CHAPTER 8

Industrial Policy

INDUSTRIAL POLICY

1. INTRODUCTION

The prospects for sustained employment growth in Ireland in the years ahead will be critically influenced by the rate of manufacturing output growth, the structure of that growth and the extent of linkage with the rest of the domestic economy. In 1992, there were 223,000 people directly employed in manufacturing industry, representing 19.8% of total employment.[56] In addition to this direct employment effect, the manufacturing sector generates a substantial number of indirect jobs in other areas of the economy, particularly in services. Estimates prepared by O'Malley (1993) suggest that something of the order of 172,000 non-manufacturing jobs in 1990 were supported to a significant degree by manufacturing industry. The future of all of these jobs, and the scope for further increases in the overall employment impact of manufacturing activity will depend on the pace and pattern of future industrial development.

The development of the manufacturing sector depends on many factors, including macro-economic policy, physical infrastructure, education and training, and incomes policies. The importance of these broader influences on industrial development highlights the need to ensure consistency across different areas of Government policy. It does not however, rule out a role for active measures focused on the traditional instruments of industrial policy. On the contrary, the Council has consistently argued that the Irish economy displays structural characteristics which require specifically focused developmental policies. These structural characteristics include the small size of the domestic market which requires firms to begin exporting from the earliest stages of development, the distance from large and concentrated centres of population, Ireland's technological backwardness relative to the more advanced economies of North America, Europe and Japan, and the lack of any strong capacity for innovation in Ireland.[57] The Irish economy must also face the challenges of a much faster rate of technological change, greater internationalisation of economic activity and the completion of the internal European market.

56 1992 Labour Force Survey Data (provisional figures).

57 The weakness of Ireland's national system of innovation and its implications for competitive performance are discussed in Chapter 4 of this Report.

Over the past two years Irish industrial policy has been the subject of a detailed review.[58] Many of the priorities identified as part of that review process echo themes which were first set out by the Council in the early 1980s.[59] These include:

- The need to give greater priority to the development of indigenous industry;
- The need to focus state assistance on removing specific barriers to growth. In this context, a continued shift in financial assistance away from fixed asset expenditure towards "softer" areas such as marketing, management, product development and skill development is required;
- The desirability of broadening the range of financial support provided by the State, to include not just cash grants, but also (and, in part, replaced by) loans, loan guarantees and the provision of state equity.

Section 2 of this chapter provides a brief overview of manufacturing performance, highlighting the strengths and weaknesses of the manufacturing sector. Section 3 considers the issues to be addressed in strengthening Ireland's industrial base, looking first at the development of indigenous industry and moving on to consider the role played by overseas investment in an overall strategy for endogenous development. The chapter concludes with a discussion of the priorities for policy reform.

2. REVIEW OF MANUFACTURING PERFORMANCE

Much of the performance of Ireland's manufacturing sector is impressive: for the past two decades the growth of manufacturing output and exports has consistently been among the fastest in the OECD. Moreover, while manufacturing employment fell in Ireland during the 1980s, the rate of decline was less than was experienced in many other countries and the overall trend in manufacturing employment, particularly since 1987, compares favourably with general international experience. These positive features are, however, accompanied by, and in many instances inextricably linked to, a number of more worrying characteristics: chief among these are the interconnected concerns about the "dualism" of industrial development in Ireland, the failure of indigenous industry to develop, and the low level of linkage between growth in the manufacturing sector and development in the wider economy.

58 See Culliton (1992), Moriarty (1993).

59 See, in particular, NESC Report No. 66 (1982) and associated Reports (No's 64 and 59).

Table 8.1 shows that during the period 1980-1991 the rate of outpı in Irish manufacturing industry (6.6% per annum) was the faste OECD. This rapid output growth was accompanied by an even fasl productivity growth (8.0% per annum), so that employment manufacturing industry fell by an average of 1.4% per annum over tl This decline, while not exceptional by international standa disappointing given Ireland's very strong output performance. It the exceptionally strong productivity growth in Irish manufacturing during the 1980s and the fall in employment in labour-intensive sect of which were going through a period of adaption, while others prolonged decline.

TABLE 8.1

Average Annual Growth Rates Of Manufacturing Outp Employment And Productivity, OECD Countries. 1980 - 1991 % Change per Annum

	Manufacturing Output (Vol)	Manufacturing Employment	Outpı Empl
USA	2.9	-1.3	4.
CAN	1.0	-1.2	2.
JAP	4.2	1.3	2.
GER	2.3	-0.6	2.
FR	0.7	-1.7	2.
ITALY	0.9	-1.2	2.
UK	1.4	-3.0	4.
AUSTRL	1.1	-0.9	2.
NL	2.4	-0.9	3.
BEL	1.8	N.A	N.
DEN	2.8	-0.5	3.
NOR	0.8	-2.5	3.
SWED	0.7	-2.1	2.
FIN	1.5	-2.0	3.
IRL	**6.6**	**-1.4**	**8.**
OECD	**2.5**	**-0.9**	**3.**

Source: OECD, Industrial Policy in OECD countries, Annual Review 1992.

TABLE 8.2

Changing Structure Of Output In Ireland's Manufacturing Sector
Composition Of Gross Value Added
1980 -1990

	1980	1990
HIGH-TECH	**19.6**	**38.7**
Pharm.	6.3	14.0
O + DP	4.8	10.4
Elect. Engineering	5.7	9.6
Instr. Engineering	2.8	4.7
MEDIUM-TECH	**17.5**	**11.6**
Prelim. Metal Proc.	0.8	0.6
Chemicals (excl. Pharm)	6.5	4.4
Mech. Engineering	2.5	2.2
Motor Vehicles	2.5	0.4
Other Transport	1.0	0.5
Misc. Inds.	4.2	3.5
LOW-TECH	**62.9**	**49.7**
Non-Metallic Minerals	6.8	4.5
Metal Articles	4.3	2.3
Food, Drink & Tobacco	38.0	33.4
Textiles	3.7	2.2
Clothing, Footwear & Leather	3.4	1.7
Timber & Wooden Furniture	1.4	1.2
Paper & Printing	5.3	4.4
Total Mfg. Ind.[1]	**100.0**	**100.0**

1 Totals may not sum to 100 due to rounding.

Note: Data relate to industrial enterprises employing 20 or more persons. Gross value added is measured at market prices.

Source: Census of Industrial Production 1990, Appendix 4, Enterprise Survey Results.

The causes of rapid productivity growth in Irish manufacturing industry were analysed in detail in a recent Council report.[60] The analysis showed that the high rate of productivity growth in the manufacturing sector was inextricably bound-up with the nature of manufacturing output growth in Ireland. Two features in particular were identified as contributing towards rapid productivity growth: (i) changes in the structure of manufacturing output, and (ii) the effects of transfer pricing. Both of these are intimately related to the growth of overseas owned industry in Ireland, as will be discussed below.

Table 8.2 shows that the structure of Irish manufacturing output has changed dramatically since 1980. Between 1980 and 1990, the proportion of manufacturing value-added arising in the high-tech sectors (pharmaceuticals, office and data processing, instrument and electrical engineering) almost doubled, rising from 20% to 39%. Productivity levels in high-tech industry in 1990 were over twice that of the low-tech sectors, and the gap between the three categories of industry has widened significantly over time. The compositional changes shown in Table 8.2 are indicative of a rapid shift in Irish manufacturing output, from low productivity to very high productivity sectors. This structural shift has, of itself, contributed significantly to the growth in overall productivity in the sector.

The impact of structural change on productivity growth has been greater in Ireland than in other countries. This is because (a) the *extent* of structural change experienced in Ireland far exceeds that which has occurred elsewhere in Europe and (b) the *gap in productivity levels* between high-tech and low-tech industries is exceptionally wide in Ireland, thereby accentuating the impact of any given change in structure. Both of these characteristics are exaggerated by transfer pricing practices.[61] Even without transfer pricing however, the extent of structural change in Irish manufacturing industry and the divergence in productivity levels across the different sectors of industry would remain very high by the standards of other developed economies. This reflects the fundamental nature of Irish manufacturing growth.

Changes in the structure of manufacturing employment provide a more reliable indicator of the pace of structural change than changes in the composition of net output. Unlike net output, employment data are not subject to the distorting effects of transfer pricing. Table 8.2 confirms that the extent of change in manufacturing employment shares in the 1980s was

60 NESC Report No. 94. *The Association Between Economic Growth and Employment Growth in Ireland.*

61 See NESC Report No. 94 for a detailed discussion of the impact of transfer pricing on productivity growth in the Irish manufacturing sector.

significantly greater in Ireland than in other EC countries. High-tech industries increased their share of manufacturing employment in Ireland by 9.4 percentage points between 1980 and 1988, compared with about 2 percentage points in most other countries.

TABLE 8.3

Changing Structure of EC Manufacturing Industry
Change in Employment Shares, 1980 - 1988
Percentage Points

Sector[1]	BEL	DEN	GER	FR	IRL	IT	UK
High-Tech	-1.2	+1.8	+2.3	+2.0	+9.4	+2.3	+1.9
Medium-Tech	+0.3	-2.5	+3.3	-1.5	-1.7	-3.9	-4.6
Low-Tech	+0.9	+0.7	-5.6	-0.5	-7.8	+1.6	+2.7

1 Categories as per Table 8.2.

Source: Eurostat, Structure and Activity of Industry 1980/87 and 1987/88. Irish data from CSO, Census of Industrial Production, 1988.

The impact of changes in the structure of manufacturing output has been accentuated in Ireland by the unusually wide gap between productivity levels in the high-tech and low-tech industries. This productivity gap stood at 95% in Ireland in 1988, compared with an average gap for the EC as a whole of about 16%.[62]

The existence of an exceptionally wide productivity differential between high-tech and low-tech industry in Ireland, and the fact that Ireland has experienced significantly above-average change in the structure of its manufacturing sector over the past decade, testify to the 'dual' nature of Ireland's industrial growth. High-tech industry in Ireland is dominated by overseas-owned companies, which accounted for 96.5% of net output and 84.6% of employment in this segment in 1989. Productivity levels in these foreign companies are *high* by international standards reflecting, among other things, the fact that they are concentrated in relatively fast growing areas of high-tech industry and the fact that they represent in the main the more successful elements of US and international industry. By contrast, the

62 ie. Productivity levels in high-tech industry in Ireland were 195% that of low-tech industry; the equivalent figure for the EC was about 116%.

low-tech sectors of Irish industry derive most of their characteristics from the *indigenous* industrial base.[63] Irish-owned industry is heavily concentrated in this segment, with 76% of its net output and a similar proportion of its employment classified as low-tech (see Table 8.4). Productivity levels among Irish-owned firms are *low* by international standards, thus accentuating the gap in productivity levels between high-tech and low-tech industry.

TABLE 8.4

Structure of Irish-Owned Industry 1983 and 1990

	% Total Irish-Owned Industry			
	Employment		Net Output	
	1983	1990	1983	1990
High-Tech[1]	3.7	6.4	3.5	5.6
Medium-Tech[1]	14.6	18.3	13.1	18.7
Low-Tech[1]	81.7	75.3	83.4	75.6
Total Irish Owned	**100.0**	**100.0**	**100.0**	**100.0**

1 For details of categories, see Table 8.2.

Source: Census of Industrial Production.

