NATIONAL ECONOMIC AND SOCIAL COUNCIL

Economy in 1975 and Prospects for 1976

No. 13

NATIONAL ECONOMIC AND SOCIAL COUNCIL

CONSTITUTION AND TERMS OF REFERENCE

1. The main task of the National Economic and Social Council shall be to provide a forum for discussion of the principles relating to the efficient development of the national economy and the achievement of social justice, and to advise the Government through the Minister for Finance on their application. The Council shall have regard, *inter alia*, to:

(i) the realisation of the highest possible levels of employment at adequate reward,

(ii) the attainment of the highest sustainable rate of economic growth

(iii) the fair and equitable distribution of the income and wealth of the nation,

(iv) reasonable price stability and long-term equilibrium in the balance of payments,

(v) the balanced development of all regions in the country, and

(vi) the social implications of economic growth, including the need to protect the environment.

2. The Council may consider such matters either on its own initiative or at the request of the Government.

3. Members of the Government shall be entitled to attend the Council's meetings. The Council may at any time present its views to the Government, on matters within its terms of reference. Any reports which the Council may produce shall be submitted to the Government and, together with any comments which the Government may then make thereon, shall be laid before each House of the Oireachtas and published.

4. The membership of the Council shall comprise a Chairman appointed by the Government in consultation with the interests represented on the Council

Ten persons nominated by agricultural organisations,
Ten persons nominated by the Confederation of Irish Industry and the Irish Employers' Confederation,
Ten persons nominated by the Irish Congress of Trade Unions,
Ten other persons appointed by the Government, and
Six persons representing Government Departments comprising one representative each from the Departments of Finance, Agriculture and Fisheries, Industry and Commerce, Labour and Local Government and one person representing the Departments of Health and Social Welfare.

Any other Government Department shall have the right of audience at Council meetings if warranted by the Council's agenda, subject to the right of the Chairman to regulate the numbers attending.

5. The term of office of members shall be for three years renewable. Casual vacancies shall be filled by the Government or by the nominating body as appropriate. Members filling casual vacancies may hold office until the expiry of the other members' current term of office and their membership shall then be renewable on the same basis as that of other members.

6. The Council shall have its own Secretariat, subject to the approval of the Minister for Finance in regard to numbers, remuneration and conditions of service.

7. The Council shall regulate its own procedure.

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Conventional signs and abbreviations

$ U.S. dollar
() based on incomplete data
I, II calendar half years
Billion thousand million
n.a. not available

ICTU Irish Congress of Trade Unions
CII Confederation of Irish Industry
IDA Industrial Development Authority
OECD Organisation for Economic Co-operation and Development
ESRI Economic and Social Research Institute

CHAPTER 1

THE WORLD ECONOMY

(a) The recession

1. In the *Economy in 1974 and Outlook for 1975*, the discussion of the international situation was dominated by inflation, the boom in 1972-73, and the dangers of a subsequent downturn, aggravated by the deflationary impact of the oil crisis.* The forecasts for the seven major OECD countries showed a half per cent growth rate in 1974 with some recovery into 1975, though it was suggested that these estimates would have to be reduced. It seemed that one of two things might happen in the second half of 1974: expansionary action by countries with a strong (or less weak) balance of payments position, which would help other countries to improve their positions and in that way minimise the overall fall in output and the rise in unemployment; or continuing deflationary policy attitudes aimed at reducing commodity and oil prices, reducing domestic inflation and/or redistributing the adverse balance of payments effects of the oil crisis—policies which would make a major recession a certainty.

2. In the event, deflationary attitudes prevailed. The countries best placed to take expansionary action (the United States and Germany, which were also the countries most disposed to let unemployment rise in order to reduce the rates of increase in pay and prices) did not do so sufficiently rapidly or sufficiently strongly to enable a world recession to be avoided. The forecasts made a year ago for 1975 therefore turned out to be too optimistic (see Table 1). By the last quarter of 1974 and the first quarter of 1975 the full deflationary impact of the oil crisis had worked through to most economies: in the first quarter of 1975 industrial production in OECD countries was 9 per cent below its level a year earlier; output in the EEC fell by 6 per cent.

*The impact of the oil crisis on all western economies was estimated at 3 per cent of GNP. The figure for European countries was rather higher.

TABLE 1

Output, unemployment and external balance in major countries

	1960 –1972 (average)	1973	1974	1975 *(a)*	1976 *(b)*
Real GNP (% growth)					
France	6	7	4	1	2
Germany	5	5	0	–2	4
United Kingdom *(c)*	3	5	0	0	0
United States	4	6	–2	–4	5
Major 7 *(d)*	6	7	–1	–2	4
Other OECD	5	5	3	1	3
OECD total	5	6	0	–2	4
Ireland	4	5	0	–3	0
Unemployment (e) (% labour force)					
France	1·7	2·1	2·3	3·8	5
Germany	1·0	1·3	2·7	4·7	4–5
United Kingdom	2·3	2·6	2·5	3·7	5–6
United States	4·7	4·9	5·6	9·2	9
Major 7 *(d)*	2·9	3·1	3·5	5·5	6
Major 7 (millions)	6·4	7·4	8·6	14	15–16
Ireland (thousands)	56	67	64	105–110	130
Current External Balance (f) ($ billion)					
France		–0·7	–5·9	–2	–3
Germany		4·5	9·3	8	6
United Kingdom *(c)*		–2·9	–9·0	–4	–3
United States		0·3	–0·9	3	–3
OECD total		2·0	–34·0	–15	–27
Ireland		–0·2	–0·7	–0·2	–0·2

(a) Estimates.
(b) Forecasts based on unchanged policies.
(c) OECD forecasts for the UK revised to take account of July measures.
(d) Total of France, Germany, Italy, United Kingdom, United States, Canada and Japan.
(e) The average covers 1962–1972. The 1975 figure is for June. The 1976 forecasts are NESC estimates. The figures for different countries are not drawn up on a common basis, and are therefore not strictly comparable.
(f) Average for 1960–1972 not available at source.

All figures are shown at annual rates, growth rates are taken from the previous period.

Sources: OECD, *Economic Outlook* No. 17, July 1975; *National Income and Expenditure; Irish Statistical Bulletin; Review of 1974 and Present Outlook*—June 1975.

3. During 1975 the United States, France, Germany, Japan and several of the smaller countries took expansionary action. Furthermore, there were some indications that the normal economic forces which tend to moderate any recession (the completion of the reduction in the stocks of finished goods, and some revival of residential construction—encouraged by lower interest rates) were beginning to emerge. Moreover, the demand for imports by the primary-producing countries was very much stronger than expected during the first half of 1975, though demand from this source has probably fallen away in the latter half of the year. Taken together, these developments helped to moderate the decline in economic activity that was apparent in the early months of 1975.

4. The slump in economic activity has brought widespread increases in unemployment (see Table 1). The prospects for the remainder of 1975 and for early 1976, given the normal lags between changes in output and changes in employment, are that unemployment will continue to rise at least through the remainder of 1975. In Europe, in the absence of more expansionary policies, the rise in unemployment may continue well into 1976.

5. There has been a considerable improvement in the balance of payments position of industrial countries (see Table 1). In part, this was a response to particularly buoyant demand from primary producers (including the oil producers). But the reduction in activity in industrial countries and the consequent fall in their demand for imports, particularly for stockbuilding, was the principal reason. The reduction in demand for primary products, at a time when rates of inflation were still high in industrial countries, brought an improvement in their terms of trade which also helped to improve their balance of payments positions. As the stock adjustment is completed and economic activity levels off or begins to rise slowly in the developed world, there is likely to be some recovery in the demand for primary products. The possibility of a new round of oil price increases this autumn cannot be ruled out. If oil prices were increased, the balance of payments of the industrial countries could deteriorate once again.

6. The slump has also brought a reduction in the rate of world inflation. This was most noticeable on the world commodity markets

which are particularly sensitive to the level of demand. Non-oil commodity prices were about 40 per cent lower in the first half of 1975 than a year earlier, though they still seem high in relation to the low level of world industrial output. Actual (as opposed to quoted) oil prices have also eased somewhat. There have also been marked reductions in new pay settlements, though these take some time to work their way through to earnings data. Nonetheless, in the six months to June 1975 the average annual rate of increase in earnings in manufacturing industry in the seven largest OECD countries was 14 per cent (not seasonally adjusted), compared with 19 per cent for the same period a year earlier.

