

**LESSONS LEARNED FROM THE CELTIC TIGER**

**The Strategy for Economic Renewal in Ireland**

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## **The Origins of the Celtic Tiger.**

The Celtic Tiger has many putative fathers. It could be described appropriately as a copy-cat feline, since its name was clearly inspired by the example of the Asian Tigers. The term is used to describe the Ireland that emerged from a very painful and prolonged period of economic and fiscal re-structuring which spanned the decade of the 1980s. The details were conditioned by Ireland's situation as a small, open economy which had been allowed to become uncompetitive. The essential lesson is that the longer adjustment is delayed, the more painful it becomes.

In 1980, Ireland was a relatively modern economy. It was a Member State of the European Economic Community, benefiting from substantial capital inflows from the (then) EEC's Regional Fund and from substantial net inflows of current income from the EEC's Common Agricultural Policy. Its industrial sector included a large number of multinational corporations attracted by a very favourable tax regime, including freedom to repatriate profits, a system which basically had been in existence since the mid-1960s. As in all modern economies, the contribution of the services sector to the economy was growing.

## **Before the Celtic Tiger: the problems.**

Ireland had a series of economic and fiscal problems at the beginning of the 1980s.

The oil shocks of the 1970s and persistent deficit financing by Government from 1972 onward had produced a fiscal mess. High deficits on both current and capital account produced negative Exchequer balances, reaching 13.4% of GNP in 1980. Financing these deficits brought the National Debt to 100% of GNP in 1980. In 1980, unemployment stood at 11%. Taxes were high, provoking mass demonstrations in 1979. With the exception of 1979, every Census of Population since 1926 had recorded substantial net emigration.

## **Economic and fiscal adjustment.**

There was clearly a need for serious adjustment. This began in mid-1981 with the election of a new Government. The process was not without its difficulties. The components of the adjustment inevitably created political problems, resulting in three General Elections in a period of 18 months - June 1981, February 1982 and November 1982 - and a political see-saw which temporarily interrupted the adjustment process in 1982.

A difficult period ensued, during which unemployment and emigration continued to be major preoccupations.

On the other hand, some fundamental progress was achieved in respect of inflation levels and the external trade balance.

Notwithstanding this, the fiscal picture remained discouraging for some time, despite a very restrictive approach to Government expenditure.

The difficult fiscal background gave rise to other difficulties. Industrial relations were problematic. Through most of the 1980s, industrial disputes lost us more than one working day per year for every three workers. This clearly reflected a serious malaise.

The picture was complicated by political considerations. In January, 1987, differences over budgetary policy led to the departure of the Labour Party from the Coalition Government and precipitated a General Election in February. The Fine Gael Party (the larger partner in the outgoing Government) published the controversial budget proposals as the central plank of its election platform. The principal Opposition party, Fianna Fail, claimed that these proposals were excessively and unnecessarily deflationary, and proposed a much looser fiscal stance.

Fianna Fail emerged from the election as the largest party and formed a Government, but without a safe overall majority. Thus, after seven years of gradual but incomplete adjustment, a mildly reform-minded Government had split over a further stage of adjustment and had been defeated by a party which appeared to be in denial over the need for further adjustment.

Notwithstanding the fact that the Fianna Fail party had conducted its election campaign on the basis of a looser fiscal stance, in Government it adopted most of the Fine Gael Budget proposals. The incoming Minister for Finance had clearly understood the need for further fiscal adjustment and had won the first battle in Cabinet over the shape of fiscal and economic policy.

### **Three positive factors.**

Three factors – two new and one already in existence - were to contribute in very substantial way to the successful pursuit of the reform programme.

- The first was a new departure in Opposition policy.
- The second was the development of social partnership.
- The third was an emphasis on Human Resource development, which was assisted by the Ireland's success in the early 1980s in having a concern with social cohesion built into the EC's financial aid system.

### **A new Opposition approach.**

The moderately deflationary nature of fiscal policy continued to be a matter of public controversy, since there are always examples of areas of public spending which can justifiably be increased on the basis of popularly-accepted views of social justice and equity. In 1987, health expenditure and the quality of the public health service were to the forefront of political debate (and indeed still are today). This meant that there was great pressure on the Opposition to oppose the continuation of the fiscal adjustment. The Government, lacking a safe majority, was clearly vulnerable. It also seemed to lack the capacity to re-order expenditure within the overall constraints in order to meet more closely the priorities being identified by the public and by the Opposition. There was a clear prospect that the Opposition could engineer a Parliamentary defeat of the Government on a platform of looser fiscal policy.

It seemed to me, by then Leader of the Opposition, that such an engineered defeat would have been totally perverse and could provoke both increased public cynicism and a renewed need for much more deflationary action than had yet been taken, and over a longer period. The net result would have been to undo most of the modest progress that had been achieved.

For that reason, I announced in September 1987 that, as long as the Government held to the substance of the reform programme, I would not oppose the general direction of its economic and fiscal policies. I stated that my views about economic policy had not changed just because I found myself in Opposition.

