The Irish Economy: The Recent Experience and Prospective Future Performance

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INTRODUCTION

IN the previous article the experience of the major OECD economies over the recent past has been examined under the headings of growth, unemployment, inflation and external balance. This provides an essential background against which to consider the performance of the Irish economy given both the importance of these economies for world GNP and trade and the importance of trade for the Irish economy. In this article we shall be concerned with the effects of the recession on Ireland, the immediate aftermath of the recession, the problems facing the economy in the medium term and the prospects for growth over the medium term.

THE PRE-RECESSION AND RECESSION PERIOD

In many respects the experience of Ireland prior to 1974 was similar to that of other OECD countries. In common with these the Irish economy in the period mid-1972/mid-1973 exhibited rapid growth of GNP and industrial production, reduced unemployment, an increasing rate of increase both of product and factor prices, and a widening of the current deficit in the balance of payments. Table 1 below summarises the principal aggregates.

By mid-1973 output in manufacturing industry had levelled off. There is some evidence from the Quarterly Industrial Survey

Table 1: *Main economic aggregates* 1970–1973. *Annual rates.*

					1970		1971		1972		1973	
	1970	1971	1972	1973	I	II	I	II	I	II	I	II
Manufacturing Prod. % change	3·1	4·1	4·7	12·0	−0·7	11·4	0	3.1	2·5	10·5	18·1	2·2
Live Register 000's	65·3	62·4	72·0	66·6	65·6	64·9	60·3	64·5	71·9	72·0	67·1	66·1
Unemployment % insured	7·2	7·2	8·0	7·2	7·2	7·2	6·8	7·6	8·0	8·0	7·3	7·0
Average Earnings Manufacturing % change	13·8	14·9	15·5	19·0	13·0	21·8	12·0	14·3	18·1	12·0	23·0	18·1
Consumer Prices % change	8·2	9·0	8·6	11·4	8·5	10·0	8·5	9·0	8·4	8·8	13·0	10·9
Import Prices % change	6·8	6·0	4·6	12·9	8·1	3·6	9·6	2·7	−0·2	11·0	20·7	23·2
Balance trade £m	−210·0	−216·2	−190·6	−268·0	−185	−237	−236	−197	−181	−216	−254	−293
Balance of Payments Current deficit £m	65·3	−71·0	−48·4	−82·3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Balance of Payments Current % GNP	3·90	3·72	2·12	3·00	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Retail Sales Volume % change	n.a.	2	4	5	n.a.	2¼	1·7	1·7	4·3	7·2	8·5	−5·0

N. A. = not available

conducted jointly by CII/ESRI that supply constraints represented the principal factors responsible for the slowdown in production. Table 2 below gives the relevant survey responses.

The figures, as with all such survey responses, must be treated with a certain degree of caution. They do, however, indicate a progressive tendency towards a supply constrained manufacturing sector (on some notion of full capacity utilisation) in mid-1973 with firms experiencing insufficient capacity, shortages of labour and shortages of materials. Shortages of skilled labour, particularly skilled female labour had been a constant feature of the late 1960s and early 1970s. The shortage of skilled female labour was at its most severe in the third quarter of 1973. Compounding these supply difficulties the oil embargo and ESB dispute of late 1973 further weakened output on the supply side. The normal response to supply constraints is of course increased investment and commodity and factor price adjustment. It might have been expected that investment in 1973 would rise. However, the indicators of investment weakened considerably in the second half of that year. Cement sales, seasonally corrected, fell in the third and again in the fourth quarter of the year. Imports of producers capital goods, seasonally corrected, rose by less than one per cent in the third quarter and fell marginally in the fourth quarter in value terms whilst import prices rose by $5\frac{1}{2}$ per cent and 6 per cent respectively. Of course the fall in the level of investment tells us very little about investment intentions and may be merely a further reflection of the domestic and international supply constraint. This view is strengthened when allowance is made for the impact of new firms on investment — particularly in 1972–73 with the impact of entry to the EEC and the increase in the level of job approvals occurring then. Price adjustments did of course take place as indicated by the price indices included in Table 1.

A further point worth noting is that firms felt that stocks of finished products were inadequate. The greatest shortage appears to have been at the end of the third quarter of 1973, by which time the volume of retail sales was declining. The situation in mid-1973 in Ireland was thus potentially unstable. The shortages then prevalent were reflected in reduced stock levels of materials and finished products. Inevitably firms would wish to increase output and stocks. So long as the declines in private consumption and investment were themselves temporary and a reflection of actual shortages rather than a weakening in these final demand categories, then increasing output and stocks was appropriate. However, at end 1973 two major external shocks were