7. As a result of restrictive demand management policies, the slower growth of import prices and of pay, the rate of increase in prices has begun to decelerate sharply in many countries. To date, the slowing down has been most apparent in the wholesale prices of manufacturing output. It normally takes some time for such changes to work through to the retail level, and food price increases have continued to push up consumer prices. Nonetheless, there has been some slackening in rates of increase in consumer prices. In the six months to June 1975, the average annual rate of increase in the seven largest OECD countries was 13 per cent (not seasonally adjusted), compared with a rate of 18 per cent over the same period a year earlier. The slowing down in the rates of increase in pay and prices is expected to continue through the remainder of this year and into 1976 (see Table 2).

(b) **Problems for Smaller Countries**

8. Very broadly, countries have reacted to the new world of inflation, slump and chronic balance of payments disequilibrium in two ways. Some countries have put the emphasis on controlling inflation and reducing their balance of payments deficits; others have tried to minimise the increase in unemployment. There is a sharp contrast between the United States, Germany and (to a lesser extent) Japan, and nearly all other developed nations. These three important countries have all accepted much more severe cuts in output and larger increases in unemployment as the price of more rapid progress in reducing their inflation rates and, in the case of Japan, improving its balance of payments position. In the United States and Germany these

developments were largely the result of deliberate policy attitudes, because both were particularly sensitive to inflation for historic and political reasons. The Japanese experience has been more a reflection of their particular vulnerability to the increase in oil prices and to disruptions in raw material supplies.

TABLE 2

Pay and price trends in major countries

	1962 –1972 (average)	1973	1974	1975 *(a)*	1976 *(b)*
Hourly Earnings in Manufacturing Industry (% Growth) (c)					
France	9·0	12·4	18·0	16	12
Germany	7·5	10·7	10·6	10	7
United Kingdom *(d)*	8·2	12·7	17·0	25	15
United States	4·3	6·8	8·4	9	9
Ireland *(e)*	10·3	22·6	18·9	23	18
Import Prices (f) (% Growth)					
France	2·1	7·9	47·7	4	7
Germany	0·2	6·4	25·3	0	6
United Kingdom	3·8	24·3	45·2	11	7
United States	3·2	18·8	48·1	13	7
Ireland *(h)*	3·7	21·4	38·5	10–14	8–12
Consumer Prices (% Growth)					
France	4·4	7·3	13·7	12	9
Germany	3·2	6·9	7·0	6	6
United Kingdom *(d)*	4·2	9·2	16·0	21	14
United States	3·3	6·2	11·0	8	6
OECD total	3·9	7·9	13·4	12	10
Ireland *(h)*	5·7	11·4	17·0	21–22	16
Commodity Prices (g) (% Growth)	4·0	47·7	26·8	–20	10

(a) Estimates.
(b) Forecasts based on unchanged policies.

Footnotes continued overleaf.

9. The willingness of the three largest economies to allow output and employment to fall has had important consequences for other countries. First, weak demand in the largest markets has reduced other countries' exports and hence reduced their output and employment. Second, the improved cost and price performance in the three large countries has left the others in a poorer competitive position—as a result their output and balance of payments deficits deteriorated further. Third, other countries have tried to offset some of the domestic effects of weak export markets and declining competitiveness by stimulating domestic demand—again with the consequence of a further weakening of their balance of payments.

10. The net result has been that from 1973 to 1975, when the current balances of payments position of the oil-producing countries improved by some $45 billion,* the combined external position of Germany, the Netherlands, the United States and Japan also improved by $7 billion. A corresponding deterioration occurred among other developed countries, particularly the smaller countries, and among the non–oil producing developing nations.

Footnotes to Table 2 *(continued)*

(c) 1975 figures are for June. 1976 forecasts for countries other than Ireland based on OECD forecasts.

(d) OECD forecasts for the UK revised to take account of July measures.

(e) Average weekly earnings in October each year (up to 1968 inclusive) and in September each year (from 1969). NESC estimates for 1975 and 1976.

(f) OECD forecasts do not allow for exchange rate changes from June 1975, the NESC estimates assume further depreciation of sterling.

(g) "Economist" index ($) excluding fuels.

(h) NESC estimates for 1975 and 1976.

All figures are shown at annual rates, growth rates are taken from the previous period.

Sources; OECD, *Economic Outlook* No. 17 July, 1975; Main Economic Indicators. National Accounts of OECD Countries 1960/71; Central Statistics Office; *Irish Statistical Bulletin, Statistics of Wages, Earnings and Hours of Work:* NESC Estimates.

*Within the period 1973 to 1975, significant changes took place in the combined OPEC surplus. In 1975 the surplus is projected at $50 billion (as compared with $70 billion in 1974 and $6 billion in 1973) because the volume of OPEC imports is likely to rise by about 30 per cent in 1975 (over 1974), following a rise of nearly 40 per cent in 1974, while the volume of OPEC exports is likely to fall by about 10 per cent.

11. At the same time the efforts to maintain domestic output in smaller developed countries have led to exceptionally large budget deficits. The inevitable consequence of the oil crisis and the policy attitudes of the three largest countries, therefore, has been to impose considerable financial strains on other governments wishing to maintain domestic demand and output. These strains have been the greater the more open the economies.

12. The financial strains on governments have arisen because of the need to finance huge budget deficits and large balance of payments deficits. The problem has not generally been that such finance has not been available on national or international markets—indeed, capital outflows from oil-producing countries are unavoidable. Weak domestic demand has facilitated public sector borrowing from domestic banking systems, while capital outflows from oil-producing nations and the extension of international credit have enabled balance of payments deficits to be financed. However, in 1975 it was rather more difficult to finance deficits than in 1974.

13. The real problem has been that governments, which have tried to maintain output and employment by substituting domestic demand for foreign demand, have been building up debt and debt-servicing commitments at a very rapid rate. In the period immediately following the oil crisis, many of them felt that debt could be increased rapidly for a short period while reflationary policies elsewhere brought about a recovery in export markets. This would have reduced the rate at which new debt was built up (higher exports reducing the external deficit and, by encouraging domestic output, reducing the public sector borrowing requirement). But as it became clear that the recovery of activity was likely to be longer delayed and less substantial than was first anticipated, so it became clearer that the increase in debt and debt-servicing commitments required to sustain output in some countries could be very much greater both than was anticipated and than could be sustained for more than a very limited period.

(c) **Prospect of a recovery**

14. It seems probable that the worst of the recession is now past in the United States and output will soon begin to rise. This should

improve the outlook for other countries. On the basis of present policies, however, the recovery into 1976 might at best arrest the increases in unemployment now being experienced in nearly all countries; it would do little or nothing to reduce the high unemployment and low capital utilisation which developed during the slump. Forecasts for the first half of 1976 based on these assumptions are presented in Tables 1 and 2.

15. Over the summer of 1975 the major western countries sought a co-ordinated reflationary approach to economic policy. This has led to further reflationary moves in France, Germany and Italy, and other major countries may follow. There are now therefore better prospects for a reasonably well-sustained recovery in the world economy through 1976.

16. However, as was the case during the recession, there will be wide differences in the experiences of different countries. While the three largest countries are favourably poised for expansion, many other countries will be less able to contribute to, and benefit from, the recovery. Some have balance of payments or budget deficits which are so large that the greater part of any recovery in their export markets will have to be used solely to bring about an improvement in these accounts. They may therefore have to use fiscal policy to offset much of the increase in external demand by reducing domestic demand. Other countries which have not yet brought their inflation problem under control may have to adopt or maintain restrictive policies in order to remain competitive. The need for many countries to maintain a cautious approach to policy is reinforced by the continuing instability of the international economic system—the oil producers will still be running large current balance of payments surpluses (so that other countries will still be in substantial deficit), yet there is still no satisfactory institutional arrangement for financing these deficits (i.e. for the "recycling" of "petro-dollars"). Such arrangements as do exist adopt a fairly tough attitude to countries with sizeable balance of payments deficits.

17. The most likely outcome may be as follows. There will be some recovery in world activity into the first half of 1976. Several important

countries have taken action this Autumn to ensure that the recovery continues through 1976 and into 1977. This action will not be sufficient to achieve a rapid recovery because of the fears among the larger nations (which are those most sensitive to inflation) that it could produce another inflationary outburst on commodity markets, and that it would strengthen the hand of the oil producers. Other countries which have pursued more expensionary policies will have to come more closely into line with the major countries if they are to reduce their very large external and/or budget deficits. This will tend to weaken the recovery. Countries which have not yet reduced their rates of inflation will have to do so if they are to become sufficiently competitive to benefit from the recovery. Restrictive action taken by these countries would further weaken the growth in world output and trade.