The main impetus to structural change in Ireland's manufacturing sector has come, not from any exceptional pace of change in the *indigenous* industrial base, but rather from the attraction to Ireland of large volumes of foreign direct investment. Much of this investment is concentrated in the pharmaceuticals and office and data processing sectors[64], thus enabling an

63 Note, however, that the low-tech sectors include a substantial, and growing, overseas presence, so that the dichotomy between overseas-owned, high-tech industry and Irish-owned, low-tech industry may need to be qualified in the future. In 1989, overseas-owned companies accounted for 48.1% of net output and 29.4% of employment in low-tech industry. The high output share relative to employment reflects, in part, the very high net output per employee recorded by overseas firms in the 'Other Food' category of industry and probably includes an element of transfer pricing. The employment share (29.4%) provides a good base-line estimate of the extent of the overseas presence in low-tech industry.

64 Evidence for other countries shows that the structure of foreign investment in Ireland is very typical of the pattern found elsewhere. It reflects *global* trends in the structure of mobile investment flows, rather than any deliberate policy of targeting high-tech sectors. Moreover, the extent of concentration of overseas industry in high-tech sectors should not be exaggerated: In 1989, 57.9% of the net output of overseas industry came from high-tech sectors, 11.1% from medium-tech and 31.1% from low-tech (19.1%, if the 'Other Food' category is excluded). In employment terms, the distribution of overseas industry in Ireland is quite evenly balanced, with 40.0% of overseas employment in high-tech sectors, 21.0% in medium-tech and 39.0% in low-tech (35.9%, excluding 'Other Food').

entirely new, high-tech sector to be "grafted on" to Ireland's industrial structure, at a pace which would not otherwise have been possible. Table 8.4 shows that the extent of change in the structure of *Irish-owned* industry over the period 1983-1990 was relatively modest. Moreover, much of the change documented in Table 8.4 was brought about as a result of the *contraction* of low-tech industry, particularly in the early part of the period, rather than as a result of any exceptional growth in the other categories of Irish-owned industry.[65] Given the starting position of Irish-owned industry in 1983, with an exceptionally high degree of concentration in low-tech industry, a faster than average rate of structural change among Ireland's indigenous base might have been expected.

Despite the strong growth in overall manufacturing productivity in Ireland over the past decade, the levels of productivity outside the high-tech sectors remain relatively low by international standards and there is little evidence of any generalised catch-up. Table 8.5 shows that the growth of labour productivity in medium and low-tech industries has not been uniformly higher than in other EC countries: seven of the sectors shown improved their position relative to the EC average between 1980 and 1988, but in five sectors[66] the gap in productivity levels actually widened over the period. This suggests that broadly- based growth in the underlying productivity of existing manufacturing companies may have played a relatively minor part in the overall growth of manufacturing productivity over the past decade. It also demonstrates the continued scope for substantial productivity growth among large elements of manufacturing industry, with consequent implications for manufacturing employment.

A further dimension to the dualistic structure of Irish manufacturing industry is indicated by its trade performance. The export orientation of the high-tech sector is as significant as its productivity and ownership characteristics. For example, 98% of the gross output of the office and data processing and instrument engineering sub-sectors are exported. By contrast, a substantial section of indigenous industry is heavily dependent on the domestic market. Baker (1993) shows that, in 1989, 64.8% of the gross output of Irish-owned manufacturing firms was sold on the domestic market. Just under half of this output came from firms which *only* serve the home market; the balance came from firms engaged in some level of export activity. In some cases, the heavy dependence on the domestic market reflects the existence of a degree of natural protection arising from large size, access to materials or domination of highly local markets (as in the case of paper and printing and wooden products). In other cases, such as clothing and footwear, reliance on the domestic market is a sign of relative weakness in a highly competitive and integrated international market.

65 Employment in Irish-owned industry fell from 119.5 thousand in 1983 to 104.8 thousand in 1989. This fall was made up of a decrease of 17.9 thousand in low-tech industry, partially offset by increases of 1.4 thousand and 1.5 thousand in medium and high-tech industry respectively.

66 Because of concerns about the comparability of the data used for food, drink and tobacco (see notes to Table 8.5), this sector has been excluded from the discussion.

TABLE 8.5

Productivity Levels in Medium and Low-tech Manufacturing Industry in Ireland Relative to EC Average 1980 and 1988

	Gross Value Added per Emp. '000 ECU				Prod'ty. Level in Ireland as % EC Avg.	
	1980		1988			
	IRL	EC-9	IRL	EC-9	1980	1988
MED.-TECH						
Prelim. Proc. of metals	1.9	18.6	39.4	77.5	0.64	0.51
Chemicals (excl. Pharm)	27.0	24.8	55.4	58.9	1.09	0.94
Mech. Engineering	12.6	18.4	35.7	33.4	0.68	1.07
Motor Vehicles	12.4	18.3	37.5	38.6	0.68	0.97
Other Transport	16.1	17.3	27.6	30.9	0.93	0.89
Misc. Inds.	13.2	17.1	28.1	30.7	0.77	0.91
LOW-TECH						
Non-Metallic Minerals	18.7	20.1	44.3	39.1	0.93	1.13
Metal Articles	11.5	16.9	26.5	29.5	0.68	0.90
Food, Drink & Tobacco, (excl. Other Food)	23.4[2]	19.8	38.5	35.5	1.18	1.08
Textiles	8.5	13.3	17.4	27.3	0.64	0.64
Clothing, Footwear & Leather	6.3	10.6	12.6	28.3	0.59	0.45
Timber & Wooden Furniture	9.4	15.8	21.9	29.2	0.59	0.75
Paper & Printing	13.3	19.0	30.2	44.8	0.70	0.67

1 The EC average in both years refers to the same group of 9 countries, (i.e. excluding Spain, Greece and Portugal).

2 Data for the Food, Drink and Tobacco sector for Ireland in 1980 relate to GVA at market prices. This will *overestimate* productivity levels in Ireland relative to the EC, but was deemed preferable to using the estimates prepared by Eurostat. These imply a very dramatic adjustment to the data supplied by Ireland's CSO and suggest that productivity in the sector in 1980 (as measured by GVA per employee at factor cost) was only 5.6 thousand ECU, or 28% of the EC average. This is the only sector in which such a dramatic difference occurs.

Source: Eurostat, *Structure and Activity of Industry*, 1980/81 and 1987/88.

As significant as the *level* of export performance in distinguishing the sub-sectors of manufacturing is the *geographical distribution* of exports by sector. In 1989, less than 20% of the total value of exports from the high-tech sectors (including 'Other Food') were exported to the UK. This contrasts with the situation in other sectors of manufacturing industry, where the bulk of exports still go to the UK. Among industries with a degree of natural protection, for example, 96% of exports of paper and paper products and 77% of exports in printing and publishing are to the UK. Export from the knitting, clothing, bread, sugar and confectionary and plastics sub-sectors are also heavily dependent on the UK market.

The other significant dimension of trade performance is import penetration of the domestic market. The overall import penetration of the domestic market for manufactured goods is estimated to have increased to 39% in 1990, and has risen as high as 57% in the market for exposed consumer goods.[67] The loss of domestic markets, the generally low level of export performance and the reliance of significant proportions of the exporting indigenous sector on the UK economy are indicative of the relative weakness in competitive terms of substantial sections of Irish manufacturing industry. It was noted earlier that, especially where levels of labour productivity are below average, substantial rates of output growth are required in the first place to maintain employment and then to generate increased manufacturing employment. A key challenge to industrial policy, therefore, is to support an improved performance by indigenous manufacturing industry in producing competitive products which both regain market share on the domestic market, secure existing export markets principally in the UK and diversify export performance. In the short-term, cost competitiveness is clearly a vital element in such a strategy. In the medium to long-term, however, a more broadly-based competitive performance is required. The implications of this for industrial policy form the basis of the remainder of this chapter.

3. STRENGTHENING IRELAND'S INDUSTRIAL BASE

The Council has consistently argued that the development of Ireland's industrial base must ultimately be built around a strong indigenous sector capable of competing effectively on world markets. At the same time, the Council recognises the substantial and necessary contribution to industrial output and employment which is made by overseas firms in Ireland. Industrial policy must seek to increase the contribution of both of these

67 Small Firms Association, *Putting Domestic Industry Back in Business*, May 1993.

elements of manufacturing industry, by developing stronger Irish companies and by integrating overseas firms more fully within an overall strategy of endogenous development.

The concept of endogenous development which underlies the Council's thinking on industrial policy is defined not by ownership criteria, but by the extent to which industrial growth is embedded in the local economy. The aim of endogenous development is to secure industrial growth based on sustainable sources of competitive advantage which are firmly grounded in the Irish economy. Such a strategy must have, at its core, the building-up of capabilities in Irish-owned industry. It does not, however, preclude a continued role for overseas investment: on the contrary, given the significance of the existing overseas base in Ireland and the fact that the development of indigenous industry will take time to bear fruit, the overseas sector must form an important component of any strategy for endogenous development.

Many of the policies required to develop Irish industry are also likely to favour the growth of foreign direct investment. Thus, for example, all elements of industry share a common interest in policies which ensure macroeconomic stability, low inflation, cost competitiveness and the provision of infrastructural supports in areas such as communications, transport, education and training. Moreover, the underdeveloped state of Irish industry itself inhibits the growth of foreign direct investment and reduces the scope for linkage with the domestic economy.[68] At a micro level however, there is a substantial difference between the needs of indigenous companies and those of their overseas counterparts. Because of this, the two sectors are considered separately below.

(i) Developing the Competitiveness of Indigenous Industry

The relative weakness of much of the indigenous manufacturing sector - in terms of output, productivity, employment and trade - was outlined above. This weakness points to a fundamental lack of competitiveness, reflecting deep-rooted structural deficiencies in respect of management, marketing, product development and innovation, as well as more immediate cost and finance-related constraints. The importance of competitiveness in sustaining economic growth in Ireland and the role of public policy in influencing the different dimensions of competitiveness are discussed in Chapter 4. The need

68 This factor is becoming of increasing importance, with many overseas companies now actively seeking to invest in areas where they can avail of a well developed sub-supply infrastructure.

to address specific difficulties in relation to the *funding* of industrial development is also discussed elsewhere in the Report (see Chapter 12). This section focuses on the particular role which can be played by industrial policy in seeking to improve the competitiveness of Irish industry.

For much of Irish industry, competitiveness continues to be synonymous with basic cost-competitiveness, and the evolution of costs remains a key indicator of company success or failure. Given the very low levels of profitability obtaining in Irish industrial firms, with the average return on sales amounting to just 3.6% in 1991, even fairly modest increases in costs can mean the difference between a profitable enterprise and a loss-maker. Moreover, given the heavy concentration of Irish industry in traditional sectors such as clothing and footwear or textiles[69], where payroll costs account for as much as one-third of total sales revenue, it is clear that labour costs must rank as an important element of overall cost competitiveness. This aspect of competitiveness is discussed in detail in Chapter 4, with particular reference to the evolution of recent wage trends.

While cost competitiveness may be a necessary prerequisite for the survival of Irish industry, it is not in itself a *sufficient* condition. The low level of profitability in Irish industry itself reflects a series of structural deficiencies, for which low costs can only partially compensate. These structural constraints must be addressed if Irish industry is to secure a firmly grounded and sustainable basis for long-term growth.

The need to address the structural constraints on the development of Irish industry is given added urgency by the changing nature of global competition. An era of price competition in the mass production of standardised products has given way, first to recession, and then to competition based on technological change and innovation. This has simultaneously weakened the impact of traditional industrial policy and brought to light a new bottleneck inhibiting the development of poorer regions. Research has shown that there are considerable regional differences in the rate of innovation, with businesses in poorer and peripheral regions showing less ability to innovate. Moreover, regional differences in process innovations - which tend to threaten employment - are much smaller than regional differences in product innovations - which tend to create employment opportunities. In addition, empirical and theoretical research on economic development has shifted the emphasis from the investment constraint to the knowledge and skills constraint. It is these factors which

69 See Table 8.4 for details of the structure of Irish industry in 1990.

prompted the Council to argue that a broadly defined concept of innovation must lie at the heart of future policy for Irish industry.