Table 2: *Survey responses. Trend of replies*

Quarter	1971	1972				1973				1974
Question	IV	I	II	III	IV	I	II	III	IV	I
1. Could more be produced with present resources (yes/no)	80/20	76/24	69/31	62/38	61/39	65/35	57/43	47/53	42/58	38/62
Balance	60	52	38	24	22	30	14	−6	−16	−24
2. Proportion of firms experiencing										
(i) Insufficient capacity	14	8	16	20	21	17	24	24	24	20
(ii) Shortage of labour	2	6	7	5	8	8	8	15	10	14
(iii) Shortage of materials	3	5	5	5	4	9	9	7	20	20
3. Stocks of finished products										
Excessive	17	8	5	5	4	6	3	5	7	9
Adequate	74	79	81	73	82	77	76	65	73	65
Insufficient	9	13	14	22	14	17	21	30	20	26
Balance	8	−5	−9	−17	−10	−11	−18	−25	−13	−17
4. Stocks of Materials										
Excessive	8	6	6	6	4	3	5	5	9	8
Adequate	87	89	87	87	87	83	83	83	59	63
Insufficient	5	5	7	7	9	14	12	12	32	29
Balance	3	1	−1	−1	−5	−11	−7	−7	−23	−21

Note: The figures given in Question 2 are derived from a consideration of those firms who replied "No" to Question 1, expressed as a proportion of all firms.

administered to the Irish economy, viz., the oil price rise and the cattle price fall. Both of these exerted deflationary effects on the economy.

The effect of the oil price rise on the economy has been documented reasonably well, it is not proposed to cover this ground again in an exhaustive manner. The effect of the oil price rise derived from the nature of the demand for oil and oil-based products. In the short run demand for motor spirit, gas oil, electricity etc. tends to be relatively price inelastic. A consequence of the price rise was thus a moderate decline in the demand for oil and oil-based products, an increase in total expenditure on oil and oil-based products and a decline in expenditure on other goods and services by consumers faced with a budget constraint. Of course, if demand had been elastic, or if oil or substitutes were produced domestically the situation would have been very much different.

The effect of the oil price rise was accentuated by the fall in cattle prices, seasonally corrected, from late 1973. The fall in cattle prices had two dimensions — international and domestic. Cattle prices internationally fell in 1974 compared with 1973 as sales of cattle off farms worldwide increased, because of the phase of the cattle cycle the world was in. In a situation of buoyant demand prices might have fallen in any case, but with the effect of oil prices on real incomes, demand levels at 1973 prices fell very markedly. Internally price levels were further affected by the shortage of capacity at meat exporting factories, though the possibilities for export of live cattle did place a floor under cattle prices. The fall in prices domestically for 9–10 cwt bullocks was similar to that experienced for similar bullocks exported. For lighter animals the fall domestically was somewhat greater than that experienced on exports. There are, of course, important subsidiary markets in cattle e.g., calves, and the price falls in these markets appear to have been very large. The overall effect of the cattle price fall was deflationary since the country is a net exporter of cattle and beef. Internally there were important redistributive consequences of the cattle price fall. On the one hand, there was a transfer to meat factory profits as intervention purchases at intervention prices continued as realised cattle prices fell. This provided both the incentive and the funds for further investment, among other things. There was also a transfer to domestic consumers through lower prices and this helped to cushion somewhat the effect of the oil price rise. However, for farmers as income earners there was a fall of 12 per cent in their incomes.

As a consequence of these external influences private consumption continued to fall in volume terms from the already depressed levels of the second half of 1973. The decline in private consumption might, in more normal circumstances, have led immediately to a decline in output in industry. However, as noted earlier, stock levels in industry were considered inadequate by mid-1973, so that by early 1974 industry wanted to increase stock levels. Output in manufacturing in the first quarter of 1974 increased by 4·8 per cent on the final quarter of 1973, and employment rose by 0·5 per cent. While admittedly the final quarter of 1973 had been affected by shortages, the rise in both output and employment and the previous levels of stock suggests that industry was concerned with increasing stock levels and bringing them to some desired level. The Quarterly Industrial Survey also indicates that firms expected an increase in home sales in the second quarter of 1974, so that increased output was consistent with the view that was being taken of the likely course of events. It was this view that represented the major miscalculation. Stock levels of all sorts more or less simultaneously became excessive. The consequence of excessive stock levels, reduced demand, and increased raw material prices disturbed the financial balance of firms. Output in manufacturing declined continuously from the first quarter of 1974 to mid-1975 and employment declined for rather longer — until end 1975.

Table 3: *Manufactured exports volume, OECD trade volume, % changes at annual rates*

	1974	1975	1974	1975	
			II	I	II
Irish Manufactured Exports	8½	−4½	−2	−9½	3
OECD exports	7	−4	0	−10½	6½
Imports	1	−7½	−2	−17	11
Intra-OECD trade	0	−9½	−5½	−15	7

Between the second half of 1974 and the first half of 1975 the volume of manufactured exports declined at an annual rate of 9½ per cent — a significant negative influence against average increases of just under 20 per cent per annum 1965–73. Thus external demand factors, occurring slightly later, reinforced the declines in domestic demand already underway. Manufactured exports, as defined in trade statistics, accounted in 1973–74 for approximately one-third of gross output in comparable output groupings so that the fall in exports was a major contributor to the fall in output.