(d) **Prospects for Ireland's export markets**

18. The United Kingdom is by far the most important market for Irish goods. During the first half of 1975 pay and prices were growing much too rapidly in the United Kingdom and sterling began to depreciate on the foreign exchanges. In July 1975 the Government, employers and unions agreed on measures to control the growth of incomes and prices over the next eighteen months. If these new policies are even moderately successful, they will have three effects. First, they will reduce the British rate of price inflation, making it all the more difficult for Irish producers to remain competitive on the British market. Second, they will reduce the likelihood of further depreciation of sterling, so that Irish manufactured goods would be unlikely to gain much competitive edge in third markets from this source. Third, they would have a very large deflationary impact on the British economy,* so that Ireland's main overseas market is likely, at best, to stagnate over the next year.

19. Other EEC and continental markets seem likely to recover slowly over the next eighteen months. Their growth could be about equal to

*Higher unemployment is now part of the United Kingdom's anti-inflation policies, so fiscal measures which offset more than a small proportion of the high deflationary impact of the July measures are unlikely.

the long-term average for those countries (such as Germany) which have brought their inflation and balance of payments problems under control, but somewhat below the corresponding rates in other countries (such as France and Italy).

20. The North American market should expand rapidly through the remainder of 1975 and through 1976. There should still be strong demand for imports from the oil producing countries. Demand from other primary producers is unlikely to grow at all—indeed, if commodity prices continue to fall these markets may contract.

(e) **Prospects for new industry**

21. The world depression has affected, and will continue to affect, the Irish economy by reducing the growth in demand for Irish exports. The depression is also likely to reduce the rate at which domestic and overseas firms set up new plants in Ireland. The IDA has stated that 1975 will be its "most difficult year to date in seeking new industrial projects".* The IDA expects to approve projects in 1975 which would provide 17,000 to 18,000 new jobs when in full production, as compared with its 1975 target of 23,000. Over recent years new job approvals have run as follows†:—

1970–71	1971–72	1972–73	1973–74	1974**	1975‡
12,500	8,700	14,100	23,300	26,400	17,000–18,000

In addition to reducing the number of new job approvals in 1975, the world recession together with the domestic economic situation will almost certainly reduce the number of actual jobs resulting from projects approved in earlier years.

*Annual Report: April-December 1974, IDA, 1975.

†The figures do not show a breakdown between foreign and domestic projects. The projected fall in new job approvals in 1975 reflects falls in both categories.

**Annual equivalent of April/December figures.

‡IDA Estimate.

22. It is unlikely that the situation will show much improvement in 1976. Although there may be some recovery in world output and trade, capacity utilisation is likely to remain low for some time. The incentive to invest in new capacity may therefore be weak in many countries. It will require remarkable successful efforts to safeguard Irish competitiveness, to reduce the rates of increase in Irish pay and prices, and to promote Ireland's attractions as a location for new investment, if the level of new job approvals associated with overseas projects during the remainder of the 1970s is to be restored to 1973-74 levels.

(f) **Prospects for Irish import prices**

23. With commodity prices falling and inflation slowing down in most industrialised countries, Irish import prices decelerated sharply in 1975 (see Table 2). If the United Kingdom measures are reasonably successful, this will bring further moderation in the rate of increase in Irish import prices in 1976, both through the direct effects of slower growth in the prices of UK products and through less depreciation of the sterling exchange rate. There is, of course, some danger of further depreciation in sterling, either to correct for any deterioration in the competitive position, which has not already been offset by recent changes in the exchange rate, or to offset the further deterioration likely over the period of adjustment to inflation rates obtaining elsewhere (a process which, even on optimistic assumptions, could take some years). Assuming that sterling depreciates only slightly (for example, by about 5 per cent between the Autumn of 1975 and the end of 1976) the increase in the prices of Irish merchandise imports could be 12 to 14 per cent over the same period. Since there is generally some lag between changes in import prices and changes in consumer prices, the main effect of the sharp deceleration of import prices between 1974 and 1975 will not be felt at the consumer level until 1976.

(g) **Summary**

24. The developed nations will probably emerge gradually from the depression over the next couple of years. The recovery will be led by the United States, Germany and the other countries which, since the oil crisis, sacrificed employment in order to control inflation. Other

countries which attempted to maintain employment (especially the smaller countries) will have to bring their rates of inflation down to those now being achieved by the largest economies—probably at the cost of further increases in unemployment. Countries still with inflation problems (e.g. the United Kingdom) may have to maintain or introduce restrictive policies, with considerable further loss of employment.

25. These prospects are by no means favourable to Ireland. At best, the outlook is for weak growth of export markets, and a sluggish inflow of new industrial projects from overseas. Some further deceleration in the rate of increase in import prices may provide some consolation.

CHAPTER 2

THE IRISH ECONOMY IN 1975

(a) Outline of developments in 1975

26. In 1975, output will probably fall by at least 3 per cent in real terms (see Table 3). The fall in national output was the main cause of the reduction in the volume of imports, which was principally responsible for an improvement in the balance of payments. Though the actual current external deficit may be reduced by the recession to less that £100 million, the underlying external deficit will still be very large. Unemployment is likely to be in the range 120,000 to 125,000 by the end of 1975, and this could mean a March 1976 peak of 130,000 or more. Employment opportunities between now and the end of the year will be noticeably less than in previous years for school leavers. Prices on average are likely to be more than 20 per cent higher than in 1974. The public sector borrowing requirement will be about 14 per cent of GNP—the next highest in the EEC is the UK with 7 per cent. Investment in manufacturing industry will be significantly lower than 1974. This has serious implications for output, employment, productivity and exports in 1976 and later years (see Table 3).

27. The main impact of the recession has fallen on output and employment in the industrial sector. Service sector employment and output were relatively little affected by the downturn, though continued growth of public sector employment probably disguises cutbacks in many private sector service activities.

28. Farm incomes in 1975 could be about 30 per cent higher than in 1974. Even if an increase in farm incomes of 30 per cent is achieved this year, *real* farm incomes would still be about 20 per cent lower than in 1973* (see Table 4). Average money incomes of those who

*For a more detailed discussion of developments in agriculture see Appendix A.

TABLE 3

Summary of developments in 1975

	1961 –1971	1973	1974	1975 (1)
Expenditure and output (% changes, volume)				
Private consumption	4	8	–2	–3
Public consumption	5	4	6	1
Gross fixed capital formation	9	15	–3	–7
Final domestic demand	5	8	–2	–3
Total domestic demand	5	9	–2	–8
Exports of goods and services	7	9	1	0
Imports of goods and services	8	18	–4	–12
GNP at market prices	4	5	0	–3
Consumer Prices (% changes)	5	11	17	21–22
Foreign Balance (£ million) (2)	–30	–80	–300	less than –100
Unemployment (Live register average, thousands)	50	70	70	105–110
Output by sector (% change, volume)				
Agriculture	1	1	2	2
Industry	6	12	3	–5
Services	3	6	2	–2
Total (GNP, factor cost)	4	7	2	–3
Employment by Sector (% change)				
Agriculture	–3	–3	–2	–1
Industry	2	2	2	–5
Services	1	1	2	–2
Total	0	1	1	–3

1. Estimates based on those made by ESRI and Central Bank.
2. The foreign balance figure includes net factor income from abroad.

Source: Irish Statistical Bulletin, ESRI, Central Bank.

TABLE 4

Developments in Agriculture

	1974 (CSO Estimate)	1975 Forecast
(£ millions)		
Livestock and livestock products (excluding value of changes in livestock numbers)	542	670
Livestock and livestock products (including value of changes in livestock numbers)	534	642
Crops and turf	100	118
Gross output (including stock changes)	634	760
Farm material input	175	180
Net output	459	580
Expenses less subsidies	98	118
Income in agriculture	361	462
Land annuities	3	3
Wages and salaries	35	40
Farmers' incomes and profits	323	419

remain in employment and receive the full increases under the National Agreements could be more than 30 per cent higher in 1975 than in 1974. Profits (but only when the incomes of the self-employed are included) could be 12 to 15 per cent higher and non-agricultural employee incomes (allowing for those who will not receive the basic increases) 23 to 25 per cent higher in 1975 than in 1974.

(b) How the present position was reached

29. If a country has a balance of payments record that is worse, an output record that is weaker, and an unemployment level that is higher than can easily be explained by short-term external factors beyond its control this implies that its main problem is that it has become uncompetitive.*

*Uncompetitiveness means that with the existing Irish cost of production and at the prices at which exports can be sold and imports bought, the volume of output that it is economic to produce is too low to prevent large increases in unemployment.