The context within which Irish industry must develop is one of increasing globalisation. The trend towards globalisation has changed the nature of competition, with increasing emphasis being placed on flexible responses to changing demands, fast turn-around and just-in-time delivery; superior quality, better design and product innovation. The price of a product has lessened in significance as these other features have risen. For Irish industry, with its heavy predominance of small (and often very small) firms, these trends have opened up some new opportunities, while at the same time posing considerable challenges.

The last two decades have seen a re-emergence of small firms internationally. The tendency towards industrial concentration which was visible up to the mid-1970s has been reversed in the last 10 or 15 years, and most countries are now witnessing a substantial increase in the numbers of industrial establishments with less than 100 employees.[70] Among the factors which have contributed to this trend are: the decentralisation of activities previously carried out in-house in large firms, as these companies try to save costs, achieve efficiencies by specialising on "core" functions, and secure greater flexibility and spread of risk; the appearance of new technologies which make small batch production by small firms more economic; and the promotion of small firms by political authorities as a response to rising unemployment.

The re-emergence of small firms does not in itself guarantee that the place of SMEs in international industrial structures has been secured. Small manufacturing firms are faced with a situation where the new opportunities offered by the decline in production thresholds due to economies of scale are often offset by the stringent requirements of new technologies with regard to the level and sophistication of intangible investment,[71] and the difficulty of marketing a wide range of products on a customised basis. Firms working with advanced technologies in areas where technology is evolving rapidly, as in most sectors affected by IT and in new materials, must be capable of keeping abreast of technological developments. This does not necessarily imply the capacity of every firm to carry out in-house R&D, but it does require firms to belong to networks where R&D is being done. Equally, the range and variety of intangible investments which the small industrial firm must be capable of financing are the same as those of larger firms. However,

70 See OECD (1992a), *Technology and the Economy*.

71 Intangible investments include research and development, technology licensing, training and skill formation, management and organisational change.

the financial and human resources of the small firm are often too small to do this or to establish on its own the range of external sourcing relationships which large network corporations are now setting up. Small scale production based on the new technologies also makes severe demands on firms with respect to marketing. In a production regime, based increasingly on variety and customised demand, marketing costs can become a significant burden on profitability. Collecting and processing appropriate information about micro markets and then acting on this information is a difficult and costly business for SMEs. These constraints are particularly severe in Ireland, where the average size of indigenous industrial firms is very small by international standards and the starting point in terms of management capability, technology and innovative capacity is acknowledged to be low.

In an effort to find a means through which small firms[72] can fasten on to the new competitive processes, attention has focused on the role played by *networks* and other forms of systematic linkages, both among firms and between firms and their wider environment. The concept of network conveys the essential idea of a systematic relationship of interdependency and support. The term is most frequently used to describe the agglomerations of small firms located in the North Central and North East of Italy. These "industrial districts" have become renowned for their economic success over the last 15 to 20 years. Porter's (1990) "clusters" of industries "connected through vertical and horizontal relationships" and his emphasis on the importance of geographic concentration of industry in order to increase the degree of interaction between firms touches on a similar set of issues. Equally, the NESC (1992a) study of national systems of innovation, which was discussed in Chapter 4 of this report, provides another perspective on the significance of linkages, networks and interactive mechanisms in supporting the development of competitiveness.

A recent paper by Pyke (1993) argues that the presence of agglomeration in the Italian industrial districts has offered a number of efficiencies including: speed and flexibility, the creation of a strong local labour supply, the development of a critical mass of specialised knowledge and an ease of spread of that knowledge; the facilitation of strong social bonds which smooth transactions, ease the provision of credit and assist in the development of co-operative activities; and the formation of a local or regional industrial identity, facilitating common strategies and common institutions. Because small firms do not have the individual financial or human capacity to carry out all necessary productive and marketing functions

72 The vast majority of Irish-owned industrial firms fall within the internationally accepted definition of small to medium sized enterprises (ie. less than 500 employees).

on a scale that is economic, the local community or the firms themselves need to supply collective, shared services which can be used on a "when needed" basis. Small firms benefit from the presence of both co-operative and competitive mechanisms. Co-operation helps, for example, the spread of ideas and the sharing of resources, and can improve both scale and scope capacities. Pyke concludes that small firms, *when organised appropriately*, can compete effectively with larger firms. In particular, he suggests that networks of small firms, can in theory, achieve both scale and scope economies on a par with bigger units.

Pyke identifies three possible development strategies of relevance to indigenous firms operating in an increasingly global environment:

(i) Firms can try and "go it alone" and sell on international markets as *niche specialists*: this is the path which Irish industrial policy has traditionally emphasised. The focus is on individual firms, with the aim of policy being to identify "potential winners" which can grow into big firms.

(ii) Firms can seek to become *preferred suppliers* to large, usually multi national, firms: given the predominance of multinational firms in Ireland, this has been a natural route to pursue. The establishment of the National Linkage Programme in 1985 gave formal expression to this strategy and there is evidence of slow, but perceptible, progress in this regard.[73]

(iii) Firms can combine with other small firms and supportive institutions in a *laterally oriented approach* similar to that found in the Italian industrial districts. Through networking, and through engaging in alliances and other co-operative arrangements, and the creation of common collective institutions, small firms can gain individual strength and a measure of both individual and collective independence. This insertion into a regional network system potentially removes reliance on the large corporation as the only feasible engine of development and transfers the capacity to take proactive initiative to regional institutions, such as local government and trade associations. An implication of pursuing this approach is that the focus of industrial policy would shift away from the individual firm towards the collective network of firms. The emphasis would be less on picking winners than on raising standards and capacity in the whole group of firms.

73 See eg. O'Malley (1993).

The emphasis on "clusters" in the Culliton Report could be taken as signalling an attempt to move in the direction of a "network" strategy. The details of how this might be achieved and the implications it would have for existing policies require further elaboration. In principal it would possible to pursue elements of strategies (i) and (ii) above within an overall framework determined by strategy (iii). Care is needed however to ensure that such a hybrid developmental strategy retains an overall coherence and does not become a series of individual policies which fail to connect effectively.

The evidence on networks and associated phenomena opens up a number of interesting avenues which warrant further research. There is a strong international consensus emerging that, in the future, successful policies for competitiveness will be those aimed primarily at supporting the aspects of intangible investments and collective governance which are outside the purview of individual firms, and at facilitating the formation of linkages, networks and other interactive mechanisms. If this is the case, then Ireland must seek to develop its own systems of "lateral supportive organisations", based on the lessons of other countries but adapted to suit our own particular set of social, economic, political and cultural circumstances. This may involve taking a new look at many of the "organising principals" used in the formulation and execution of industrial policy. For example, discussion of networks is often expressed in practice in terms of what are essentially *sectoral strategies*; the focus being on picking the right sector for growth, concentrating on the best firms in that sector, and providing the necessary infrastructural support. While this may be appropriate in particular cases, it can also close off many fruitful lines of exploration. Pyke points out that, while the Italian industrial districts obtain many strengths from their specialisation on particular industrial sectors, in other ways such single-industry dependency can be a source of weakness: whole localities risk major decline should there be a sudden drop in demand for the products of "the district"; moreover, the exclusion of other industries leads to the loss of vital new ideas and new inter-industrial synergies. Attempts to overcome these drawbacks involve moving away from rigid (and perhaps time bound) sectoral classifications to concentrate on the economic *functions* being performed by the networks. In Spain, for example, attempts are being made to "diversify" an agglomeration of small firm plastic toy producers near Valencia with a parallel industry of plastic kitchen ware. The idea is that many of the same technologies and skills are suited to both industries, but the markets are essentially unrelated: a drop in demand for toys does not necessarily mean a decline in demand for kitchen ware. It is the identification of the *economic role* of different types of policy and institution, rather than

the comparison of actual policies, which can make a study of dynamic regions in other countries useful to policy-makers in Ireland.

The above discussion has potentially important implications for the conduct of industrial policy. Further research is required to determine how the trends and initiatives outlined can be adapted to Irish conditions and can feed through into the development of specific policy proposals. A number of preliminary observations can be made at this stage, however:

- The broad thrust of industrial policy in recent years, with a movement away from an emphasis on capacity expansion to the *development of business capability*, is supported by the above analysis. The future growth of Irish industry requires a competitiveness which is founded on appropriate cost structures, but which is supplemented critically by strengths in "intangible" areas such as management, marketing, innovation, technology and design. These aspects of competitiveness are likely to become increasingly important in the years ahead.

- In this regard, the continued shift in State financial assistance away from fixed asset investment towards the "softer" areas of people, skills and business capability is appropriate. This shift in resources is particularly important, since market failures in the provision of private finance are particularly acute in these areas[74].

- There are now a range of programmes in operation in the development agencies aimed at addressing deficiencies in management and marketing capability, and in product development. These programmes represent a welcome development. They are however, still largely experimental in nature and much work remains to be done in determining the most effective means through which the State can intervene in these areas.

- A specific issue which needs to be addressed in this context is the question of the *evaluation criteria* to be used in assessing State expenditure on intangible investments. The need to ensure value for money has resulted in a significant tightening of monitoring and evaluation procedures applied to industrial development budgets in recent years. This is clearly a desirable development. In the short to medium-term, however, State expenditure in support of "intangibles" may show only modest results when measured in terms of net gains in employment from the initial base. In principle, the effectiveness of State intervention should be judged by reference to the level of

74 See Chapter 12 on Financing the Development of Irish Business.

employment which would have existed in the *absence* of such intervention. There are clearly practical and methodological difficulties in developing and implementing such an approach. The criteria used in assessing State-backed *fixed asset* expenditure (which include, for example, strict performance clauses relating financial payments directly to employment growth) may need to be modified, however, in the case of State investment in intangibles. This reflects the longer pay-back period of such investments[75], as well as more general difficulties associated with isolating the impact of intangible investment on company performance.

- In recent years, the export performance of a number of indigenous companies has been improved by purchasing distribution networks in foreign markets. Generally, these companies have been large firms with substantial resources. The development of export performance by other small economies has been significantly aided by this approach of investmenting in wholly-owned or joint venture distribution or manufacturing companies in other countries. The development of a stronger presence in export markets can, in appropriate circumstances, contribute significantly to overall company performance, thereby strengthening the prospects for growth in output, incomes and employment in the domestic economy. In recent years, IDA and An Bord Tráchtála have been involved in developing new mechanisms along these lines, designed to support market access by Irish firms operating overseas. As yet, the number of firms assisted under such mechanisms remains very limited. Consideration should be given to finding ways to involve a greater number of Irish firms, including specifically, measures to support the involvement of *smaller* companies heavily dependent on export markets.

- The increasing emphasis on innovation, technology and skills as key determinants of competitiveness places considerable demands on the capacity of individual companies to respond quickly and flexibly to change. Employee/management relations which help to break-down the strong in-built resistance to change and support a process of continuous learning and adaption can play a useful role in this regard. The model of employee/management relations prevalent in Continental Europe has some attractions in this regard.

75 Christensen (1992) notes that significant national differences in pay-back periods for investment in technology are increasingly recognised as important contributors to significant divergences in economic performance.

- Finally, the analysis suggests that State support for individual companies in "intangible" areas such as management, marketing, innovation, technology and design is likely to be ineffective unless it is integrated within a wider programme of support which includes interventions at the intermediate level of the sector, industry or region. The Council believes that the creation of a supportive network for industrial firms would provide individual companies with a greater prospect of success than a series of interventions at company level which are not followed through effectively within the wider economy. The task of devising policies of this sort will pose a major challenge to the organisational and inventive capacity of the State system. If it succeeds however, it could contribute significantly to the development of a strong indigenous industrial base.