From Table 3 it is apparent that the decline in manufactured exports in the first half of 1975 was not unique to Ireland. The extent of the decline does not seem to have been extraordinary given the movements in OECD trade. By mid-1975 World trade began to recover and this was reflected in increasing manufactured exports from Ireland, though in the second half of 1975 the increase was small, running at an annual level of 3 per cent. The rather slower recovery in Ireland's manufactured exports may have been due to the effect on profitability of the deterioration in early 1975 in the domestic cost position of individual companies relative to competitors abroad.

In early 1975 basic rates of pay increased by 10 per cent on foot of an escalator clause in the 1974 National Pay Agreement. This was followed by two consecutive quarterly movements in basic rates of pay of 8 per cent and 5 per cent as a result of the indexation clauses of the 1975 Agreement. The order of magnitude was roughly similar to that experienced in the UK. In the absence of a countervailing movement in exchange rates in 1975 (a movement that came very much later, in 1976) there was a significant worsening of the domestic cost situation of firms *vis-à-vis* competitors outside the sterling area, and this undoubtedly affected the initial pace of the recovery in exports.

From the first quarter level of 1974 through to mid-1975 output in manufacturing declined in response to the decline in external and internal demand, and the need to reconstitute firms' cash position through destocking. The decline in output between the peak in early 1974 and the trough in mid-1975 was 10 per cent, whereas the decline in consumer demand was 7½ per cent and in manufactured exports was 8½ per cent. Destocking was thus as important a feature of the downturn in Ireland as internationally, in accentuating the effects of movements in other components of final demand. Once stock levels reached desired levels output could be expected to increase. By the second half of 1975 there was a reduction in firms' excess levels of stocks of materials and finished products, though on balance, stock levels still seemed somewhat excessive. External demand, as mentioned earlier, began to increase in the second half of 1975. The June 1975 budget affected a reduction in consumer prices in the third quarter of that year. Private consumption in real terms increased in that quarter.

Thus in the third quarter of 1975 there was a confluence of factors favourable to output increases, viz., the easing of the excess stock position, the increase in exports, and the increase in real consumer demand. Of course the interpretation of the changes in real consumer demand is difficult as we cannot isolate out the autonomous from the induced. Two factors would seem to be relevant here. First, the movement in agricultural incomes and, secondly, the movement in non-agricultural employment and incomes.

Cattle prices began to recover in the final two months of 1974 and by the second quarter of 1975 had reached their previous peak. Table 4 below illustrates the movement in agricultural prices, a better indicator of movements in agricultural incomes, over the relevant period.

Table 4: *Agricultural prices per cent change quarter-to-quarter seasonally corrected*

	I	II	III	IV	Year
1974	−9·0	4·8	0·2	5·5	1·4
1975	11·2	5·4	5·9	8·1	28·1

In 1975 as a whole, farmers' incomes increased by 47 per cent so that the change in farmers' incomes represented a positive, largely exogeneously determined, boost to consumption in the first half of 1975. (The size of the increase in 1975 following a fall of 11·6 per cent in 1974 is relevant for our purposes only in so far as in 1974 the fall in incomes represented a downward influence and in 1975 the rise represented an upward influence on private consumption through the effects on disposable income.)

For non-agricultural incomes the timing of pay increases under the 1975 Agreement where allowance is made for employment changes, suggests that non-agricultural disposable income in money terms increased in the third quarter and this coupled with the reduction in consumer prices as a result of measures introduced in the June budget made possible increases in real consumption. Output, in response to the demand pressures, rose in the third quarter of 1975 and continued to increase up to the third quarter of 1977.

THE AFTERMATH OF THE RECESSION

Mid-1975 clearly marks the turning point, when output began to rise after five successive quarterly falls. Over the subsequent period increased exports provided the continuing stimulus as fiscal policy adversely affected domestic demand in 1976 compared with 1975 and in 1977 compared with 1976 (Dowling, this volume) though in the latter period the effect was marginal. Manufactured exports in volume terms rose by 20 per cent in 1976 and by 21 per cent in 1977. By end 1976 the deflationary effect of fiscal policy on consumer demand was outweighed by the income and employment effect of increased exports. Since then private consumption has continued to increase, when due allowance is made for the effect of the timing of payments under the National Pay Agreements.