30. It is always very difficult to judge the stage at which loss of competitiveness starts to cut sharply into output and employment. Sometimes a country has such a strong competitive position that it can absorb more rapid cost increases than its competitors over a fairly long period without serious effects on economic activity. This may well have been the case in Ireland until the beginning of the 1970's.

31. There is considerable support for the conclusion that Irish industry has been getting less competitive as compared with British industry and that the competitive advantage of four or five years ago has now been completely eroded. This means that additional losses of competitiveness now lead to much larger losses of output and employment than they did previously. In its turn, British industry does not seem to be competitive with that in the rest of the world. This means that Irish industry is even less competitive against most other countries. If Irish industry is uncompetitive, this will have implications for the whole economy. There is no obvious process or pattern of economic development in which sectors other than industry (e.g. the public and other service sectors) could provide the additional sustainable employment that is required, at acceptable living standards and with manageable balance of payments deficits.

32. The evidence that supports the conclusion that competitiveness has been eroded and lost is as follows. *First,* the difficulties encountered in recent years by exporters of manufactured goods. In its annual report for 1974, Córas Tráchtála states: "Too high a proportion of current pay rises is compensation for increases in living costs unmatched by corresponding increases in the production of wealth. This . . . prices our goods out of export markets and the home market . . . Lest anyone be in any doubt about the effects of inflation on export competitiveness it must be stated that Córas Tráchtála's staff have, since the middle of 1974, encountered an increasing number of instances where business has been lost to Ireland because our prices have been too high ".

33. *Second,* the deterioration in the record of industrial exports and the increased share of imports in domestic consumption. The following

figures compare the growth of Irish export markets with the growth of Irish exports, and show the increasing share of the home market for transportable goods taken by competing imports.

Annual average % *Change in volume*	1962 to 1972	1973 to 1975
Growth of export markets	7	2
Growth of exports	8	1
Gain (+), loss (−)	+1	−1

Loss of competitiveness has also brought an increased share of competing imports to the domestic market, meaning less Irish output and employment. The shares of competing imports have run as follows (% home consumption, transportable goods)* :

1962–1971	1972	1973	1974	1975
16·8	21·3	23·7	(24)	(25)

As trade becomes freer, the share of imports would be expected to rise. However, export performance should improve because other countries have been reducing their tariffs against Irish exports. It is the deterioration on both counts (deteriorating performance in export markets and against competing imports) that supports the conclusion that Irish industry has become less competitive.

34. *Third,* at the beginning of 1975 the pound was probably overvalued.† Since then, sterling has depreciated by a few percentage points and UK costs have been rising faster than elsewhere, so the same broad conclusion still holds. At the same time, Irish manufactur-

*The official series do not go beyond 1973; figures for subsequent years are NESC estimates based on much less detailed examination of output and trade figures.

†See *Economic Policy Review,* Department of Applied Economics, University of Cambridge, February 1975, which suggested that sterling would have to be devalued by from 20 to 25 per cent in order to establish a satisfactory UK balance of payments position.

ing industry has been losing any competitive advantage it had against British manufacturing industry. This is illustrated by Table 5, which shows that Irish labour costs in manufacturing industry have been rising faster than those in the United Kingdom. When this happens (assuming that very few manufacturers in Ireland produce goods for which there are not substitutes readily available elsewhere, so that they cannot simply raise their prices and hope to sell the same quantity of goods), then profits are squeezed or disappear. As this happens, manufacturers lose both the incentive and the means to invest and they can no longer keep up with technical innovations in their field, so that their longer-term ability to survive is jeopardised. Others simply cannot cover their costs at the prices available and they go out of business straight away (see Table 5).

TABLE 5

Wage costs per unit of output
(manufacturing industry, 1970=100)

	1965	1970	1972	1974
Ireland				
Output per man-hour	81	100	110	122
Earnings per hour	60	100	133	191
Unit wage costs	74	100	122	156
United Kingdom				
Output per man-hour	83	100	112	118
Earnings per hour	67	100	128	171
Unit wage costs (*a*)	79	100	118	148
Relative Costs				
Irish index as % UK index	94	100	103	105

Source: Review of 1974 and Present Outlook—June 1975; National Institute Economic Review; OECD, Main Economic Indicators.

(c) **How competitiveness was lost**

35. The steps by which the economy has reached its present position can be described briefly. *First,* the 1974 National Agreement, which was substantially negotiated before the full effect of the rise in oil

prices was appreciated, provided for average rates of increases in employee incomes of 18 per cent or more over a twelve-month period, with an escalator provision if consumer prices rose by more than 10 per cent between November 1973 and November 1974. The economic aim of the 1974 Budget, which followed the ratification of the 1974 National Agreement, was "to promote growth and ensure that the economy operates at a level close to full utilisation of capacity". The decision of the Government "to provide a further boost for the economy" in the 1974 Budget was based on the expectation that the major countries would generally act to offset the deflationary impact of the increase in oil prices that occurred towards the end of 1973. The rise in consumer prices during the twelve months following November 1973 was, however, much greater than expected, so that the increase in incomes payable in the early months of 1975 under the escalator clause of the 1974 National Agreement was 10 per cent. By the time this escalator increase was paid, it was clear that concerted action had not been taken by the major trading countries to avoid a world recession.

36. *Second*, in the January 1975 Budget (which preceded the negotiation of the 1975 National Agreement), priority was " given in the Governments approach to present economic problems to maintaining employment and preserving living standards". The Minister for Finance concluded that "the tax adjustments and the allocation of increased funds to stimulate employment, production and demand, qualify this budget for the description 'carefully expansionary' ". The Budget* increased personal allowances and social welfare benefits, increased the indirect taxes on beer, spirits and tobacco, and almost doubled the current budget deficit (from £64 million to £125 million). The direct effect of the December 1974 increase in the excise duty on petrol and the indirect tax increases in the January 1975 Budget was to add 3 percentage points to the increase in the consumer price index.

37. *Third*, the 1975 National Agreement† sought to protect employees' living standards by providing pay increases that would compensate

*Details of the January 1975 Budget are given in Appendix B.
†For details of the 1975 National Agreement, see Appendix B.

for the increase in prices from November 1974. Workers subject to the agreement were eligible for the first phase at varying dates within the period 1 April to 1 June 1975, and for the remaining phases at three-monthly intervals thereafter. The first phase increase of 8 per cent followed closely upon the 10 per cent increase under the escalator clause in the 1974 Agreement.* Of the increase of 8 per cent in pay, 3 percentage points were explained by the indirect tax increases imposed in December 1974 and in the January 1975 Budget. These increases became payable at a time when national output was falling, and gave compensation for increases in indirect taxes against the expressed wishes of the Government.†

38. During 1975, the world recession deepened and the prospect of an upturn in world trade and activity receded into 1976. The recession in external markets reduced the demand for Irish manufactured exports.** At the same time, the continuing rapid rise in domestic costs and prices—as a result of the National Agreements and budgetary measures in 1974 and early 1975 and at rates greater than could be compensated for by the depreciation of sterling—reduced or eliminated the competitiveness of Irish products. For these reasons, the volume of manufactured exports fell through 1975. By raising costs and lowering the profitability of exporting, the Agreements reduced two key employment-creating forces in the economy—exports and private fixed investment.

*In retrospect, an increase of 60 to 65 per cent in basic rates of pay over a two-year period when real income was tending to fall may seem a curious way for a small, trading nation to prepare for, or attempt to ride out, a recession in world trade. It compares with average increases of 35 per cent in other EEC countries, 45 per cent in the UK, and much lower increases elsewhere (see Table 2).

†Paragraph 122 of the White Paper *A National Partnership* stated: "It is also essential that any re-distribution of income through the tax system in order to help the deprived sections of the community, particularly social welfare recipients, is not nullified by the better-off seeking compensation for any additional tax imposed for this purpose." In his January 1975 Budget Statement, the Minister for Finance said: "In particular, it is of vital importance that the rise in the consumer price index resulting from today's tax measures on non-essentials should not be used as a basis for demands for further income increases."

**For the first half of 1975 manufactured goods exports (SITC 5 to 8) were higher than in the corresponding period of 1974 (seasonally adjusted), but the *volume* of these exports was lower.

39. The growing public sector deficit, the increases in agricultural incomes, and the increases in wages and salaries under the 1974 and 1975 National Agreements, were forces working to maintain domestic demand. However, they were not strong enough to offset the effects of the fall in manufactured exports and the tendency for personal savings to rise.* As a result, unemployment continued to rise and national output to fall. The falling levels of output and employment were reflected in a marked reduction in the current external deficit.

