalization, and indeed about Irish government priorities in implementing the fiscal retrenchment programme. There is therefore widespread support for the view that Ireland should not depart from the European policy framework, but should engage even more actively with it. Irish economic prospects are often seen as primarily dependent on the fortunes of the British and US economies, with a sidelong look at the European economy. But Ireland’s economic and political fortunes are now also intimately linked with those of the other countries of the European periphery, and these will be strongly shaped by the terms of debate that hold in the strongest European economies, especially Germany, and in the heart of the European institutions themselves.

And yet this poses one of the most intractable issues not only for Ireland but for the evolving European political system itself. As the late Irish political scientist Peter Mair has noted, there is a growing gap between what he calls the politics of responsiveness on the one hand, and the politics of responsibility on the other (Mair 2009). Politicians are elected at national level to respond to the interests and concerns of the people who vote for them: this is an integral part of what we
value in the democratic process. There is little appetite for transferring more political power to European institutions, even if this is said to be a necessary part of crisis management. But increasingly, voters find that they can change their politicians but not the policies at national level, because governments are responsible to actors that are beyond national borders but over whose decisions they have relatively little formative influence. This point holds even for countries that are not part of European Monetary Union, for many new measures to strengthen economic coordination apply to all EU member states, and indeed, Iceland has though it preferable to look for economic security inside the shelter of the EU. Whether or to what degree the emergent system of economic coordination is amenable to real practices of democratic participation and accountability remains to be seen.

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