Turning back to the actual rise in manufactured exports in 1976 and 1977 the increases were somewhat greater than might have been expected on the basis of world trade volumes. Current forecasts suggest that there could be a further increase of 12½–15 per cent in 1978 — again somewhat higher than changes in world trade would imply. Several factors would seem to be relevant. On the cost side, the modification to the 1975 National Pay Agreement led to a reduction in the rate of increase in domestic costs *vis-à-vis* UK firms in the second half of 1975, and the depreciation of sterling in 1976 provided further cost advantages given the basic terms of the National Pay Agreements. On the supply side, it seems likely that we are witnessing the output effect of new foreign investment that had taken place in the early 1970s. Unfortunately, on published data it is not possible to disentangle the effect on exports and output of new firms and the restructuring of existing firms. If there has been a major structural shift within manufacturing towards newer firms whose orientation is more towards exports then increased supply would possibly be the major influence on increased exports. Table 5 below provides data on job losses and job creation in manufacturing over recent years.

It is apparent that manufacturing industry has undergone a major structural shift over the years 1973–76. Job losses encompass losses due

Table 5: *Job creation and job losses in manufacturing industry 000's*

	1973	1974	1975	1976
Gross Jobs Created	17·8	16·2	14·5	20·4
Gross Jobs Lost	−10·0	−20·2	−28·7	−15·8
Net Gains	+7·8	−4·0	−14·2	+4·6
Employment at end year	207·5	203·5	189·3	193·9

Source: IDA Annual Report 1976. The 1976 figures will require modification in the light of revisions to the end 1976 total now 194·7, implying net job gains of 5·4 thousand.

to the recession, losses arising from EEC entry and other structural shifts. If the picture is correct then it would not be surprising if a considerable proportion of the increase in manufactured exports came from new firms.

GNP, EMPLOYMENT, INFLATION AND EXTERNAL BALANCE 1970–78

The previous sections have provided an analysis of the causal factors affecting the economy in the immediate pre-recession period, the recession itself and the immediate post-recession period. In this section it is proposed to look at the performance of major traditional target variables — GNP growth, employment and unemployment, inflation and domestic costs, and the balance of payments.

GNP Growth

Unfortunately, GNP data for Ireland are on an annual basis only. It is thus not possible to pick up important turning points for GNP or its components. Table 6 below summarises changes, on an annual basis, in real GNP and its components from an expenditure side, whilst Table 7 considers GNP from an output stance.

It must be noted that the tables are arithmetic rather than causal in nature. For instance in considering Tables 7 (a) and 7 (b) it would be incorrect to deduce that the fall of 6·2 per cent in output in industry led to a fall of 2·26 per cent in GNP in 1975. The sectors are not independent and any initiating cause would tend to be magnified not only in the sector directly affected but also in other sectors. Bearing this very large proviso in mind the tables give some indication of the net effect on the expenditure components of GNP and on sectoral output of the factors referred to in the earlier sections of the paper. In Table 8 below the growth rates of GNP from Ireland are compared with OECD figures over an extended period and over the recent past.

It is apparent from the table that over an extended period pre-recession GNP growth was considerably less in Ireland than in the OECD area. In 1974 and 1975, the recession years, the deviation from previous growth rates was less for Ireland but the recovery phase in 1976 was considerably weaker. In contrast with the earlier period GNP growth in Ireland in 1977 was significantly above OECD growth and current forecasts are that the gap will be maintained in 1978.

Table 6: *Expenditures on gross national product* 1970–1978

(*a*) % *Changes*

	1970	1971	1972	1973	1974	1975	1976	1977*	1978**
Private Consumption	2·7	2·9	5·5	5·2	−0·2	−3·2	2·8	5	6
Public Consumption	7·4	9·0	7·5	5·9	7·9	5·6	2·0	3	5
Gross Investment (inc. Stocks)	−0·8	3·3	8·2	18·6	−3·0	−24·9	21·5	11	8
Exports of Goods & Services[1]	3·9	3·5	4·0	9·8	1·6	5·0	8·0	12½	10
Imports of Goods & Services	2·3	4·0	6·2	19·8	−1·0	−11·6	15·3	12½	11
GNP at market price	3·0	3·6	5·6	3·8	1·5	−0·2	3·0	5½	5

(*b*) *Contribution to GNP growth*

	1970	1971	1972	1973	1974	1975	1976	1977*	1978**
Private Consumption	1·82	2·00	3·74	3·50	−0·16	−2·17	1·82	3¼	3¾
Public Consumption	1·02	1·30	1·12	0·91	1·22	0·93	0·36	½	1
Gross Investment	0·04	2·00	0·58	4·44	−1·35	−1·57	0·99	2½	1¾
Stocks	−0·24	−1·22	1·36	0·05	0·50	−5·00	3·27	¼	¼
External Sector[1]	0·42	−0·44	−1·21	−5·08	1·27	7·64	−3·42	−1	−1¾
GNP at market prices	3·00	3·6	5·6	3·8	1·5	−0·2	3·0	5½	5