40. The path by which the economy reached its present position can be summarised briefly. The 1974 and 1975 Agreements were negotiated and ratified by employers and unions, despite their clearly adverse implications for output, employment and foreign trade. The Agreements raised public expenditure on wages and salaries at a time when the Government wished to increase social security benefits and reduce the burden of personal direct taxes.

41. Recent experience is providing more and more evidence that unless industry remains competitive, expansionary domestic policies cannot replace the lost employment. If industry becomes sufficiently uncompetitive (as is the case now) large numbers of domestic and export orders and of jobs are lost. If fiscal policy is relaxed in an attempt to fill the gap, the public sector deficit, or the balance of payments deficit, or both, will tend to rise so rapidly that they become unmanageably large before the jobs are replaced. By not paying sufficient attention to the competitive position and the ability of export orders to provide employment (at no cost to the Exchequer, since the capacity is already there), and by attempting to substitute domestic demand for overseas demand, the policies of employers, unions and Government contributed to the loss of competitiveness, the rise in unemployment and the massive public sector deficit.

*This increase in personal savings is not peculiar to Ireland. It is not easy to explain satisfactorily why it is occurring. One possible explanation is that the fear of unemployment has led to an unwillingness to incur continuing liabilities—for example, hire purchase commitments. However, these influences must have been offset to some extent by some dissaving by those who have lost their jobs.

(d) **The mid-1975 measures**

42. By the middle of 1975, it was clear that the trends that then seemed established in prices, incomes and unemployment were not acceptable and in any case could not be sustained. In our *Report on Inflation* we pointed out that if the then current trends in Irish costs and prices were to continue, the Government could be forced to deflate or even devalue relative to sterling. Deflation would further depress output and employment: it would succeed in curbing the rate of increase in costs and prices only when unemployment had reached a level that made smaller increases in money incomes acceptable. No one knew how high that level would have to be, or for how long it would have to be maintained, before this happened. Devaluation would merely recognise the fact that real incomes were higher than could be sustained by domestic output and would succeed only if average real incomes were reduced. It would take time to make its effects felt on output and employment and might erode confidence in the Irish currency. If the rate of increase in money incomes could not be kept below that in prices following devaluation, the economy could get into a " vicious circle " of accelerating inflation and a depreciating exchange rate, both being continuously aggravated by erosion of confidence in the country's ability to solve its problems and in its currency.

43. In our *Report on Inflation* we argued that the medium-term target should be to reduce the rate of inflation in Ireland to 3 to 5 percentage points below that occurring in the UK and to keep it there. This would make possible revaluations of the Irish pound relative to sterling, and reduce the impact of British inflation on Irish costs and prices. We therefore recommended measures that would help to create the necessary conditions for an appreciation in the Irish currency. These consisted of a package to achieve a temporary reduction in prices and a slower growth in money incomes, and steps to reduce the rate of increase in money incomes and the public sector borrowing requirement in 1976. Other packages were put forward in June 1975 by the CII and in the ESRI Quarterly Economic Commentary.*

*The proposals in the NESC *Report on Inflation* and those put forward by the CII and the ESRI are summarised in Appendix C.

44. In the June 1975 Budget, the Government's aim was two-fold in nature: priority was "accorded to tackling the problem of inflation and to stimulating economic activity". In that budget, the Minister for Finance removed VAT from clothing, footwear, electricity and all fuel (except road fuels), introduced subsidies on most CIE rates and fares, bread and flour, butter, liquid milk and town gas, introduced (for a twelve-month period) a Premium Employment Programme to encourage re-employment on a full-time basis in manufacturing industry* of workers who had lost their jobs as a result of the recession, and increased public capital expenditure in housing, telephones, industry and agriculture by £27 million. To help finance these measures, a surcharge of 10 per cent was applied to income tax payable by individuals at the rate of 35 per cent and upwards, those employees previously outside the PAYE system (mainly public sector employees) were to be brought into the system, and a limited index-linked savings scheme was announced. In the June 1975 Budget, the current budget deficit for the year, after allowing for reduced buoyancy in revenue and the cost of the measures then introduced, was expected to be £242 million. Exchequer returns suggest that this figure might be exceeded.

45. The Minister asked that "in return for a slowing down of price increases, there should be a corresponding slowing down of income increases . . . .". The essence of the budget measures was that "there should be a tangible step, in the form of a scaling-down of the (1975) National Agreement provisions, towards the easing of inflation, in return for the measures taken by the Government to reduce the cost of living and to boost employment". In the event, the 1975 National Agreement was modified by the removal of the 4 per cent floor and the 5 per cent ceiling in the third and fourth phases.

46. The effects of the June 1975 Budget measures are compared below with the effects of the package outlined in our *Report on Inflation*. It seems likely that over the twelve months from June 1975, the Budget package will have a smaller impact on output and unemployment, on the rates of increase in prices and money incomes, and on public sector borrowing, than the package described in our *Report on*

*This scheme was later extended to agriculture though on different terms.

Inflation. By comparison with what would otherwise have probably happened, the budgetary measures are likely to give temporary support to real employee incomes, whereas the NESC package recognised the need for some reduction. As a result, the main expansionary influence of the former is likely to come from an increase in personal consumption, and not from an increase in export demand.

Estimated Effects by mid-1976

(by comparison with what the situation would otherwise have been)

	Measures adopted*	NESC package
Output (%)	2	2 to 3
Prices (%)	—5	—7
Average incomes (%)†	—3	—10
Unemployment	—17,000	—25,000
Foreign balance (£m)	—25	0
Public sector borrowing (£m, annual rate)	+10	—20
Effects over year to mid-1976		
Public Sector borrowing (£m)	+50	+70

47. When account is taken of the effects in this year of the June 1975 Budget, the economic forecasts for 1975 are not encouraging. Indeed, the estimates of the probable out-turn for 1975 set out in paragraph 26 above rest on assumptions that may err on the side of optimism.

*The Budget calculations include the effects of finance made available by the banks to finance house purchase. The effects of the NESC package exclude the effects of this increase—the increase in public capital expenditure in the NESC package would have required additional borrowing from the banks and it was not clear that the banks could provide this *and* finance for house purchase.

†Those in employment, before allowing for tax and price changes. This is the best measure of the impact on costs and the competitive position.

(e) **Summary**

48. Output will probably fall by at least 3 per cent in 1975. Unemployment has risen in response and will rise further to 130,000 or more by March 1976. The foreign deficit has improved significantly but the public sector deficit has risen very substantially. The world recession was partly to blame, but the situation was made even worse by allowing Irish products to become uncompetitive on world markets. The size of the increases in pay contributed to the uncompetitiveness, and therefore to the fall in output and the increase in unemployment. Domestic demand was substituted for falling foreign demand without enough being done, and done in good enough time, to restore competitiveness.

CHAPTER 3

THE IRISH ECONOMY IN 1976

(a) **The Legacy of 1975**

49. To a significant extent, the economic situation in 1976 will be determined by forces now operating both inside and outside Ireland. The most important of these influences are as follows:

(*a*) The pressures to deflate which are now being felt in other small countries with lower public sector deficits than Ireland will also be present here.*

(*b*) Even if an upturn develops in the outside world, this will not provide significant external support for a rapid expansion of exports. Exports will not rise appreciably because on present trends, the economy will still be uncompetitive. *Without any 1976 Agreement*, the money incomes of those in employment who receive the full increases under the National Agreements will be 15 per cent higher in 1976 than in 1975.

(*c*) The lagged reaction to the fall in output in 1975 will still be pushing up unemployment in Ireland. This will be reinforced by the slowing down in the rates at which new firms are being set up and at which firms recently established are moving towards full production.

(*d*) There will be increasingly severe inequities within the Irish economy. The burden of the recession is falling most heavily on the unemployed. The number of companies going out of business is now running at a much higher level. During next year, an increasingly large number of the unemployed will have been out of work for nine months or more. Their income from social security benefits will then fall (in the absence of policy changes) and their real living standards (and their incomes relative to those still in employment) will fall even further. There will also be additional severe unemployment outside that recorded by the official statistics, notably among women and school leavers.

(*e*) A second source of widespread inequity will be among employees still in employment. Those in secure occupations have got the basic pay increases due under the 1975 National Pay Agreement. By the end of the year as many as 100,000 private sector employees may not have received the full increases. This figure is based on the best information available from trade unions, employers and Government Departments. These employees, many of them in the industrial sector, will suffer two disadvantages—the threat of unemployment, and earnings which have fallen relative to other sections of the community.