(ii) The Role of Overseas Firms in a Strategy for Endogenous Development

Overseas-owned firms play a critical role in the Irish economy. In 1991, overseas firms accounted for approximately 70% of the net output of manufacturing industry in Ireland and for 44% of manufacturing employment. While the overseas sector is identified most readily with high-tech activity, there is a sizeable overseas presence in all sectors of manufacturing in Ireland. Manufacturing employment in overseas companies has held up better than indigenous employment since 1983. O'Malley (1993) has shown that direct employment in overseas manufacturing companies remained virtually stable (-0.1%) between 1983 and 1991, compared to a decline of 8% in total manufacturing employment and a decline of 13.4% in indigenous manufacturing over the same period.

The employment impact of manufacturing industry is not confined to those directly employed. Secondary employment is supported by the purchase of services by manufacturing companies, by the expenditure of the employees of manufacturing companies and by the spending of the taxes raised from manufacturing companies and their employees. O'Malley has calculated that in 1991 every job in an overseas manufacturing firm supported another indirect job in the services sector. He estimates moreover, that the ratio of secondary to direct employment for overseas industry has *risen* since 1983 (not least through the recent increases in the effective rate of corporation tax on the profits of overseas companies). The implication of O'Malley's analysis is that 54% of the total employment impact, both direct and indirect, of manufacturing industry in Ireland is accounted for by the overseas sector.

The level of employment in Irish manufacturing firms supplying the overseas sector is also quite substantial. The achievement of effective linkages between the overseas and indigenous manufacturing sectors, through supply linkages, has been a prominent objective of industrial policy over the past decade. O'Malley has calculated that there were 14,700 employed in producing industrial products as inputs for overseas industry in 1991. This represented a ratio of 17 jobs in indigenous manufacturing per 100 jobs in the overseas sector. More significantly, O'Malley calculates that this induced manufacturing employment effect has strengthened during the 1980s. While not all the supported manufacturing employment accrues to the benefit of indigenous companies, the vast majority does and would represent the equivalent of 13% of indigenous manufacturing employment in 1991.

Given the significance of overseas firms in the economy and the fact that new initiatives to develop Irish-owned industry will take time to bear fruit, it is clear that the overseas sector must form a vital component of any strategy for endogenous development in Ireland. The continued contribution of the overseas sector will depend upon the fate of existing enterprises and the rate of new investment. In the past, Ireland has had a very good record in attracting and retaining foreign direct investment (FDI)[76]. Ireland's share of the market for mobile investment has fallen significantly over the past decade however, and a number of recent trends pose a further threat in this regard. Moreover, after a decade of very rapid growth in the 1980s, mobile investment flows slowed considerably in 1990 and 1991. The relatively modest growth prospects for the international economy in the 1990s (see Chapter 2), allied to the consolidation of regional trading areas (including the European Single Market) suggest that the overall growth of foreign direct investment may remain subdued in the short to medium-term.

A number of factors are contributing to the decline in Ireland's share of the market for mobile investment: first, the dramatic increase in FDI up to 1989 (with volume growth of almost 20% per annum) combined with the sharp rise in the number of countries seeking to act as *hosts* to overseas investors meant that some loss of market share was to be expected.

Second, and of more concern, the rapid growth of mobile investment flows in the 1980s was accompanied by substantial changes in the *structure* and *form* of mobile investment. The proportion of foreign direct investment devoted to manufacturing has fallen over time so that, by the mid-1980s about 40% of total foreign investment was in services compared to 25% in the early

76 One of the criticisms made in the Telesis Report (1982) was that Ireland's share of the market for FDI at that time was *too* high and was indicative of over-generous financial and fiscal incentives.

1970s. This trend has continued up to the present time and shows no sign of stopping. There has also been a marked change in the nature of foreign investment, with greater emphasis on acquisitions, joint ventures and other forms of business alliance rather than on greenfield investments[77]. While the IDA's sectoral brief was expanded in the 1980s to include internationally-traded services[78], the focus of activities has remained very narrowly centred around the financial services and software industries. Moreover, there are difficulties in dealing with the more complex forms of mobile investment which now predominate: the underdeveloped state of much of Irish industry limits the scope for "business alliances" with indigenous companies[79]. In addition, the new form of investments poses organisational and managerial challenges which are significantly greater than those faced in dealing with greenfield operations. The result of these structural changes is that *an increasing proportion of mobile investment flows lies outside the traditional sphere of IDA activity*.

A third factor which has reduced Ireland's share of the market for mobile investments has been the *intensification of competition*, reflecting in part the rise in unemployment in OECD and EC economies since the early 1980s. This competition is not just from other late-developing or peripheral economies; it is also, critically, from advanced economies, several of them within the EC. Within the growing pool of countries vying for mobile investment, there are signs that the *regional pattern* of global FDI is changing. A 1990 survey of 700 US companies reported by Mackenzie (1993) noted that the balance of advantage for *manufacturing* projects was shifting from Western Europe to Eastern Europe. Western European strengths were seen increasingly as favouring projects in distribution, back-office activities and the location of European/Regional headquarters, with positive attributes also for R&D facilities and branch sales offices.

77 The OECD (1992) show that 80% of total inward investment in the United States was in respect of acquisitions, while mergers and acquisitions through foreign investment in Europe increased fourfold through the 1980s.

78 The range of service activities which qualify for assistance under IDA's International Services Programme is: Data Processing Services; Software Development Services; Technical and Consulting Services; Commercial Laboratory Services; Administrative Headquarters Services; Research and Development Services; Media Recording Services; Training Services; Publishing Services; International Financial Services; and Healthcare Services. Only a limited range of these activities qualify for the 10% rate of corporation tax; notably, data processing services, software development services and technical or consulting services linked to those two services, as well as international financial service activities provided by companies located in the IFSC.

79 It is interesting however, that in the relatively well developed food, drink and tobacco sector, there has been a substantial level of overseas acquisition and take-over in recent years. This trend has itself raised a number of policy questions about whether the *stars* of Irish industry can remain in Irish hands.

Ireland however, has difficulty in competing with other Western European economies in several of these activities, because of its peripheral location away from the main European markets.

Finally, the competitiveness of Ireland's *incentive package* for overseas industry has declined in recent years: Tax incentives through the very low rate of corporate tax on the traded sector constitute the major element in this incentive package. Direct expenditures in the form of grants and subsidies are also important. The 10% tax rate, while still attractive, has lost some of its effectiveness as a result of the steady downwards trend in corporate tax rates internationally; changes in tax laws in a number of key source countries such as Germany and the US also pose a continuing threat; in addition, the introduction of special tax incentives within specific regions in a number of competitor countries (eg. France, Belgium) has further undermined Ireland's position. At the same time, the level of direct grant-aid to overseas investors has been reduced as part of the overall squeeze on industrial development budgets. This trend has not been mirrored to the same extent in all of our competitors.[80]

A recent survey of firms which had undertaken new investments in Europe (EC Commission, 1993) found that Ireland's main attraction was perceived to be a low cost base comprising low labour costs, low levels of corporate taxation and generous incentives. Language was reported as an important ancillary characteristic. The survey also suggested that Ireland was beginning to be recognised as a centre for excellence in electronics and software, with a ready supply of skilled labour. Where Ireland had *not* been short-listed as a possible investment location, the main reasons cited were the related considerations of peripherality, transportation costs and distribution difficulties (including concerns about delivery dates).

The principal factors influencing location decisions in manufacturing *generally* were found to be proximity to markets, the availability of labour with an industrial background and, in some sectors (notably electronics, software and R&D) the availability of specific skills, the quality of the transport infrastructure, quality of life and personal factors where a substantial number of personnel were expected to relocate, culture and language affinity with the host country (especially important for US and Asian investors making their first investment in Europe), proximity to companies producing similar or related products and promotion by national and local government. The level of financial incentive available, rather than

80 The most recent EC survey of State aids shows that, in terms of grants per person employed, aids to manufacturing *increased* in 1990 in six member States (Belgium, Denmark, Italy, Luxembourg, The Netherlands and Portugal).

the rate of corporate taxation per se, was reported as significant to the choice of region for manufacturing companies.

These influences on location decisions are likely to change over time as a result of changing macroeconomic and structural conditions. For example completion of the single market will, as the Council pointed out in Report No.89, create pressures to concentrate production in certain sectors in order to realise economies of scale and maximise flexibility. In such sectors, characterised by declining or uncertain demand as well as relatively undifferentiated products, concentration is likely to be achieved through mergers and acquisitions. Non-EC companies may still choose to enter such markets through greenfield investments. Peripheral regions, such as Ireland, are likely to lose out through such a process of rationalisation, especially if labour cost differentials are eroded. This factor has implications for the *existing* stock of overseas investment in Ireland, as well as for the rate of new investment. On the other hand, the integration of markets and the impact of new technologies will make location decisions open to the possibilities of applying flexible production systems. This would imply rather less emphasis on cost factors and rather more on the availability of highly skilled labour, capacity in R&D, good communications and transport infrastructure, high quality educational and environmental facilities and proximity to firms engaged in the same or related activities.

Looking ahead to the future, it is clear that the factors determining the location of mobile investments are changing and there is no guarantee that Ireland will continue to attract such investment on the same scale as in the past. Many of the international trends in the market for mobile investment are adverse for Ireland and threaten our ability to maintain market share. The policy actions required to reverse this process include:

- ***Upgrading Ireland's "Product":***

  The fact that Ireland's attractiveness as a location for mobile investment depends so heavily on its low cost base must be seen as a problem. While a low-cost base is important (both in encouraging incoming investment and in facilitating the development of the existing stock of overseas industry in Ireland), it is not enough. It must be supplemented by competitive strengths in other non-cost areas. Moreover, Ireland's cost base is heavily dependent on a tax regime and set of financial incentives which are costly to maintain and which can be replicated, surpassed or, in the case of tax incentives, rendered ineffective by other countries. The underlying cost base in Ireland (exclusive of grants and subsidies) is significantly higher than that of low-cost economies such as Greece and Portugal within the EC, or Eastern Europe. Projects which are *primarily* cost-driven will tend to favour these locations. Ireland's main competitors in the market for mobile investment are the developed regions of the EC such as Scotland, France and Wales. This reflects the nature of the industrial development to which we aspire, as well as the existing levels of costs in the economy. Investments in these regions are driven by a much wider range of considerations than cost alone. The growing importance of non-cost factors in influencing locational decisions increases the urgency of developing a self-sustaining basis for competitive advantage in the market for mobile investment, which is not dependent on costly (and ultimately vulnerable) tax and other financial incentives.

- ***Broadening the Focus:***

  The changing pattern of mobile investment flows and, in particular, the growing importance of service activities and of business alliances within foreign direct investment creates an urgent need for Ireland to broaden the focus of its promotional activities. The Council believes that increased emphasis must be put on expanding the range of internationally-traded service activities targeted by Ireland. There would appear to be some scope for doing this, initially at least, within the existing parameters of the IDA's International Services Programme.[81] In the context of a move to promote greater overseas investment in the services sector, the Council suggests that the opportunity should be taken to re-examine the nature of Ireland's incentive package and, in particular, the relative merits of tax incentives, direct grants and other forms of support. Given the constraints on the overall development budget, the resources required to secure a higher level of overseas investment in the services sector will need to come from a shift in priorities within the existing overseas budget. Budget reductions at the level of individual programmes should not, however, be seen as a *principle* of public finance management, irrespective of the characteristics of the project under review. Allocations to individual programmes should be determined by the costs and benefits they offer, relative to alternative uses of available public finances and relative to the option of *not* incurring public expenditure, thereby facilitating reductions in taxation.