[1]Including net factor income. *Estimate **Forecast

Sources: 1970–1975 NIE 1975 (Prl 6248)
1976 Economic Review and Outlook
1977–1978 Quarterly Economic Commentary ESRI June 1978 (forthcoming)

Table 7: *Gross domestic and national product 1970–1978*

(a) % change

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Agriculture, forestry, fishing	2·7	6·4	5·1	0·2	4·8	11·8	−8½	7	4
Industry	3·0	6·2	4·1	10·5	1·1	−6·2	9	8	7½
Services	1·9	5·4	4·3	6·0	2·0	1·8	2½	3½	3¾
Gross Domestic Product (factor cost)	2·4	5·8	4·4	6·6	2·1	0·5	2½	5½	5
GNP (market prices) Output data	2·3	5·4	4·9	6·3	1·8	−1·3	—	—	—
GNP (market prices) Expenditure data	3·0	3·6	5·6	3·8	1·5	−0·2	3·0	5½	5
(b) % contribution to GDP at factor cost growth									
Agriculture, forestry, fishing	·49	1·07	·86	0·03	·76	1·92	−1½	1¼	¾
Industry	1·05	2·19	1·44	3·71	·42	−2·26	2¾	2½	2¼
Services	·90	2·58	2·06	2·87	·96	·85	1¼	1¾	2
Gross Domestic Product (factor cost)	2·4	5·8	4·4	6·6	2·1	0·5	2½	5½	5

Sources: 1970–1975 NIE 1975 (Prl 6248)
1976–1977 Estimated
1978 Forecast

Table 8: *Growth of real GNP*

	Average 1959–60—1972–73	1972	1973	1974	1975	1976	1977*	1978**
Ireland	4·3	5·6	3·8	1·5	−0·2	3	5½	5
OECD	5·5	5·7	6·3	0·3	−1·0	5·2	3½	3½

*Estimate
**Forecast

For Ireland the figures for 1977/78 are taken from the June *Quarterly Economic Commentary,* for OECD the figures for 1977/78 are taken from *Economic Outlook* December 1977. For Ireland the figures are based on GNP at market prices while for the OECD they are based on a mixture of GNP and GDP from the expenditure side. This makes only a minor difference.

Employment and unemployment

The movement in GNP had its counterpart in changes in employment, unemployment and participation rates. Table 9 below illustrates the trend over the recent period.

With the exception of the emigration series the remainder refer to a stock or a rate at a point in time. The dating of figures is thus somewhat misleading in that the figure, for say, April 1974 is more relevant to 1973 than to 1974. With this in mind the figures are instructive, mirroring the movement in output described in the previous section.

The position of the labour market is summarised in the series for total employment, measured unemployment, participation rates and net migration considered as an interacting set. Total employment fell by 31 thousand between April 1974 and April 1976. Measured unemployment increased by 44 thousand in the same period and the participation rate fell by more than might have been expected given the secular decline in this rate over the long term. The fall in employment and the lack of job opportunities when the potential labour force was rising. This explains the relative deterioration in both the unemployment and participation rate series, and at a later date the emigration in 1976 and 1977.

Ideally, we would like to discuss the time pattern of movements in employment in different sectors. Unfortunately, employment data are very weak outside manufacturing. In manufacturing industry employment fell from a peak of 206·9 thousand in the first quarter of

1974 to a trough of 187·8 in the first quarter of 1976. In building and construction employment appears to have peaked in the second quarter of 1974 but employment increases do not appear to have occurred until 1977.

Live Register statistics show a more or less continuous rise in those registered from January 1974 at 64·8 thousand to 115·6 thousand seasonally corrected at July 1976. Thereafter the Live Register fell and stabilised in the range 111–113 thousand for most of 1977 before declining rapidly to 106·7 thousand by end April 1978. Movements in the Live Register relate of course not merely to changes in employment, as undoubtedly migration flows, among other factors, affect the data.

The reduction in employment that has taken place over the recent past has been due to a combination of causes — the recession itself, the effect of tariff reduction and other structural factors within the EEC, and the imbalance in the financial structure of firms through relative

Table 9: *Employment, unemployment 1971–1978*

	1971	1972	1973	1974	1975	1976	1977*	1978**
1. Employment in Agriculture	273	267	260	254	252	243	238	233
2. Employment in Industry	323	317	324	331	315	304	312	326
3. Employment in Services	459	466	473	481	483	488	491	499
4. Total Employment	1,055	1,050	1,057	1,066	1,050	1,035	1,041	1,058
5. Unemployment	65	71	66	64	90	108	105	99
6. 4+5 Labour force	1,120	1,121	1,123	1,130	1,140	1,143	1,146	1,157
7. =5/6 Unemployment %	5·8	6·3	5·9	5·9	7·9	9·4	9·2	8·6
8. Population over 14	2,047	2,073	2,099	2,122	2,147	2,171	2,191	2,206
9. 6/8 Participation rate	54·7	54·1	53·5	53·3	53·1	52	52·3	52·4
10. Net migration in year to April	−4·3	0·7	1·8	3·3	4·1	0·4	−4·0	−10

Source: Economic Review & Outlook, June 1977 (Prl 6293)
The figures relate to mid April and are in thousands of people, unless otherwise stated.
*Estimate
**Forecast

cost changes and demand declines. While the first of these factors is reversible and the second expected on entry to the EEC, the third factor is a cause of more concern.