*These pressures were discussed in Chapter 1.

(b) **Policy Priorities**

50. The Government, employers and trade unions have all clearly indicated that the main policy goal must be to minimise unemployment. Not only is unemployment at present levels an enormous waste of national resources which the country can ill afford, but it is also creating social stresses and unwarranted hardship. The economy is not suffering from excess demand, nor would large reductions in unemployment create excess demand. There is, therefore, no reason to believe that the reduction of unemployment would make inflation, or other policy problems, more difficult to solve.

51. Significant or lasting reductions in unemployment cannot be achieved by reflationary policies alone, for two main reasons. First, the public sector borrowing requirement would be increased* by such policies and would become unmanageable before the desired reduction in unemployment was achieved. Second, as has already been

*This increase would be a lasting increase. It would not be the sort of temporary increase we suggested in our *Report on Inflation,* designed to offset cuts in living standards caused by pay restraint. These temporary increases would have been offset by the beneficial revenue effects of increased output and employment in export industries.

stated, the substitution of domestic demand for the foreign demand lost by uncompetitiveness is no basis for a sound recovery in employment. In a small open economy such as Ireland, a pre-condition for effecting a significant reduction in unemployment is an improvement in industrial competitiveness.

(c) Prospects with no policy changes—first option

52. Given the legacy of 1975, the outlook for the Irish economy in 1976 will depend mainly on the following:

(*a*) what happens in the world outside Ireland, and especially in Britain;

(*b*) the terms of the 1976 National Agreement—or of the settlements which are negotiated if there is no Agreement;

(*c*) economic policy in Ireland—especially whether or not measures are introduced to influence the rate of growth in money incomes and to reduce public sector borrowing.

To get a clearer picture of what could happen in 1976, it is necessary to make specific assumptions about (*a*), (*b*) and (*c*) above.

53. No Irish agency can materially influence what happens to the world economy. At this stage, it seems probable that an upturn in world trade and activity could occur during 1976, but most likely in the latter half of the year. It also seems possible that the upswing will be weaker and will develop at a slower pace than that which occurred in 1971/73.

54. The main external influence on the Irish economy is what happens in Britain. Measures have been introduced in Britain—mainly, a limit of £6 per week on increases in earned incomes, with no increases for incomes of £8,500 p.a. or more—with the aim of reducing the rate of increase in prices to 10 per cent by the end of 1976. In considering what policies would be appropriate for Ireland in 1976, it would be prudent to assume that the British measures will be largely,

if not wholly, successful. If Irish policies are based on this assumption, and if the British measures do not succeed, the relative competitiveness of Irish products will deteriorate less rapidly or improve. If Irish policies were based on the assumption that British policies would not be successful, and if in the event they were, a further and rapid deterioration in the economic situation here would be unavoidable.

55. Given the assumptions about what will happen in 1975 in Britain and the world in general, the economic situation in Ireland will depend mainly on what happens to money incomes and on what economic policies are applied. In the remainder of this chapter, a number of options are discussed.

56. The first option is what would happen in 1976 if there were no policy changes. In this option, it is assumed that if there is any general increase in pay, it will continue the terms of the revised 1975 National Agreement (namely, simple indexation), and that there will be no change in tax-rates or in the volume of public current and capital expenditures. This latter means that there would be no change in the number employed in the public sector and that existing services (including social services) would be maintained in real terms at their 1975 levels. In addition, it is assumed that social security benefits will be raised in line with prices and that the parity between the Irish pound and sterling will be maintained.

57. The consequences of these assumptions can be sketched in broad terms. Money incomes and prices would both rise at slower rates than in 1975 but at rates faster than those likely to obtain in the British economy in 1976. Consumer prices could be 15 per cent or more higher than in 1975. There would be little (if any) growth in national output. Given the maintenance of parity between the Irish pound and sterling, and even allowing for some further depreciation of the latter, a further deterioration in the competitiveness of Irish products would occur. The economy would benefit only to a limited extent, if at all, from the upturn in world trade and activity in 1976. Unemployment would be likely to rise further and would approach 140,000 by the end of 1976. Any balance of payments deficit would be small and there would be little difficulty in financing it.

58. The continuing depression in the economy would further reduce the buoyancy of revenue. This, together with the assumption made about Government expenditures, would mean a continuing increase in public sector borrowing. The payment of interest and the repayment of the principal for the large and mainly short-term public borrowings in 1974 and 1975 would be making a significant contribution to the growth in the overall public sector deficit. The growth in unemployment and the pressure to extend full employment benefit beyond nine months would make further additions to the deficit. For these reasons, the public sector borrowing requirement could be even higher in 1976 than in 1975.

59. This first possibility would pose serious economic problems in 1976 and 1977. For example, the financing of the public sector borrowing requirement by external loans would be very difficult, if not impossible. Perhaps as much as one-fifth of employees in the private sector (including large numbers who are not members of trade unions) may not receive all phases of the 1974 and 1975 Agreements in full. This would upset the customary pay differentials and relativities. Any tendency for private industry to benefit from the upturn in the world economy could therefore be quickly stifled by demands that the customary relationships should be restored. More important, the further deterioration in the economic situation and the continued rise in unemployment could threaten political stability in 1976.

60. The budgetary and pay assumptions underlying this first option—and especially those relating to the attempt to maintain real incomes by indexation and the payment of the increases under the National Agreement to all public sector employees without loss of employment—seem to reflect widely held attitudes. If these assumptions turn out to be true, the economic prospects for 1976 are bleak and the prolongation of the economic depression in Ireland into 1977 and 1978 is probably unavoidable. The possibility of improvement would arise only when the depression, by a process of attrition, had brought about a reduction in real incomes sufficient to restore competitiveness.

(d) **Prospects with pay restraint—second option**

61. Industrial competitiveness can be improved if pay rises more slowly than in competing countries. Indeed, Ireland is such a very

small part of the world economy that there is no reason why there should be large increases in unemployment—no matter what happens in overseas markets—if rates of pay are such as to keep Irish products competitive, because the volume of Irish exports could always be maintained. The greater the restraint in increases in money incomes, the quicker can unemployment be reduced. Pay restraint is therefore the second policy option which is examined.

62. Pay restraint might be effected by allowing much smaller percentage increases in pay than had occurred in prices. With restraint, price increases would continue in 1976 as a result of pay increases in 1975 and of any increases which occurred in import and food prices. Pay restraint would therefore mean reductions in the real income of employees who kept their jobs, but increases for those who would otherwise have been unemployed.

63. By reducing costs (or the rate of increase in them), pay restraint would make Irish prices more competitive. Restraint should be applied as soon as possible, because pay in other countries has for some time been rising much slower than in Ireland. A month or two could elapse before the effects worked through to ex-factory prices, and perhaps three to four months before they were reflected in the behaviour of retail prices. The effects on the volume of manufactured exports might not be visible until the end of the third quarter of 1976. For some products, the restraint might not have restored competitiveness in international markets until the fourth quarter of 1976 or even later.

64. If no offsetting measures were introduced, the initial effects of the pay restraint could be a fall in domestic demand and a further increase in unemployment. Thereafter, as the effects worked through to export prices, the volume of manufactured exports would start rising and output and employment would increase. By the first half of 1977, unemployment could probably be reduced to the level which obtained at the beginning of 1976, and it should continue to fall thereafter if the upswing in the world economy was maintained. This would make possible some relaxation during 1977.

65. A sufficient degree of restraint would do more than improve competitiveness and raise employment. It could help to bring about a situation in which Ireland could reach full employment with a manageable balance of payments position. It would, as exports and employment picked up, help to improve the public finances. It would help to remove the most rapidly growing source of inequity in Irish society—the maintenance of the living standards of those in employment by forcing more people into unemployment at greatly reduced living standards. By strengthening the industrial sector and industrial profits, and by moderating the increase in agricultural costs, it would encourage the investment that is needed in new machinery and jobs and also allow industrial employees greater equality with those in more secure (and now better paid) employment.

66. There would, however, be difficulties. Ideally, restraint on the part of those in employment should be based on consent. It could, but need not, mean some temporary deflation of domestic demand. Even without any reflationary measures, this deflation would be temporary because higher employment as a result of rising exports would soon offset the lower real expenditure of those now in employment. While this readjustment would involve lesser problems than no attempt to readjust, very careful management of domestic demand (perhaps involving changes in expenditure and tax plans) would be required to avoid a cumulative deflation of demand.