81 See footnote No. 78 for details of internationally-traded service activities qualifying for IDA support.

- ***Positioning Ireland Within the Context of Strong, Regionally-Focused, EC Policies:***

  EC policy has a potentially significant role to play as an active instrument for regional development and the promotion of cohesion within the community. Overseas investment flows, if appropriately distributed, can constitute an important means of accelerating growth in employment and living standards in the peripheral areas of the Community relative to the core. To date, the experience has been the opposite: The core regions of the Community compete very vigorously with more peripheral countries, such as Ireland, using high levels of incentives to add to their inherent advantages in the attraction of mobile investment. The share of the largest four member States in total EC spending on aid to industry increased from 75% in the mid-1980s to over 80% in 1993. This is clearly detrimental to EC efforts to promote greater cohesion within the Community. The Council recommends that Ireland take a lead role in promoting the concept of strong, regionally focused, EC policies which act as positive instruments for development and cohesion within the Community. In the context of such a regionally focused approach, and specifically with regard to EC *Competition* Policy, the Council recommends that Ireland should press strongly for a progressive reduction in the overall level of State aids in the Community, while establishing within this a strong *positive differential* in the level of State aids available in peripheral regions, relative to the core.

4. THE PRIORITIES FOR POLICY REFORM

The basic agenda for industrial policy reform has remained relatively unchanged since the Council first set out its views on this subject in the early 1980s. The recent review of industrial policy carried out by the Culliton Group showed that, despite progress in some areas, many of the concerns expressed by the Council at that time remain valid, and the proposals put forward by the Review Group have much in common with the Council's earlier recommendations. In this context, the Council notes, with approval, that the establishment of the Moriarty Task Force marked an attempt to move the focus from policy formulation to the vital area of implementation.

The Council's position on industrial policy reflects the desire to create a strong industrial sector, firmly rooted in the domestic economy, which is capable of achieving self-sustaining growth in an increasingly global environment. It is built around two principals: *first*, increased emphasis should be placed on the development of indigenous enterprises and resources, while continuing to recognise and support the role played by overseas investment in Ireland and *second*, policy should aim to overcome the structural constraints on growth and increase the innovation potential of the economy. These are necessary elements of a strategy to develop the competitive performance of Irish industry, especially the indigenous sector. They presuppose that the competitive potential of industry is maintained through appropriate macroeconomic and microeconomic policies and by appropriate developments in income levels. No programme of industrial policy development, no matter how sophisticated or selective, can compensate for a fundamentally uncompetitive economy, whether arising from fiscal imbalance or a high relative cost base. It is the pursuit of industrial policy objectives as part of an overall strategy for economic and social development which provides a realistic basis for the implementation of industrial policy. The Council therefore welcomes the conclusion of the Industrial Policy Review Group, accepted by the Government, that it is the competitiveness and productivity of the economy as a whole which forms the decisive determinant of industrial performance. The validity of this approach was amply demonstrated by the success of the indigenous sector on the UK market in the recent past when our underlying competitiveness strengthened relative to the UK economy.

With regard to the process of policy formulation, the Council welcomes the development of policy represented by the report of the Industrial Policy Review Group. the recommendations of the Task Force on its implementation and the detailed response by Government to these recommendations. The Council notes the recommendations and decisions taken with regard to taxation, the cost and quality of infrastructure and the relevance and effectiveness of education and training policies. These are the subject of discussion elsewhere in this report. As regards expenditure on aid to industrial development, the Council endorses the proposals to accelerate the shift away from investment in fixed assets to support which targets structural weaknesses in the indigenous sector. The Council's views on the financing of industrial development are set out in a separate chapter of this report.

Within the new structural and policy arrangements which have been decided upon, the Council identifies a number of issues which should be pursued as a matter of priority. With regard to *overseas investment*, the Council believes that the changing trends in the market for mobile investment pose a threat to the existing stock of overseas industry and, in particular. to the rate of new investment. *Immediate action is required to overcome this threat.* Three priorities were highlighted as meriting particular attention: First, the need to upgrade Ireland's 'product' in order to provide more firmly-grounded locational advantages than those derived purely from tax and financial incentives. The Council believes that this must constitute the key objective for overseas investment policy in the medium-term. Second, the Council emphasises the urgent need to broaden the focus of Ireland's promotional activity to include, in particular, a much broader range of internationally -traded service activities. Finally, the Council recommends that Ireland should take a lead role in the development of strong, regionally focused EC policies. Such policies could act as important instruments for regional development and the promotion of cohesion within the Community. In the context of such a regionally focused approach, and specifically with regard to EC Competition Policy, Ireland should press strongly for a progressive reduction in the overall level of State aids in the Community, while establishing within this a strong positive differential in the level of State aids available in peripheral regions relative to the core.

With regard to the development of the *indigenous sector*, the Council recognises the cumulative disadvantage which Irish industries face through their lack of established presence in important consumer and intermediate markets, compounded by distance from some of the more important of such markets. The thrust of development policy must be to remedy these disadvantages. Priority must be given to strengthening the capacity of management to appreciate, appropriate and apply changes in technology; to interact with consumers in such a way as to anticipate trends in the market and to engage in collaborative arrangements with competitors within an industry which enable them, while remaining rivals, to share the cost, financial and otherwise, of developing a supportive environment for their business.

The broad thrust of industrial policy in recent years has sought to shift the focus away from capacity expansion towards the development of business capability and broadly-based competitive strengthens in Irish industry. The Council supports this development but argues that it does not go far enough. In particular, the Council suggests that State support for individual companies in intangible' areas such as management, marketing, innovation, technology and design is likely to be ineffective unless it is integrated within a wider programme of support which includes interventions at the intermediate level of the industry, sector or region. The creation of a supportive network for industrial firms would provide individual companies with a greater prospect of success than a series of interventions at company level which are not followed through effectively within the wider economy. The task of devising policies of this sort will pose a major challenge to the organisational and inventive capacity of the State system. If it succeeds however, it could contribute significantly to the development of a strong indigenous industrial base.

The primary task facing agencies seeking to support the development of the indigenous sector is to help to identify and foster the sources of competitive advantage in the Irish economy. The Industrial Policy Review Group argued that the food industry is one such sector. The Council discusses elsewhere in this report the requirements to transform a comparative advantage in aspects of agriculture into a competitive advantage in the food industry. The identification and strengthening of competitive advantage - whether it is based on access to raw materials, design, product image or skilled labour - is at the heart of any strategy to strengthen our industrial base. The Council regards it as the key priority to be pursued in the formulation and implementation of industrial policy over the coming years.

CHAPTER 9

Agriculture, Food and Rural Development

AGRICULTURE, FOOD AND RURAL DEVELOPMENT

1. INTRODUCTION

In seeking to accelerate the rate of economic growth and hence of sustainable employment, it is appropriate to consider the contribution which the efficient development of natural resources can make to economic development.

The history of economic development demonstrates how natural resources provide the basis for a range of industries.[82] Initially unprocessed products are exported followed by slightly processed exports. The returns from these exports are invested in upgrading and developing more complex products. Related and supported industries develop. There is a process of continuous interaction among all the related industries which supports innovation. Over time cumulative advantages develop, so that an internationally competitive cluster of industries emerges.

Traditionally the pattern of resource development in Ireland has not followed this virtuous circle, although there are positive aspects to the development of Ireland's natural resource based industries.

In 1992 employment in agriculture and food was 187,000 which represents around 17% of total employment while employment in food and drink accounts for around 22% of manufacturing employment. This points to the importance of the sector from the point of view of maintaining employment.

The outline of this chapter is as follows. Section 2 reviews employment trends. The following sections discuss current policy issues in agriculture, food, forestry, fisheries, the equine industry and rural development respectively.

2. EMPLOYMENT PERFORMANCE

(i) Agriculture

Employment in agriculture has long been subject to continuous decline as is the normal pattern of economic development. The long-run decline in agricultural employment can be expected to continue. However, the

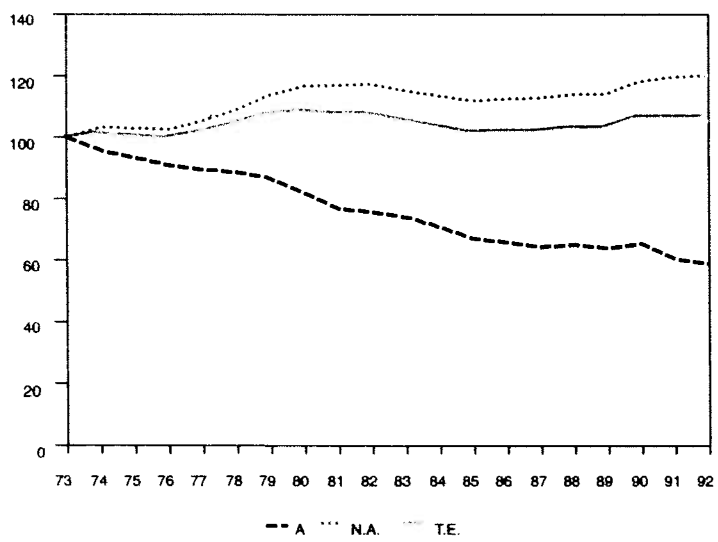
82 This process is discussed by Dr Lars Mjøset in his report for the Council (NESC, 1992a).

agricultural employment base is now lower, so that a decline at the same historical rate will have less impact on total employment performance in the years ahead.

FIGURE 9.1

Employment in Agriculture, 1973-1992

1973=100



A: Employment in Agriculture, Forestry and Fisheries.

N.A.: Non Agricultural Employment

T.E.: Total Employment

Source: CSO Labour Force Survey.

(ii) Food Industry

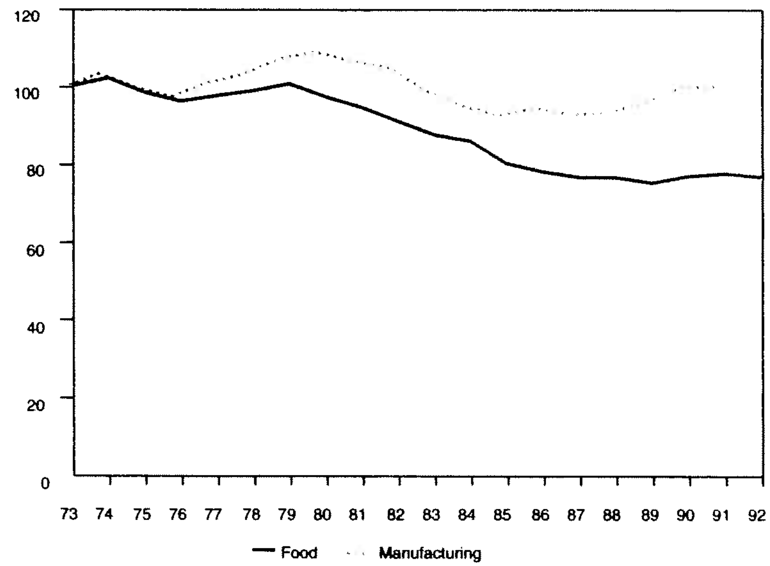
During the 1970s employment in the food industry was maintained. However, during the 1980s the food industry experienced a large fall in employment, in common with manufacturing industry generally. There was a modest recovery of employment in the late-1980s. One factor behind the recorded decline in employment is the contracting out of services. Allowing for this the underlying employment performance would be somewhat better

than the official figures suggest. This has been a particular feature of the dairy sector.