In any firm capital expenditure occurs for a variety of reasons. Two extremes that could be considered are (i) a situation where capacity is expanded with no change in unit costs and (ii) where no change in capacity takes place but unit costs fall. In the former case, the rationale behind investment tends to be expected sales resulting in increased capacity, whereas in the latter case the rationale tends to be the increase in profitability resulting from cost reduction without any change in sales or prices. In recent years investment in Ireland has been more weighted towards the latter case — where investment decisions have been directed primarily towards cost reduction. Of course for a fully employed economy this is desirable as it tends to maximise labour productivity and hence the real wage. For an economy like Ireland, in the process of transformation from an agricultural and protected industrial sector to an industrial economy in a free trade environment it is not quite so ideal. A feature of the Irish economy in the period 1960–73 was the very high level of investment (averaging $19\frac{1}{2}$ per cent of GNP over the period) and the poor performance on total employment which rose from 1,052 thousand in April 1961 to 1,066 thousand in April 1974 (non-agricultural employment rose from 673 to 712 thousand over the same period). In the more recent period, 1974 to 1977, investment has averaged almost 25 per cent of GNP.

The failure of investment to lead to major employment gains is noteworthy and perhaps deserving of speculation. Average real and money income per employee has been rising more rapidly in Ireland than in the UK. A plausible hypothesis is that, given parity of the Irish pound with sterling, money income increases necessitated defensive investment throughout the earlier period. The recession merely highlighted this feature. Investment was expected to be the mechanism whereby employment increased — yet the employment effects to date are disappointing. Ireland, in the recession period has not been unique, as a fairly widespread phenomenon has been increased investment accompanied by reduced employment. There can be no doubt that the relative price changes that have occurred since 1973 affected traditional and expected patterns of investment, and many firms are still in the process of adaptation. Indeed the present investment incentives, ranging from grants to favourable leasing arrangements from banks, place the real cost of capital at historically low levels and must intensify pressure towards capital deepening.

Inflation

In contrast with previous recessions the latest recession was accompanied by a general rise in price levels. The experience of Ireland closely paralleled that of the UK (discussed in the previous chapter as part of a more general discussion in the OECD area). This of course is not surprising given (i) the maintenance of a fixed exchange rate with sterling, (ii) the UK is the dominant trading partner, (iii) exports and imports constitute such a large proportion of activity in goods and services and (iv) demand patterns for non-tradeable goods and services tend to be somewhat similar for a variety of cultural and historical reasons. Under conditions (i)–(iv) it would be expected that inflation rates would be broadly similar. Table 10 below shows comparative movements in the private consumption deflator for both countries with the OECD average change in consumer prices.

Table 10: *Comparative inflation rates*

	1963–73	1972	1973	1974	1975	1976	1977	1978[3]
UK[1]	5·2	6·7	8·4	16·4	23·6	15·4	14½	8½
Ireland[1]	6·5	9·2	12·4	15·2	22·7	17·0	13½	7½
OECD[2]	4·6	4·7	7·8	13·6	11·4	8·6	8·7	n.a.

[1]Percentage change in deflator for private consumption
[2]Percentage change in consumer prices
[3]Forecast
N. A. =not available

So long as the above characteristics of the Irish economy in relation to the UK exist it is not surprising that the table shows a closer proximity in measured inflation between Ireland and the UK than between Ireland and the OECD. Inflation rates are, of course, unlikely to be identical — the figures for 1974–78 are somewhat atypical and arise from the operation of a variety of compensating influences. Over the pre-recession period consumer prices, on average, did tend to rise more rapidly in Ireland than in the UK — the differences in 1972 and 1973 were quite substantial. The effect of deviations between Ireland and the UK in domestic costs comes through primarily on company profitability. If domestic costs in Ireland are rising more rapidly than in the UK then profitability in the traded goods sector will tend to be reduced — and measured inflation will tend to be higher as prices of non-traded goods rise. Relative cost reductions in Ireland would not necessarily result in lower export prices for traded goods but profitability in the traded goods sector would rise and measured inflation would be lower in Ireland than in the UK because of the effect of cost increases on the non-traded goods sector. Increasing profitability in the traded goods sector performs a useful function as available studies indicate that supply elasticities are reasonably large and exports would increase. In the long term relative cost gains could only be maintained up to full employment. Attempts to maintain a relative cost advantage at full employment would result in excess demand pressure. Unfortunately it is difficult to see how a relative cost advantage can be achieved.