67. If pay restraint is forthcoming, every effort should be made by the Government to reflate demand within the constraints on Government borrowing. In any reflationary measures, the emphasis should be placed on increasing productive capital expenditures rather than on raising current expenditures. Such emphasis would expand production capacity, remove the risk of the unemployed beginning to feel unemployable, and help to regenerate business confidence.

(e) **Deflation—the third option**

68. Deflation could be used to restore competitiveness.* Deflation means cutting government expenditure and/or raising tax revenues.

*A policy of deflation might also become necessary if the Government were forced to reduce public sector borrowing.

The inevitable result would be higher unemployment. Increases in tax rates would reduce private disposable incomes and reduce private expenditures on domestic goods and imports. Government expenditure could be cut (or prevented from rising as fast as it otherwise would) by limiting the growth in public service salaries (for example, by the Government pleading inability to pay the full increases), by reducing the numbers whose employment is financed by the Exchequer, by reducing or curbing the growth in social services such as education, health, housing and income maintenance, or by setting limits to the deficits of public enterprises. The deflationary impact will vary with the taxes that are raised and with the particular expenditures that are reduced.

69. Given existing institutions and attitudes, the initial reaction to an increase in tax rates might be demands for larger increases in money incomes. Moreover, social tensions would be created because the main brunt of the increased unemployment would be borne by employees in the private sector. In these circumstances, it is not possible to predict how strong the deflation would have to be, or for how long it would have to be maintained, before employees were induced to accept the smaller increases in money incomes that would be required to restore competitiveness. However, it seems probable that the deflation might have to be severe and protracted before this happened. To the extent that this did not happen, the brunt of the cut in real incomes would have to be borne by the old, the disadvantaged and the unemployed—that is, those least able to bear the burden.

70. The aim of a deflationary policy is to reduce excess demand in the economy, raise unemployment, and lower the rate of pay increase by weakening the bargaining power of the trade unions. There can be little doubt that deflation works if pursued with sufficient vigour and for sufficiently long.* However in our view, the competitive position could be restored, and restored more quickly, by pay restraint within the framework of a new National Agreement. This would avoid an even greater part of the adjustment to a satisfactory competitive position being borne by disruptions to economic activity, the unrest and

*Indeed, the inclusion of the "inability to pay" clause in the last National Pay Agreement was a recognition by the three parties of the importance of market forces in determining pay.

the broadening of income differentials which might well result from deflation, the abandonment of National Agreements and a return to a "free-for-all".*

(f) **Devaluation—a fourth option**

71. With the first option discussed above—which may be epitomised as "doing nothing and letting events take their course"—unemployment will rise and the domestic depression will deepen until reductions in real incomes that are big enough to restore competitiveness become acceptable. That might not happen until 1977 or 1978. With the third option—deflation—the process might be speeded up and competitiveness restored by the beginning of 1977. With the second option—pay restraint—the process of establishing the preconditions for renewed growth in the economy would be further speeded up. The difference between the three options so far discussed lies mainly in the length of time that would elapse before the essential basis for the improvement was established.

72. A fourth option would be a devaluation of the Irish pound relative to sterling, in order to restore competitiveness. Devaluation would be the "textbook" means of achieving a rapid reduction in export prices (in terms of foreign currencies) and/or increased profit margins and the associated favourable effects on employment.

73. However, a devaluation would have a number of serious disadvantages. For example, it would raise domestic prices, making the inflation problem more difficult to solve. This is in clear contrast to the option of pay restraint, which would help both unemployment and prices. The inevitable price increases might lead to income rises so great that the advantage of devaluation was lost. If a devaluation is to succeed, therefore, it would require agreements on income developments as difficult to achieve as straightforward pay restraint. The fact that it was not possible to restrain the growth in money incomes that caused the devaluation would provide no grounds for confidence that policies would be applied to restrain the growth in money incomes after the devaluation to make it successful. Devaluation of the Irish

*It is a curious requirement of deflationary policies that they require much greater numbers of people to be unemployed for a much longer time than do alternative arrangements aimed at restoring competitiveness and, hence, employment.

pound would add another complication to the relationship between the Republic and Northern Ireland. This would be regrettable.
Agricultural exports would not benefit from a devaluation of the Irish pound (unless accompanied by an offsetting adjustment in monetary compensatory amounts).

74. To sum up, while devaluation would be the textbook answer to many current Irish economic problems, these problems could be solved in other ways which are less unpalatable and less risky, and which in any case would be a necessary part of the strategy required to make a devaluation successful.

(g) **Another possibility—import controls**

75. Both trade unions and employer organisations have argued that some form of import controls would help solve at least some of the present economic problems. Import controls would reduce the share of imports on the domestic market, and therefore increase employment in industries producing for the domestic market. In achieving these aims, they would work faster than other policies—such as pay restraint, deflation or devaluation—which have the same objective of raising employment. In theory, import controls might achieve these aims without the adverse movements in the terms of trade (that is, a rise in import prices relative to export prices) that is associated with these other policies.

76. However, in Irish circumstances the arguments against general import controls are overwhelming. Such controls might provoke retaliatory action, and thus cut off markets for Irish exports. They would be contrary to the rules of the GATT and the EEC. Given the small size of the Irish economy, their effects would be limited—they would not make exports more competitive and could give no assistance to most Irish export industries. If nonetheless applied, they would featherbed inefficient Irish industries, and deny the Irish consumer access to the wide range of goods available on the world market. In the sort of economy that would emerge, income levels would be low relative to those experienced in the recent past and in comparison to current expectations.

77. The aim for a small economy like Ireland must be to have free access to other markets for exports and for the imported goods that

consumers want. To the extent that import controls can be used without undue cost to the Irish consumer or disruption of existing trading arrangements—and this limits their coverage to selective controls or action to stop dumping—they should be used. But within these limits their contribution towards a solution of the *general* problems now facing the Irish economy would be trivial. The costs of adjusting to the sort of society implied by the use of general import controls would be far greater than the costs of dealing with the real problem—namely, restoring competitiveness.

(h) **Summary and Conclusions**

78. In 1975, the world recession reduced Irish exports, output and employment. Pay increases were so large as compared to those in other countries, that without offsetting improvements in marketing, management and productivity, the economy became uncompetitive on world markets. Unless competitiveness is restored, it will not be possible to maintain employment and there will be no hope of creating the new jobs required by a growing population.

79. If nothing is done (i.e. if pay continues to be fully linked to prices and Government policies remain unchanged) the situation will deteriorate further. The main symptoms of the deterioration will be higher unemployment and greater inequities within the labour force, with those in secure employment doing well relative to those in activities subject to external competition and relative to the unemployed.

80. This prospect is clearly unsatisfactory. Other policy options must therefore be examined. In our view, import controls, devaluation and deflation would not be satisfactory policies. The only alternative is income restraint. If competitiveness is to be restored, pay restraint means increases in the average incomes of those in employment that are smaller than those occurring in other countries, and this in turn means percentage pay increases that are less than the anticipated percentage increase in prices.

81. Voluntary income restraint in the form of a new National Pay Agreement would be preferable to statutory measures. The kind of new Agreement which is required must not be divorced from the general economic situation, or more specifically, from decisions on fiscal and monetary policy.*

*As was the case, to nations cost in 1974 and 1975.

82. Restraint of incomes in order to improve competitiveness would raise industrial profits, and this may not have widespread appeal. But industrial profits must be earned in sufficient quantity to ensure future investment and jobs. These profits are not generally earned at present in the sectors of Irish industry which are exposed to external competition from imports or which rely on exports, nor will they be earned unless there is pay restraint.

83. One reason why many find it difficult to accept the need for higher industrial profits may be that the distinction between the need for these profits and the ownership, control and use of them is often not drawn sufficiently clearly. This distinction will not be clear until there is a broader measure of agreement about such things as:

(*a*) the extent to which workers should be involved in management;

(*b*) the degree to which profits in the private non-industrial sector should be taxed;

(*c*) the degree to which the state might participate in the generation and ownership of profits, either as a shareholder or as an entrepreneur.*

84. If suitable arrangements can be made, the distribution between wages and profits need not be the source of the severe conflict which tradition might suggest. It must be remembered that there are other and growing sources of strain—between employed and unemployed, and between industry and the rest of the economy. Proposals for pay restraint cannot ignore the conflicting interests of these groups.

85. The greater the restraint on pay, the greater the positive effects on employment over the longer run. However, there could be temporary short-run deflationary effects. If pay is restrained, these effects must be examined closely, along with the role which fiscal policy can play in countering the deflationary effects on aggregate real incomes and employment within the constraints of the public sector borrowing and balance of payments position. In any reflationary action which is taken, the emphasis should be on raising productive capital expenditure rather than current expenditures.