In most walks of life, such a statement would seem pretty straightforward, self-evident and unremarkable. In the political climate of Ireland in 1987, however, it was almost revolutionary. It became known as the “Tallaght Strategy”, named for the Dublin suburb where I delivered the speech at a Chamber of Commerce lunch. It caused great unease and bafflement in my own Fine Gael Party, bemused satisfaction in the Fianna Fail Government party, was ignored by the Labour Party and was described as a “blank cheque” by the Progressive Democrats. The media, on the whole, did not know what to make of it, since it was an action that fell outside their frame of reference for political analysis and comment.

It worked. It gave the Government and, in particular the new Minister for Finance, the assurance of knowing that they would not be tripped up on the reform programme. The Minister for Finance stuck to the programme and, by the time that Government fell in 1989 as a result of a series of minor Parliamentary defeats on the details of expenditure plans, no party seriously advocated any substantial departure from the overall thrust of the reform programme. Fiscal common sense had become a standard part of the political vocabulary.

While the political system was rather baffled by the Tallaght Strategy, the general public had a much more immediate and intuitive understanding of what it was about. To this day, it is the topic most frequently raised with me by people I meet for the first time and is more important in the public memory than my previous reputation as a hard-hearted, high-taxing and parsimonious Minister for Finance.

The public are sometimes better at real politics than the politicians!

**The first Partnership Agreement: the “Programme for National Recovery”, October, 1987.**

The reform process was further helped by the institution, in the Autumn of 1987, of a new “social partnership” agreed between the Government, the trade unions, the main employers’ organization, the construction industry organization, the largest farmers’ organization, the young farmers’ organization and the organization representing the agricultural co-operatives.

In an effort to foster understanding of the need for and the problems of adjustment, the incumbent Government had instituted a series of round-table discussions with organisations representing trade unions, employers and farmers in the Autumn of 1986. The objective was to seek to identify and, if possible, to expand, areas of common understanding of the

constraints on public policy and to explore the possibility of building agreement on appropriate and acceptable adjustment and development strategies.

Progress was very slow. Initially, the trade unions were rather unreceptive and suspicious of the Government's motives. They probably did not wish to be drawn into agreements which would limit what they saw as the proper scope of their action in defence of their members' interests. Employers took a more positive view, since they hoped that there would be some result in terms of a cooling of a tense industrial relations situation. The farmers, as usual, had their own agenda.

There is some reason to believe that both the trade unions and the employers felt (for different reasons) that they could get a better deal from a new Government after a General Election than from the incumbent Government drawing toward the end of its statutory term. The talks dragged on through the Autumn and into the end of the year and were interrupted by the collapse of the Government in the following January.

The new Government resumed the talks with the "Social Partners". It quickly became clear that it Government did not intend to loosen fiscal policy (contrary to what it had said during the election campaign) and the other parties to the talks evidently accepted that there was little point in further argument on this point. The agreement was therefore negotiated against the background of a continuation of tight fiscal policy.

This first social partnership agreement was, in essence, a very simple deal: the Government promised a moderation of personal taxes and, in return, the trade unions agreed to moderate the level of wage demands.

*"8. An appropriate pattern of pay development has an essential part to play in the success of this Programme. Lower income taxation and a low level of inflation can help to bring about more moderate pay expectations. It is for this reason that the Government as part of tax reform under the Programme intend to make the income tax reductions outlined in Section III."*

This constituted an historic innovation in Government policy. It was the first occasion in Irish history on which a Government had entered into an agreement on taxation policy with any outside body.

The reductions proposed in income tax for the following three years were the only quantified commitments set out in the Programme: everything else was purely aspirational. In the event, the reductions in income taxation over the period of the Programme were even more substantial than had been envisaged.

Positive results were achieved during the Programme period in respect of GNP growth rates, employment and the Exchequer balance.

It has not been possible to gauge the exact effect of the measures set out in the Programme. They were clearly not the only factors contributing to overall economic and fiscal improvement but it is generally agreed that they had a positive effect. The "Social Partners"

agreed that the exercise was worth repeating when the first Programme came to its end and negotiations on its successor started during the course of 1990.

**The second Partnership Agreement: the “Programme for Economic and Social Progress”, January, 1991.**

This Programme introduced a number of innovations.

- First, it marked the beginning of a series of increasingly pretentious titles.
- Second, it marked the beginning of an expansion in the number of “Social Partners” around the table.
- Third and most important, it marked the beginning of a deeper penetration into economic and social policy by measures agreed in the context of the social partnership negotiations.

Since the first Programme concerned “national recovery” and had to be seen to have succeeded, its successor had to go beyond recovery, hence the reference to “progress”.

A new partner was brought into the process. This was the second-largest farmer organization in the country and this move constituted a politically important step in the direction of “inclusiveness”

This second Programme went beyond the simple exchange of pay restraint for tax cuts. It contained a provision setting ceilings on rates of pay increase in the private sector for the years 1991, 1992 and 1993 and provisions relating to the development of pay rates in the public sector. In addition, however, it contained public service commitments well outside the scope of the original “tax cuts for pay restraint” deal.

In addition, the Programme contained a significant number of unquantified commitments to extra Government expenditure and even a number of commitments or forecasts of increases in expenditure by the private sector.