External Balance

Since independence Ireland has operated under a sterling exchange standard, in a pure form in earlier years and modified somewhat in later years. The essence of such a system is the more or less automatic adjustment through monetary contraction or expansion of a deficit or a surplus in the basic balance of payments (taken as equivalent to a fall or a rise in external reserves). External balance is a matter of concern over the short-run in so far as the operation of an automatic adjustment mechanism can lead to instability in demand and output, and falls in reserves can lead to capital flight. Indeed the emergence of a current deficit can itself lead to capital flight, and this is an added factor for policymakers.

There have been periods, in the early and mid-1950s, and again in the mid-1960s, when the balance of payments has been a matter of concern. In all cases large current deficits were accompanied by falls in external reserves. Domestic policy was demand contractionary to contain both the current deficit and to increase external reserves.

The period of the recession was somewhat atypical. The balance of payments on current account went further into deficit in 1974 to £280 million compared with £82 million in 1973. The size of the deficit was a reflection of a variety of major factors operating in one direction (i) the oil price rise, (ii) the cattle price fall and (iii) the restocking following the shortages of 1973. Fiscal policy, in a major departure from historical behaviour, was stimulatory in 1974 (Dowling, this volume) and the external reserves were increased by a combination of Central Government external borrowing and private capital inflows. The importance of the stage of the cycle to the balance of payments was apparent in 1975 when the external deficit fell to £4 million — a direct reflection of the phase of the cycle the economy was at. As the economy moved out of recession the deficit increased again to £140 million in 1976 and to £125 million in 1977. For an economy like Ireland's the existence of an external deficit on the current account of the balance of payments is hardly surprising. With any growth in external demand the lags between increasing industrial exports and the import of materials necessary for those exports more or less automatically requires the existence of a widening trade gap. This of course is magnified if growth in industrial exports is very rapid, as it has been for Ireland. In addition to a worsening of the deficit as a result of trade the very process of new industry formation through foreign grant-aided firms affects the current account of the balance of payments adversely as projects get off the ground. Of course for any such projects the direct trade affect is compensated for by foreign capital inflows — the timing and degree of compensation depending on the timing and extent of the domestic grant. It is somewhat ironic to note, given comment in the balance of payments, that the external current deficit could be reduced if growth in exports and investment were discouraged. Table 11 below summarises relevant balance of payments data.

THE PROSPECTS FOR THE FUTURE

The previous sections have considered the performance of the economy over the immediate past. The recession left Ireland, in common with other countries, with a legacy of problems. In particular the increased unemployment of the recession, taken in conjunction with the potential growth of the labour force over the medium to long term has presented the economy with a major employment problem. This has shifted the emphasis of policy statements more directly towards employment creation. In considering two pre-planning exercises "Economic and Social Development 1976–80" published in September 1976 and "National Development 1977–80" published in January 1978 it is apparent that the prime target of policy is employment creation. The later document sets explicit employment creation targets and output targets considered consistent with these employment targets. The preparation of targets is a useful function but it is important that the targets are realisable and not merely statements of the needs of society. The realisation of targets depends essentially on the appropriateness of the view of the factors determining the growth of the economy, and the realism of the assumptions made concerning autonomous events.

Table 11: *Balance of payments 1970–1977 £million*

	1970	1971	1972	1973	1974	1975	1976	1977
Balance on Current account	−65·3	−71·0	−48·4	−82·3	−280·2	−4	−140	−125
Direct Investment liabilities	13·5	10·4	12·7	21·6	21·9	72	95	n.a.
Omit Government Borrowing	11·6	15·1	22·3	29·0	138·5	160	295	n.a.
Commercial Banks			84·1	−26·2	39·2	34	95	n.a.
Other Capital Movement	42·6	136·3	−19·6	61·0	140·7	−80	−65	n.a.
Change in Reserves	2·4	90·8	51·1	3·1	60·1	181	280	245

In previous sections it has been suggested that external influences play a major role in influencing the level of output, employment, inflation and external balance in Ireland. Domestic growth policy should thus concern itself with encouraging those internal factors favourable to growth — in particular the expansion of productive capacity and the maintenance of competitiveness at the company level. Stabilisation policy in the short run should be demand expansionary in periods of slack world demand with a consequent worsening in the external balance and demand contractionary in periods of buoyant world demand when external balance will improve.