FIGURE 9.2

Employment in Manufacturing Industry and Food, 1973-1992

1973=100



Source: CSO Industrial Employment and CSO Labour Force Survey.

There have been important differences in employment performance across the food industry (see Table 9.1). It is useful to distinguish the primary processing sector, the output of which is strongly linked to agricultural output and the secondary food manufacturing sector. Since 1973 employment in the primary processing sector has been maintained. There was an increase in employment during the 1970s and a decline in the 1980s (subject to the caveat above regarding contracting out) leaving no net change. There has been a large increase in the sector's output reflecting the strong growth in agricultural output since 1973.

By contrast employment in secondary processing has fallen since 1973. There was a large decline in employment during the 1980s. This reflects the general experience of indigenous industry with which the food industry shares many characteristics. The decline in employment during the 1980s (insofar as it was not simply due to contracting out of functions) was partly due to rationalisation to achieve higher productivity but another influence was the decline in output in some sub-sectors such as bakery, where output declined at an annual rate of 1.9% between 1980 and 1985.

Since 1987 the secondary processing sector has fared somewhat better, in that the rate of decline of employment has been slower than before. This reflects a much improved output performance by the sugar, chocolate and sugar confectionary sub-sectors. The output of the bread, biscuit and flour confectionery sectors has continued to decline, reflecting a continued loss of domestic market share to imports.

It is necessary to treat 'other foods' as a separate category, since the performance of this sector does not relate to the general food industry performance. This sector is dominated by the production of soft drink concentrate and has experienced dramatic output and productivity growth, as well as a positive employment record. The extent to which the recorded output growth in this sector requires to be viewed with caution was discussed in detail in Council Report No. 94.

The modest gain in total employment since 1987 reflects gains in two sectors: other foods and meat. It would appear that this gain in employment in the meat sector has involved more people in the deboning and further preparation of beef and pig-meat (Kelly, 1992).

Finally, it is worth noting one area, fish farming, which is not included in the food industry employment figures in Table 9.1. This newly established industry has made a positive contribution to employment growth in recent years, with employment increasing by 1,180 (full and part-time jobs) between 1987 and 1991. There has also been employment growth in fish processing.

There has been a significant level of capital investment in the industry in recent years. The investment in the industry is mainly reflected in an improvement in the quality and sustainability of employment, rather than a direct increase in numbers employed.

TABLE 9.1

Employment By Industrial Sector

	1972	**1980**	**1987**	**1990**	**1992**
FOOD	42.8	45.9	36.7	35.4	36.6
(i) *Primary Processing*	20.6	24.1	20.0	19.5	20.6
Slaughtering & Preserving of Meat	8.4	9.6	9.4	9.4	10.9
Manufacturing of Dairy Products	7.5	10.2	7.6	7.4	7.1
Grain Milling & Feed Manufacturing	4.7	4.3	3.0	2.7	2.6
(ii) *Secondary Processing*	16.3	15.9	11.0	9.9	9.6
Bread, Biscuits & Flour Confectionery	9.7	8.8	6.7	5.8	5.3
Sugar, Cocoa, Chocolate & Sugar Confect.	6.6	7.1	4.3	4.1	4.3
(iii) *Other Foods*	5.9	5.9	5.6	6.0	6.4
DRINK	7.5	7.7	5.5	4.6	4.5
TOTAL FOOD & DRINK	50.3	53.6	42.2	40.0	41.1

Source: CSO Industrial Employment.

3. ISSUES IN AGRICULTURAL POLICY

(i) Approaches

There are two broad perspectives on the role of agricultural policies. One perspective views the role of agriculture as the production of food at minimum cost. Cost minimisation implies that consumers will get food at minimum cost while farmers will receive the competitively-determined market return from their factors of production. This perspective would recognise that there are adjustment costs associated with the decline in employment due to ongoing productivity improvements, but would consider any interference with this adjustment process as undesirable.

An alternative perspective starts from the premise that the farmer has, or should have, *two* roles: firstly, producing food and secondly, protecting the environment in the context of rural development. From this perspective the optimal number of those engaged in farming is not necessarily equivalent to the minimum necessary to produce the required agricultural output. In its 1985 Green Paper the EC Commission's view was stated as follows:

> "The European Community is confronted with the question whether it wishes to maintain a substantial number of workers in agriculture. To that question there can be only a positive reply. The need to maintain the

social tissue in the rural regions, to conserve the natural environment, and to safeguard the landscape created by two millennia of farming, are reasons which determine the choice of society in favour of a Green Europe' which at the same time protects employment possibilities for those in agriculture and serves the long-term interest of all Europe's citizens. An agriculture on the model of the USA, with vast spaces of land and few farmers, is neither possible nor desirable in European conditions, in which the basic concept remains the family farm." (Commission, 1985).

This approach was confirmed in the 1991 Reflections paper from the Commission on the reform of the CAP:

> "Sufficient numbers of farmers must be kept on the land. There is no other way to preserve the natural environment, traditional landscapes and a model of agriculture based on the family farm as favoured by society generally. This requires an active rural development policy and this policy will not be created without farmers" (Commission, 1991).

The Commission emphasised that rural development was not confined to agriculture: "Other forms of economic activity which help to maintain rural populations and strengthen the economy of rural areas will be promoted".

The Council shares the Commission's view of the multi-dimensional role of the farmer in rural society. The Council is also very much concerned with efficiency and competitiveness. It is necessary to find an appropriate balance among conflicting objectives for the agricultural sector. It is helpful in this context to consider the categorisation of farmers proposed by the Agriculture and Food Policy Review Group.

This approach envisages a core sector of highly efficient farmers, dynamic, adaptable and aware, whose produce would be closely geared to the needs of a food processing industry far more consumer-orientated and market-led than the present one. A further 'mixed-income' farm sector, consisting of holdings which for economic or social reasons remain outside the 'core' group but supply some produce to the food industry, would derive a large part of its income from off-farm jobs and other diversification possibilities now beginning to open up.

Movement of land to the 'core' and 'mixed-income' sectors, already taking place, would be helped by pension arrangements attractive in particular to small farmers with underutilised land, and directed at transfer to persons with qualifications and ability in farming.

The next section addresses external policy developments in the agricultural sector. These developments point towards greater liberalisation which reinforce the importance of efficiency and competitiveness. The problem of low farm incomes is then discussed.

(ii) Cap Reform and GATT

In 1992 agreement was reached on a significant reform of the CAP. The Council's position on CAP reform can be summarised as follows:

> "The Council regards CAP reform as inevitable. Moreover, the Council considers that CAP reform is desirable insofar as it leads to a more viable system of agricultural support. The Council does not favour dismantling the CAP. While recognising both the inevitability and desirability of greater liberalisation, the Council shares the (European) Community's rejection of a free trade solution for agriculture. It favours instead a solution which derives from the Community's traditional approach to market adjustment, that is an approach which recognises the social dimension of markets and the social costs and benefits which are generated by adjustment to the exigencies of market forces. In particular, it is the Council's view that a reformed CAP must operate as an important instrument for achieving economic and social cohesion." (NESC, 1992).

In early 1992, the Council analysed the likely impact of the then proposals for CAP reform on the economy. On balance it was concluded that the likely net outcome was a modest reduction in national income, with annual GNP growth rates slightly lower than they would otherwise have been in the first few years following implementation. Even a modest reduction in growth rates was considered to be a matter of serious concern, given Ireland's relative economic position (NESC, 1992). The Council concluded that CAP reform should be regarded as a continuing process. Indeed, the Council noted that many aspects of the projected impact of the Commission's proposals would represent a significant degree of continuity with previous trends.

The forecast of a modest net impact on the national economy was critically dependent on the continued payment of the compensation terms of the reform package. If compensation were to be abolished the consequences for Ireland would be more severe than for other member States. The CAP reform proposals were also seen to have an adverse impact on employment in food processing. Since 1980 employment in primary processing of agricultural produce has been falling despite the large growth in agricultural output. CAP reform was seen, effectively, as curtailing the growth of output of all the mainstream enterprises. Given a static level of output, the decline in employment in primary processing was expected by the Council to accelerate in the years ahead due to the pressure for rationalisation and improved productivity.

The Council has identified a number of principles which should guide policy in relation to the CAP. These are:

(a) policy proposals should be evaluated from an economy-wide rather than a sectoral perspective;

(b) the direction of long-run development should shape the short-term conduct of policy;

(c) trade-offs between conflicting policy goals should be recognised and a balance struck in the interests of strategic development;

(d) the future of rural society requires a comprehensive policy approach which transcends the agricultural sector;

(e) the future of the CAP should be assessed in terms of the impact on convergence and cohesion within the EC.

Under CAP refom a substantial shift from price support to direct income support has occurred. The Council has emphasised the importance of continuation of these compensatory payments. Assurances on future budgetary provision were given at the Edinburgh Summit (December, 1992) in the context of the decisions on the future financing of the EC.

A central issue in assessing the outcome of the CAP reform process is the impact of the agreement on competitiveness. On the one hand, the reduction in cereal prices and the support agreed for the production of maize silage will be of most benefit to producers who are intensive users of cereals. This will tend to have an adverse effect on the competitiveness of Irish producers.

In the original CAP reform prosposals intensive producers were excluded from compensatory premia. This exclusion clause was dropped during the course of the negotiations. From Ireland's point of view it would have been better if the original proposal for an exclusion clause had been retained. But this was not acceptable to several Member States who, if Ireland had insisted on this, would inevitably have sought even more severe limitations on intervention.

An important change achieved by Ireland in the course of the negotiations was the introduction of a Spring slaughter premium for beef. The Council recommended that such a premium should be sought as a means of reducing the seasonality of beef production. The Council welcomes the introduction of the slaughter premium and notes that it is consistent with supporting the long-run commercial development of the industry. Given the length of the beef production cycle it can only be expected to have a gradual effect over time. However, the introduction of this premium would appear to have had a positive effect in 1993: steer slaughterings were up by 24% in the first quarter. The premium is subject to a limitation. If final quarter production were to fall below 40% of total production then the premium would be withdrawn. There is a danger that the premium could be withdrawn in 1994. The Council favours the relaxation of this requirement in the interest of encouraging the commercial development of the industry. This counter-seasonal premium will tend to strengthen long-run competitiveness.

Competitiveness in agriculture as in other areas of the economy is affected by many factors. The Council considers that there is a need to monitor the competitiveness situation on an ongoing basis. For example, a negative feature of the operation of the reformed CAP for Irish producers arises from a number of restrictions on intervention for beef which the Commission has recently announced. Firstly, a carcass weight limit has been introduced. When fully applied, this would make 58% of Irish steer beef ineligible for intervention support. This will lead farmers to reverse breeding programmes and finish cattle at lower weights. Teagasc has estimated that this measure will reduce output and exports by 17,500 tonnes per annum with an annual loss of up to £42m to the economy. Secondly, the Commission has introduced a new carcass trim which it is estimated will reduce intervention returns by up to £10 per head (or £3 million per year). Thirdly, the Commission has decided that factories slaughtering for intervention may debone on site only their portion of a national quota of 1,000 tonnes per week plus 50% of their remaining sales into intervention. Alternatively, they may opt to transfer all their intervention beef in carcass form to an independently-managed deboning hall where all the tonnage may be deboned. This would necessitate considerable movement of product and additional costs in order to qualify for full intervention support. These restrictions could put further downward pressure on prices at times of significant dependence on intervention and are a matter of serious concern.The Council favours a move from intervention to commercial markets but believes that it is essential that this change take place on a gradual basis to permit successful adjustment by the industry.