Finally, it contained an even greater number and variety of unquantified and aspirational statements than the first Programme.

Agreement on the second Programme marked the definitive inclusion of the partnership process into Irish public life and policy-making.

**Subsequent Partnership Programmes.**

The first two Programmes have been followed by five more with increasingly elaborate titles.

## **Additional Partners.**

By the time the “Programme for Prosperity and Fairness” had been concluded in 2000, twelve further organizations had been added to those involved in the process. These additional organizations, some of them representative and some of them effectively self-appointed, cover a wide range of interests.

Many of these organizations are themselves federations or umbrella groups with membership made up of voluntary community-based organizations of many kinds. Thus, it may be said that the partnership process has a considerable reach into civil society and access to insights into the attitudes of many sectors of the public.

There are, however, some questions to which there are no clear answers.

- First, to what extent can these groups give a true picture of opinion or needs in the segment which they are held to represent?
- Second, what is the real influence of the groups which have been added as the process has rolled on?

The trade unions are represented by the Irish Congress of Trade Unions (ICTU), the national umbrella organization of (most) of the organised trade union movement, with the internal stresses common to all such organisations. There are questions about the standing of this group. About one third of the Irish labour force is unionised today. Thus, ICTU has only a very tenuous claim to representing the views and interests of the other two thirds of the labour force. Moreover, the public sector is more unionised than the private sector, and ICTU may therefore be seen to be more heavily influenced by the interests of workers in the sheltered, non-traded sectors of the economy than by those of workers in the exposed sectors.

The ICTU has a cadre of expert, experienced negotiators. They are arguably more expert and more experienced than the public servants representing the Government at the talks, and they are certainly more experienced than the representatives of any of the other non-Government groups. It is inevitable, in my view, that they will dominate the discussions. This is not a criticism of the trade union or Government negotiators: it is simply a statement of fact.

The crucial decisions in the partnership talks are not drawn up in plenary sessions: they are worked out in successive bilateral negotiations between the principal parties and then submitted to plenary examination. It is inevitable in such circumstances that the most expert partners will be the most successful in influencing the final outcome.

Objectively, therefore, the partnership process is one in which the strongest party is one which represents only one third of the work force. I am not persuaded that this necessarily gives the best result in terms of the overall national interest in any negotiation.

The addition of extra “partners” to the process may well have been motivated by a desire on the part of the Government (and even, perhaps, on the part of the other partners) to ensure a greater degree of inclusiveness. However that may be, it has also had the effect of diffusing

the focus and diluting the strength of the case being presented to the Government in the negotiations, except in the case of the trade unions. The multiplication of partners has further consolidated the already strong negotiating position of the trade unions. Inclusiveness does not guarantee effective participation or influence.

### **Multiplication of fora and organizations.**

Over the life of the partnership process so far, we have witnessed the birth of an extensive array of specialized fora to deal with specific issues. These have functions additional to those of the central monitoring committee structure, which has itself undergone some modification over the period and in 2003 was re-christened as the Steering Group for the Agreement.

While most of these additional fora probably carry out useful work, much of which would be needed independently of the partnership process, it is hard to avoid the impression that some of them may give the participants a sense of “belonging” rather any real determining function in matters of importance.

### **Scope of Partnership process.**

The scope of the process is now so wide, at least on the surface, that it begs the question as to whether it runs the risk of supplanting the normal democratic Parliamentary process. This question becomes all the more important when account is taken of the manner in which each successive agreement has been concluded.

Each agreement is concluded between the partners. The Irish Parliament has no say in the matter. None of the agreements has been formally put to the Parliamentary process for approval.

Moreover, by the time any of these agreements has been brought before the public (not to speak of the Parliament), the social partners have already committed themselves to it. If there were a mechanism by which Parliament could substantially vary the terms of an agreement or even reject it, the effect on industrial relations at national level would probably be dramatic.

### **The value of partnership.**

The value of the original components remains. Ireland has now enjoyed, for the greater part of 20 years, a period of industrial peace and high growth levels. It would be difficult to argue that this sustained progress would have been achieved in the absence of the kind of joint endeavour which the social partnership process has fostered. The system, however, currently displays what I regard as a worrying trend toward undemocratic corporatism in the determination of important aspects of economic and social policy. In addition, I believe that there are grounds for concluding that this partnership model frequently produces sub-optimal economic and social solutions.

### **Human Resource development.**

The 1960s decisions to open the economy and to facilitate FDI to the greatest possible extent were backed up by a new approach to education. This, in turn, produced a well-educated and flexible workforce which increased Ireland's attractiveness to foreign investors. This lesson was re-applied in the 1980s and informed Ireland's successful insistence that EC Cohesion Funds be available for HR development. This, in its turn, facilitated re-training and skills development in the 1980s as a response to high levels of unemployment. The result was a further impetus to FDI, with consequent employment gains.

### **What worked for Ireland?**

1. The establishment of fiscal common sense as an essential ingredient of public policy.
2. The establishment, through the partnership process, of the fact that moderation in taxation and in wage development has positive outcomes for employment levels.
3. The emphasis on human resource development as a tool of adjustment.

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