It is within this sort of context that the prospects of the Irish economy must be viewed. As noted in the previous chapter the growth of world trade and income weakened considerably in 1977 and seems likely to remain weak in 1978. The outlook for the immediate future is very uncertain as essentially the same fears of inflation and a deterioration of current balances remain — fears that prevailed prior to and during the recession as negative influences on policy. Thus, on the basis of present policies, it is apparent that the world, over the immediate future, is unlikely to witness a return to the growth path that prevailed in the post-war period up to 1973. It follows therefore that the achievement of pre-recession rates of growth for the Irish economy will be exceptionally difficult. In a period of rapid growth internationally it would be possible to envisage a favourable scenario — a rapid growth in exports of existing firms, additions to productive capacity and exports by new firms etc. In the absence of this rapid growth the stock of existing firms will not find the volume of exports increasing rapidly and the flow of new foreign investment will weaken. The extent of the weakening of new foreign investment is difficult to gauge, as our membership of the EEC may still act as a positive factor for some new foreign firms. *A priori* then the achievement of rapid growth within this sort of international climate would appear implausible.

The particular figures used in the White Paper for industrial and manufactured exports were growth rates of 15 and 16 per cent up to 1980. In the period 1968–73 when manufactured exports were growing by just less than 20 per cent the growth of GNP averaged $4\frac{1}{4}$ per cent. The industrial sector has, of course, increased in importance in GNP since that period but this would only support an upward movement in the growth rate of slightly less than 1 per cent, *ceteris paribus*. The achievement of even these targets for industrial and manufactured exports is unlikely, given the possibilities for world trade growth. The impact of fiscal policy on growth in the period to 1980 is also relevant. In 1978 fiscal policy is stimulatory, (Dowling, this volume) but the targets for the borrowing requirement for 1979 and 1980, if supported by policy imply a contractionary fiscal policy in both these years. The effect on GNP being, of course, a function of the specific measures but the direction being deflationary.

The situation is thus that the target increase in industrial exports coupled with the target level for the Government borrowing requirement would not lead to any major difference between the target future growth experience and that of the period 1968–73. Both of these variables include influences from investment in exports from increased capacity of firms (new and existing), and in the public capital programme where capital grants to enterprises are one element of the borrowing requirement.

Even if external influences were favourable and the economy were likely to exhibit factors conducive to rapid growth the continuation of this rapid growth following the growth of 5–6 per cent in 1977 would inevitably lead to bottlenecks in particular sectors, e.g., skilled manpower, traffic congestion in cities etc. In any economy there are real resource constraints and these can be expected to become operable under rapid growth, leading to increased prices. Indeed even in present circumstances, in the first year covered by the White Paper, money incomes are likely to grow more rapidly than in other countries when allowance is made for exchange rate movements. This arises not only from the basic terms of the current National Pay Agreement which seem large in money terms, but also from the tendency of incomes to rise more rapidly in periods of growth through productivity gains, job shifting and so on. It could not be maintained that in external currency terms the domestic cost structure for the majority of firms engaged in exports is likely to improve in 1978. Indeed it must be expected that with the possibility of continued growth domestic costs would further escalate. In essence then, the possibility of making competitive gains in domestic costs through income restraint, while desirable, is unlikely.

This has clear implications for employment over the medium term. So long as a tendency towards rapid growth leads to increased factor prices the possibilities for further investment and employment creation of existing firms are limited. The maintenance of domestic costs at favourable levels is a necessary but not sufficient condition for further capacity expanding investment by existing firms. The increases in pay for 1978 under the National Pay Agreement are likely to lead to further defensive investment. Thus when the job creation programme of the public sector is completed it is unlikely that employment as a whole will increase as rapidly as might be desired.

The increase in domestic costs has further implications in terms of likely inflation beyond 1978. World inflation rates in 1979 are forecast to increase slightly more rapidly than in 1978 — indeed forecasts for the UK show a slightly larger increase. It follows that the inflation targets of the White Paper are unlikely to be realised without exchange rate movements and these have output and employment consequences.

It is evident from the foregoing that a somewhat negative view is being taken of the targets presented in the White Paper — in particular those relating to growth. It is worth while to consider where the differences arise. Essentially a much more pessimistic view is taken of external factors and these effect growth through the effects on exports, new foreign investment, and new investment by existing firms. Over and above this it seems unlikely that, even if external factors were favourable, the economy could grow as rapidly as targeted in 1979 and 1980 in the face of what must be deflationary budgets in these years if the targeted borrowing requirement is to be realised. At a different level the behavioural assumption on domestic costs, i.e., that they can be contained in the face of rapid growth, seems implausible. The planning problem in a society like Ireland is to devise mechanisms, within the external environment and its constraints, to increase the productive capacity and competitiveness of the economy, or, more precisely, to prevent domestic costs from increasing simply because of growth in output, and to ensure that the investment made possible by curtailing domestic costs actually takes place.

CONCLUSION

In this article the principal characteristics exhibited by the Irish economy over the period of the recession were summarised. It was suggested that the experience was somewhat similar to that felt by other countries. Some aspects of medium-term targets of the Government were discussed. External factors were cited as likely to be somewhat more unfavourable than assumed in the White Paper suggesting that target growth rates are unlikely to be realised.