The pressures for agricultural policy reform are both internal and external. Internal pressures include the rising domestic costs associated with the CAP and the uneven distribution of CAP support. External pressure derives from the Community's emergence as a significant net agricultural exporter. When the Community was a significant net importer the price support system could function reasonably smoothly. Price support necessitated restricting access to the internal market, but it did not involve direct conflict on external markets. But as the Community has become a significant net exporter, this has brought the Community increasingly into conflict with its trading partners. CAP reform sought, inter alia, to reduce these conflicts. In parallel, GATT negotiations have been seeking to reach agreement on agricultural trade at a global level.

As the GATT negotiations have proceeded, it appears that a new agreement will pose additional problems for the agriculture and food sector. The main features of the Blair House Agreement between the EC Commission and the US and the Draft Final Act of 1991 (the Dunkel proposals), which is likely to form the basis for agreement on agricultural trade within the Uruguay Round are:

(a) ***Exports***: The reduction of export *subsidies* by 36% and the reduction of subsidised *exports* by 21% in volume terms over six years from the average in the base period 1986 to 1990. In the first year, subsidised exports must be reduced below the base period level by an amount equivalent to equal annual reductions over the period (This is the 'front loading' issue).

(b) ***Imports:*** Border protection measures are to be changed into customs tariffs which will be reduced by 36% over six years. Each tariff must be reduced by a minimum of 15% over six years. In addition, there is to be a commitment to minimum access for specific imports. A tariff quota with a reduced tariff will be established allowing for imports of a quantity equal to 3% of domestic consumption in the first year (probably 1995), rising to 5% by the final year (probably 2,000).

(c) ***Internal support:*** The reduction of internal support by 20% over six years. Some categories of direct payments (i.e. decoupled payments) are exempt. The requirements are that they are based on a fixed area, yield or number of animals and do not increase support for commodities above the levels applying in 1992.

(d) ***Rebalancing:*** The Community wished to obtain the right to raise the import duty on certain cereal substitutes and oilseeds provided the overall reduction in tariff levels was maintained. The US did not accept the EC rebalancing proposal but the Blair House agreement provides that if the EC imports of non-grain feed ingredients increase to a level which undermines the implementation of CAP reform, the parties agree to consult with a view to finding a mutually acceptable solution.

The EC Commission has argued that the proposals for the treatment of agriculture within the GATT, agreed between EC and US negotiators, are consistent with the framework of CAP reform as agreed last year. However, the Minister for Agriculture and Food has stated that evaluation to date has shown that this was not the case and has outlined a number of serious difficulties which the proposed agreement could create for Irish producers.

The most serious problems occur in the beef sector. One reason for this is that no increase in beef consumption is forecast for the Community, so that any GATT concessions on market access by third countries or reduced exports will have to be accommodated by reducing Community production. The extent of the problem will depend, inter alia, on whether or not "*aggregation*" is permitted. Aggregation refers to the treatment of import commitments and means that credits in some areas could be used to offset deficits in other areas. The EC Commission is proposing a substantial degree of aggregation. Without aggregation there would be a substantial increase in white meat imports, which would reduce both white and red meat prices and further reduce beef consumption. This indirect effect on the beef market would have significant negative consequences for the Irish beef industry. Even if aggregation is achieved, the current GATT proposals would require a reduction in beef production in excess of those agreed under CAP reform. The Minister for Agriculture and Food has estimated that a reduction of EC beef production of 5% would be required, in addition to the reduction already agreed under CAP reform.

A substantial cut in EC beef production is a matter of serious concern for Ireland. About 88% of Irish beef production is exported from Ireland. In a situation of market over-supply, net exporting regions, such as Ireland, are most vulnerable to price falls. As Ireland accounts for 24% of total EC beef exports to the world market, the Irish beef industry is particularly at risk from cuts in export refunds. A major problem is the 'front loading' issue which would imply a concentration of output reductions in 1995.

It is clear that the Irish beef industry needs to address the challenge of developing new markets. One possible market is South East Asia. The Japanese market for beef is growing rapidly. The only EC member states with potential access to this market are Ireland and Denmark due to the stringent health status requirements. However, EC access to these markets is restricted as export refunds are not permitted. The EC agreed in 1985 to refrain from applying export refunds to these markets in response to pressure in GATT from other exporting countries. The emerging GATT agreement would extend this restriction of export refunds. Under a new GATT deal in which export refunds would be subject to overall ceilings, agreement should be sought on the withdrawal of the restriction on export refunds to Japan and other South East Asian countries. This would be a useful short-term initiative to help producers establish a presence in this rapidly growing market before the market is entirely secured by Australian and American competitors.

In its communication outlining proposals for CAP reform the Commission recognised that farmers should be compensated for lower prices, that there would be advantage in doing this in a manner which would reduce production and reflect greater concern for the environment, that there should be a better distribution of support among farmers taking into account the difficulties of some categories of producers on regions. The Council notes that any additional price reductions due to a GATT agreement do not differ in principle from those under CAP reform so that these principles should apply equally to any further reductions.

However, there are two important constraints on the Community's ability to provide compensation for losses stemming from a GATT agreement. Firstly, a ceiling on the CAP budget has been fixed to the end of the decade by the Edinburgh summit and expenditure in the first year of CAP reform is close to that ceiling. It is doubtful if the existing CAP budget could accommodate any significant level of compensation for additional reductions. Secondly, there is the issue that GATT would impose some constraints on the overall level of compensation and the form in which compensation would be paid. To be consistent with a GATT agreement compensation would have to be "decoupled" from production.

If additional supply control measures prove necessary, the Council recommends that the principle of cohesion should be applied to the distribution of any such measures. Should additional milk quota or suckler premia quota cuts be required there is a case for differential application of any such cuts to Ireland. This case is based on:

(i) the importance of the dairy and beef sectors in the Irish economy;

(ii) the competitiveness of the dairy sector in particular;

(iii) the need to support less intensive production because of the environmental problems caused by intensive production systems;

(iv) the merits of applying the CAP on a differential basis as an instrument for assisting objective I regions.

As the Council stated in *A Strategy for the Nineties*, there are great advantages to achieving an agreed global approach to the reform of agricultural support systems in the context of the general trade negotiations now under way. Restrictions on agricultural output[83] of the magnitude envisaged under the emerging GATT agreement are a matter of great concern on both sectoral and national grounds. Their resistance in the Irish context is therefore fully understandable. The benefits to Ireland from the boost to world trade and growth likely to follow on a successful outcome to the Uruguay Round are such that the implications for agriculture must be viewed in the context of the likely impact of the GATT arrangements as a whole. The Council's position on GATT and agriculture can be summarised as follows: Firstly, if the GATT round is concluded it is likely that the outcome will not be significantly different from the main elements of the draft Blair House agreement and this would broadly define the trading environment in which agriculture will operate for the rest of this decade. Secondly, the Council recommends that Ireland should use its position within the EC to secure the most satisfactory outcome from a GATT agreement, including the arrangements for implementation. Thirdly, if the final outcome of the GATT negoatiations results in price or volume reductions to EC agriculture in excess of the CAP reform decisions, the EC must provide compensation for such losses, and the burden of adjustment must not be disproportionate to Ireland's economy. This is in accordance with the Council's support for the principle of cohesion.

(iii) Strengthening Competitiveness

Whatever the outcome of the GATT negotiations it is clear that the long-run trend is towards greater liberalisation. For this reason the competitiveness of agriculture is an increasingly important concern. The competitiveness of agriculture is influenced by a number of factors including education, research and structural reform.

Education:

The competitiveness of the agricultural sector depends fundamentally on the human capital of those engaged in the sector. There are weaknesses in this

83 Note that the output referred to takes place above world market prices.

area, which is one aspect of the structural problem in agriculture. However, there has been a substantial improvement in the standard of education and training of those entering farming over the past decade. This is helped by the linking of eligibility for grants to completion of the Certificate in Farming.

Education and training needs to be an ongoing activity. The standard to be sought should be best international practice. The recent visit by New Zealand researchers has demonstrated the potential of applying best practice techniques to increase producer incomes.

Income distribution considerations also justify a role for the state in diffusion of new techniques. The Office of Technological Assessment, US Congress (1986) warn that the "small" and perhaps "moderate" sized farms experience longer time lags in adopting new techniques, and require special attention and extension services if they, as a community, are to survive. Murphy (1988) states that if dairy prices fall, there will be a structural change in favour of the "large" farms, for this is where the comparative advantage lies. If this is the case, then it is the role of government, according to Stiglitz (1988), to intervene. The state needs to focus on extension, and perhaps financial services to help smaller farms adapt to new techniques, thus ensuring a more even spread of benefits to research (Boyle and Ryan, 1992).

Research:

In a time when the economy is preparing itself to face a more competitive market-place, the potential contribution of research to the deepening competitiveness may be under-estimated. Research can directly affect competitiveness by developing new products, and by improving the quality of inputs, thereby improving their productivity. Furthermore, technological innovation enhances an economy's comparative advantage which leads to gains in competitiveness. To survive in the world markets of the future, it is necessary to have strong government involvement in agricultural research and development (Boyle and Ryan, 1992).

The importance of government involvement in research is based on theoretical and empirical considerations. The theoretical argument is based mainly on the idea of externalities. There are positive externalities to research which will lead private investment in research to be below the socially optimal level. Boyle and Ryan (1992) review a number of empirical studies on the rates of return to research. While there is diversity in these results, there is agreement that the rates of return are high.

Numerous reports and commentators have concluded that level of funding for agricultural and food research is inadequate.[84] The ESRI evaluation of the Structural Funds, 1989-93, recommended that in the commercial agricultural sub-programme there should be an increase in the funding for R&D, especially in biotechnology-led developments, directed towards raising productivity, improving quality and diversification.

The Council regards the current level of resources devoted to public good agricultural and food research as inadequate. An allocation of resources from the new round of Structural Funds could contribute to correcting this deficiency. Expenditure on research represents long-term investment and therefore would be consistent in this respect with the guiding principles of the Structural Funds.

Structural Reform:

Strengthening competitiveness requires that greater progress be made in overcoming the structural weaknesses of the sector. These include the large number of non-viable farm holdings which are typically controlled by elderly farmers and the fact that the decline in the number of farmers has not been matched by an equivalent decline in the number of *holdings*. This in turn requires new approaches at both Community and national level. The Council's view is that *future Irish structural policy should give priority to achieving effective land use rather than to maintaining the maximum number of holdings at inadequate income levels*. This, however, is recommended only within the context of complementary productivity policies and non-agricultural programmes for rural areas and taking account of the early retirement scheme (see below).

In the context of CAP reform, with limitations on output in all the major enterprises, it could be argued that structural reform merits lower priority than in the past. The Council does not accept this argument. Despite current limitations on production it is clear that the general direction of agricultural policy will be towards greater liberalisation. In this context, structural reform is essential to achieve and maintain long-run competitiveness in agriculture. In addition, the efficient development of the food industry depends upon a strong agricultural sector to supply raw materials with the quality and consistency that are necessary. This in turn requires that the structural weaknesses be addressed.

84 These include Boyle and Ryan, (1992) Research Group in Agriculture and Food (1992) and specifically on food research: Report of the Expert Group on the Food Industry (1993) and Culliton (1992).

TABLE 9.2

Age Distribution of Farmers, 1991

Age	% of Farmers
Less than 35 years	14
35-44	21
45-54	22
55-65	22
65+	22
ALL	100

The CAP reform agreement contains provisions for an early retirement plan. This is particularly relevant in the Irish context, since it is estimated that 44% of farmers are over 55 years of age, and they control a considerable share of the total area devoted to agriculture. The new retirement scheme provides for a pension up to a maximum of 10,000 ECU for full-time farmers and agricultural workers aged 55 or more and not yet in receipt of a pension, for 10 years or until the age of 70 is reached. Previous attempts to encourage early retirement have been unsuccessful. The terms of the current scheme are more generous than previous schemes and it has evoked considerable interest among farmers. To qualify for this pension there is a requirement for the enlargement of holdings to promote structural reform. The Council welcomes this scheme and urges that it be promoted through the relevant national and sectoral channels.