*Considering the weakness of the domestically-owned industrial sector, there is no reason to think that there is not room for both the encouragement of private industry and much more public sector participation in activities normally thought of as private sector activities. There is also room for reflection on how national savings, be they State-controlled or privately controlled, can best be channelled into Irish-owned industry—again public or private.

APPENDIX A

DEVELOPMENTS IN AGRICULTURE

1974 was an extremely difficult year for farming. While the value of agricultural output remained close to its 1973 level, the effect of the very large increases in costs during the year meant that agricultural incomes decreased dramatically from the previous year's level.

The gross value of agricultural output for 1974 has been estimated at £631 million, which is a small increase over that for the previous year. The volume of output of cattle increased substantially but the average unit value declined. Creamery milk production declined by about 6 per cent though milk prices were higher than in 1973. The December 1974 census showed a drop of 2 per cent in the number of cows and a drop of 13 per cent in the number of heifers in calf relative to the levels in December 1973.

The pig industry also went through a very difficult period. The breeding herd was down 24 per cent in December 1974 over a year earlier, though there were indications that numbers were increasing again at the turn of the year. Sheep numbers continued to decline. Poultry and egg producers were caught between depressed market conditions and escalating feed bills and poultry numbers were down 10 per cent on a year earlier. In the tillage sector, acreage of potatoes, sugar beet and wheat all declined, while barley only showed a marginal increase. Though yields were good the conditions at harvest were the most difficult for many years and most of the wheat crop was declared unmillable.

Total farm incomes decreased by about 11½ per cent from their 1973 level of £364 million, to an estimated £323 million in 1974. When the rate of inflation of 17 per cent during 1974 is taken into account, farm incomes in fact fell by 24 per cent in real terms in 1974 as compared with 1973. Some sectors of farming were much more heavily hit than others—in particular producers of small store cattle.

In Table 4 an attempt is made to give a picture of the possible outturn in agriculture in 1975. Both the volume and the unit value of cattle output should increase substantially in 1975, but a sizeable reduction in inventory is expected during the year. Creamery milk output should increase by about 6 per cent. The volume of output of both sheep and pigs should be lower than for 1974. On the crops side, sugar beet is the only crop where a reasonable volume increase could be expected. The total cost of farm materials will increase only slightly over its 1974 level; the price increase being almost totally cancelled by the volume decrease. The other expenses in agriculture are expected to increase in price terms by the inflation rate, and a slight volume reduction is expected. The broad conclusion seems to be that farm incomes could increase by about 30 per cent this year. The real reduction in farm incomes in 1974 will not be corrected in 1975. 1973 was the only recent year when the relationship between farmers' incomes and those of non-farmers was judged satisfactory by agriculturists. However, between 1973 and 1975 farm incomes have declined by about 20 per cent in real terms. On the other hand, income levels in agriculture would have been substantially lower if Ireland were not a member of the EEC.

Looking to the future, some recovery could be expected in some of the major markets, particularly beef, in 1976 and 1977. Against this, while inflation in Ireland continues at a higher rate than for the EEC as a whole, price increases from Brussels will not fully compensate for cost increases incurred by Irish farmers. The consequence of this would be continued downward pressure on farm incomes.

APPENDIX B

SUMMARIES OF JANUARY 1975 BUDGET AND 1975 NATIONAL PAY AGREEMENT

The Budget

The Budget was presented against a background of an opening position on current account in 1975 which showed little change from the 1974 outturn. The public capital programme for 1975 showed no growth in real terms and its composition suggested a fall in real expenditure on building and construction—that part of the programme with the most direct and immediate effects on Irish output and employment, but also the part where costs have risen fastest. The policy changes announced in the budget included extra provision for public current expenditure in 1974 of about £73 million, mainly through additional provision for public service pay and increased social welfare benefits. These expenditure increases were slightly offset by net increases in revenue, estimated at £11 million in 1975, increased personal and company tax allowances being more than offset by increased indirect taxation on non-essentials (mainly tobacco and alcohol). These increases in indirect taxation were in addition to higher petrol taxes introduced in December, estimated to bring in an extra £27 million. Although the expressed wish of the Government was that these indirect tax increases should not be compensated for in income increases, their total *direct and indirect* effect added about 4 per cent to the consumer price level and to rates of pay. The table below summarises the main changes.

Revenue (£ million)			*Expenditure (£ million)*		
Opening estimate		1,115	Opening estimate		1,170
Beer, tobacco etc.	+32		Public Sector pay	+40	
Other indirect tax	+7		Social welfare	+35	
Personal tax relief	−10		Other	+4	
Company tax relief	−12		Departmental balance	−6	
Change		+11	Change		+73
Total		1,126	Total		1,252
Deficit		125			
Total expenditure		1,252			1,252

The 1975 National Pay Agreement

The Agreement, which was negotiated after the January 1975 Budget, provided for growth in pre-tax incomes broadly in line with prices. There were four phases, the first giving an 8 per cent pay rise (the increase in the consumer price index between November 1974 and February 1975). The next three instalments were to be paid at quarterly intervals, their size again linked to the increase in consumer prices, but with each increase subject to a 4 per cent minimum and a 5 per cent maximum. There was provision for discussions on a final threshold increase at the close of the agreement to compensate for any increase in the consumer price index in the year to November 1975 in excess of 23 per cent, the possible threshold increase giving 1 per cent in additional pay for each additional 1 per cent rise in the consumer price index, subject to a maximum threshold increase of 3 per cent.

APPENDIX C

SUMMARY OF PROPOSALS AND MEASURES ADOPTED IN MID-1975

(i) **Measures adopted in June 1975 Budget**

(*a*) Indirect tax and subsidy changes designed to bring an immediate reduction of 4 per cent in the consumer index.

(*b*) 10 per cent surcharge on personal income tax liabilities in 1975 in the 35 per cent range and above.

(*c*) Announcement of extension of PAYE (no action yet).

(*d*) £27 million extra public capital expenditure in 1975.

(*e*) £40 million made available for housing finance over two years by the commercial banks.

(*f*) Employment premium payable to certain employers as they increase their labour force.

Following the budget, the floor and ceiling were removed from the terms of the 1975 National Pay Agreement as applicable to the third and fourth phases.

(ii) **NESC: Report on Inflation**

(*a*) Reduction in indirect taxation along the lines adopted.

(*b*) Increases in direct personal taxation as adopted.

(*c*) Non-payment of the second phase of the 1975 Agreement.

(*d*) Much greater increases in public capital expenditure than undertaken. (But the revised current budget deficit **was** far greater than assumed in the NESC Report).

(*e*) Further changes in direct taxation in exchange for smaller pay increases later in the year.

(iii) **ESRI: Quarterly Economic Commentary, June 1975**

(*a*) An incomes freeze until employment began to increase.

(*b*) Increased public capital expenditure to counteract any deflationary effect of the freeze.

Of all the packages proposed, this would have had the greatest impact on the competitive position and the maximum beneficial effect on employment. In drawing up the NESC package, it was felt that it would be difficult to raise capital expenditure sufficiently rapidly to achieve the desired effects, so a combination of smaller capital expenditure increases and indirect tax cuts were proposed to offset any deflationary effects of lower pay and higher taxes. The net effect on incomes over the remaining span of the 1975 National Pay Agreement would not have been very different.

(iv) **Confederation of Irish Industry**

(*a*) Indexation clauses to cover only 90 per cent of price increases.

(*b*) This 90 per cent to be reduced by a proportion sufficient to offset additions to the pay bill from anomaly settlements, moves towards equal pay, and other special provisions.

(*c*) Non-payment of the second phase of the 1975 Agreement.

(*d*) Indexation of tax allowances and tax thresholds.

(*e*) Indexation of social welfare benefits.

(*f*) Short-term provision of finance for private housing along the lines adopted.

These measures were designed as part of a package which was to solve inflation by reductions in demand pressures, brought about by eliminating the public sector deficit, reducing domestic demand by 4 to 5 per cent and increasing output for export by 6 per cent over a three year period. It was felt that these changes would eliminate the 6 per cent excess demand understood from statements by the Minister for Finance to be present in the economy. Changes in the exchange rate were ruled out. However, it is doubtful whether the implied transfer of resources to exports could have been achieved over the period without the additional measure of a substantial devaluation, which would have necessitated unspecified deflation to reduce domestic demand.

RESERVATION BY IRISH CONGRESS OF TRADE UNIONS

The ICTU representatives cannot commit themselves to any view on this Report or on its implications, and must therefore reserve their position.

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