(iv) Low Farm Incomes

Due to structural and demographic changes a poverty problem is a characteristic of the farming sector. Callan et al (1989) found that in 1986 36% of households headed by a farmer fell below the 50% poverty line, defined as 50% of average state household income. This was influenced by the particularly low farm incomes in 1986. The 1987 Household Budget Survey data show that 25% of farm households were below this poverty line, which still leaves the risk of poverty for farmers at more than double that for the self-employed and six times that of employees.

Unfortunately more recent comparable data are not available on the extent of poverty in agriculture and other sectors of society. There is more recent data available from the National Farm Survey on Family *Farm* Income (i.e.

income from farming excluding social welfare payments and off-farm earnings). The distribution of family farm income is shown below. The proportion of family farm incomes below £2,500 (in nominal terms) has fallen from 52% in 1986 to 38% in 1992. However, the determination of the extent of poverty among farm households requires information on all household characteristics, including income from other sources.

TABLE 9.3

Distribution of Family Farm Income per Farm 1992

Level of Income	% of Family Farm Incomes
<£2,500	38
£2,500 - £5,000	20
£5,000 - £10,000	20
£10,000 - £15,000	9
£15,000 - £20,000	5
>£20,000	8
All	100

Source: National Farm Survey, Teagasc, 1992.

Note: The income in this table refers only to income from farming (including subsidies). Other income received by farm households is not included.

Analysis of the NFS data indicates that round 10% of farm families have no income other than farming *and* and have a family farm income below £5,000. Clearly this group has a significant low income problem. However, the problem of poverty among farmers, in the sense of household income below the 50% poverty line, is not confined to this group.

Direct income payments have an important role to play in alleviating the problems of low farm incomes which are not amenable to the effects of structural change. The Council's general position is that direct income payments are a more efficient means of achieving an income redistribution objective than price support. Such transfers may be justified on environmental and rural policy grounds as in, for example, the EC agri-environmental schemes, in addition to stated income or distributive grounds.

TABLE 9.4

Composition of Gross Household Income (%)
1973 and 1987

Income Component	Under 30 Acres	30-50 Acres	50-100 Acres	100+ Acres
		1973		
Farm	32.8	57.0	69.3	81.6
Non-Farm	25.1	16.7	14.2	8.4
Other direct income	15.9	14.0	10.9	7.5
State transfers	26.1	12.3	5.5	2.5
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**
		1987		
Farm	15.2	30.5	53.6	70.0
Non-Farm	34.9	32.8	22.6	14.5
Other direct income	9.4	12.2	9.7	7.9
State transfers	40.3	24.5	14.0	7.5
TOTAL	100.0	100.0	100.0	100.0

Source: Commins (1992).

One way of reducing the problem of low farm income is through the provision of off-farm employment by developing the rural economy. Many farmers have succeeded in solving their income problems by obtaining off-farm employment. There has been an increase in the past two decades in the share of income derived from non-farm sources on all farm sizes, but this trend has been particularly strong on small farms. In 1987 non-farm earned income represented 70% of farm and non-farm earned income for farm households with less than thirty acres. State transfers have also played an increasingly important role in farm income. A considerable proportion of farm income is in the form of direct payments.

Therefore the ***household*** economy of smaller farms is not primarily dependent on the CAP price support policies. This reflects the substitution of direct payments for price support under CAP as well as the growing share of income derived from non-farm employment, and state transfers. For this reason the trends in regard to regional employment are of as much significance for farm household income as the impact of the changes due to CAP reform and GATT.

4. DEVELOPMENT OF THE FOOD INDUSTRY

(i) Strategic Direction

The Council's view is that the desired strategic direction of the Irish food industry is to move up the value chain. The recent Report of the Expert Group on the food industry shared this view on the desired direction of development. This is consistent with the Council's general view of the importance of upgrading the structure of indigenous industry. While the scale of Ireland's agricultural exports is such that commodities will continue to be a significant share of exports for the foreseeable future, it is only by pursuing a clear strategy of moving up the value chain that the contribution of the agri-food sector to the national economy can be maximised and additional employment generated.

Food Industry Value Chain

Commodities

Food Ingredients

Consumer Goods - Standard - Speciality

The importance of developing in a value-added direction is confirmed by a recent report by Hitchens and Birnie for the Council (NESC, 1993). This report compared a leading Irish food company to Danish counterparts. The authors found that physical productivity in Ireland was similar to Denmark but *value added* per employee was lower. This reflected differences in the products produced by the Irish firm compared to Danish firms, which in turn was reflected in a different corporate strategy regarding growth and acquisitions.

There have, however, been dissenters from the view that the focus of policy should be to move up the value chain. Boyle (1992) explicitly makes this argument: "it is important to indicate that neither strategy is necessarily better than the other despite the frequent suggestions to the contrary in the Irish debate." Boyle's argument is developed as follows:

> "The economic basis for Ireland's concentration in commodity production and exports is because it possesses a comparative advantage at this end of the value chain. In commodity production competitiveness principally depends on the price of the raw material which in turn

depends on the competitiveness of the producers of the raw material. (We have already argued that) Irish primary output production is competitive. The main reasons for our strong competitive position are our relatively low feed and overhead costs. These factors in turn stem from our grass based production system which of course is highly seasonal. Thus, the abundant factor is our seasonal grass growth. In other words our competitiveness in commodity production is intimately related to seasonality." (Boyle, 1992)

Boyle further argues that the structure of Irish agricultural output and exports is sustainable because the structure cannot be readily imitated. It is based on a natural climatic advantage. Boyle draws a comparison between Irish dairy exports and those of New Zealand and notes that the study of the New Zealand economy based on Michael Porter's methodology (Crocombe et al, 1991) did not make any reference to seasonality as an obstacle to the diversification of the New Zealand dairy industry.

The comparison with New Zealand is relevant as there are many similarities to be identified. New Zealand is also a small economy in which agriculture plays a major role. Traditionally, New Zealand, like Ireland, has been a supplier of basic agricultural commodities to the UK market. It has a similar climate to Ireland which provides the basis for low cost seasonal production. Like Ireland, its agricultural exports still have a very strong commodity orientation.

However, while it is true that New Zealand has achieved considerable success, as a low cost, highly competitive producer, it would be wrong to infer that New Zealand is satisfied with its current positioning. Crocombe et al note that the New Zealand dairy industry illustrates how factor advantages in commodity industries can be precarious. "Despite our cost advantages which have been the result of favourable natural conditions and investments in production efficiency, our margins have fallen and our returns have become volatile. This is due in part to the poor profitability of the industries we compete in, and in part to our position in these industries. Significant upgrading of New Zealand's sources of competitive advantage will be necessary to obtain more secure and profitable positions."

The solution proposed to this problem by Crocombe et al is sustained investment in building new advantages through developing sophisticated products and consumer brands and thus reducing exposure to volatile markets for undifferentiated commodities. This involves a sustained investment in management, marketing and technical skills to optimise these long-term investments. The difficulties in achieving this are not underestimated but it

was also noted that such upgrading would provide exciting opportunities for talented New Zealanders.

(ii) Developing the Food Industry

From a development perspective, the challenge for the food industry, as for indigenous industry generally, is to develop more complex, higher value-added products. This includes for example, higher value-added dairy products requiring out-of-season milk. This activity is difficult and does not offer secure short-term returns. It includes overcoming a variety of barriers to entry in the international market-place. This raises the question as to what role (if any) public policy can play in this process. The report of the Expert Group on the food industry provides a plan to develop the industry in a market-based and value-added direction. This plan has been accepted by the Government.

Culliton (1992) believed that there was excessive dependence by the food industry on state incentives. The Council considers that this applies in particular to fixed asset investment. Continuous investment in production facilities for standard commodities is undoubtedly necessary to maintain competitiveness. But such investment in fixed assets is the least risky type of investment and so is the least difficult to finance privately. This implies that the provision of grants for such fixed asset investment does not merit priority in the allocation of scarce public resources. This argument applies generally so there is no obvious reason why it has not held for the food industry. In fact many parts of the food industry have strong cash flows so should not face undue difficulty in financing standardised fixed asset investment. Non-PLC Co-Ops have used these funds to retire debt, strengthen balance sheets and modernise factories. PLC Co-Ops have used the funds to help build larger food companies (Harte, 1992).

The most risky type of investment is in the intangibles of a business, including developing management capabilities, training and new product development. The Council welcomes the shift in resources towards such intangible investment recommended by the Expert Food Group. The Council also welcomes the progressive movement from non-repayable grants to other repayable forms of finance.

Seasonality

The issue of seasonality has received attention in a myriad of reports on the development of the food industry. Seasonality is an issue because the marketing of fresh consumer products requires an even supply of raw materials. Ireland's highly seasonal supply of milk and beef therefore makes it more difficult to supply fresh products to consumer markets, which provides the greatest level of added value and employment to the national economy.

This would suggest that seasonality is a barrier to development of the food industry. There is, however, a rational basis for seasonal production. A seasonal pattern of production minimises costs and therefore, other things being equal, maximises profit at farm level. In the absence of any increase in revenue it would not be rational for farmers to change the seasonal pattern of production. Where appropriate incentives have been offered to farmers to produce out-of-season milk, they have responded. In fact, in a number of cases winter milk schemes have been discontinued because co-ops lacked high value-added products to utilise the raw material available.

It follows that the effective response to the seasonality question is to develop new products with sufficiently high prices to cover the additional costs of year-round production. If markets for new products with a sufficiently high degree of value-added can be developed, then seasonality will not be an obstacle to their production. Seasonality is however a constraint on developing products which will not command a significant market premium, such as mainstream semi-hard cheese.

By providing a guaranteed market for seasonal products the CAP is likely to have reinforced seasonality and inhibited the search for markets for food products. The CAP provides crucial support to the market at the seasonal peak of supply and therefore eliminates the downward price pressure which would otherwise occur at the peak of supply. This implies that the premium which has to be offered to secure out-of-season production is greater than it would be in the absence of price support.

Given (i) the role of price support in providing incentives for seasonal production and (ii) the national interest in moving up the food industry value chain which requires *some* movement away from seasonal production, it is appropriate to take initiatives to encourage some reduction in seasonality. The measures recommended by the Expert Food Group should prove helpful in this respect:

> The allocation by Teagasc of additional research resources to identifying ways of lowering the cost of off-peak production; increased investment in product and market development; changes in factory payment practices to favour quality animals; a relaxation of the 40% criterion for the Spring slaughter premium; retention of market clearing arrangements to deal with the peak cattle supply in the Autumn while taking account of the need not to undermine the returns from Winter finishing; and encouragement of producer groups.

Conclusion

The overall objective of the Council with regard to the food industry is to develop a market-oriented industry and to increase value-added. While it is inappropriate for the Council to comment on the specific financial recommendations in the Expert Group's plan, the Council welcomes the adoption of a plan developed by the major groups involved in the food sector which supports the Council's objectives, in particular by placing special emphasis on the areas of food ingredients and consumer foods.

(iii) CAP and the Beef Processing Industry

There are a number of different ways in which beef can be exported, ranging from live exports to cooked meat products. From the point of view of maximising employment and value-added it is desirable to move as far along the value-added chain as possible.

Progress has been made in increasing added value in the beef industry. Live exports have declined from 39% of exports in 1973 to only 8% of exports in 1991. There has been a continuous increase in the proportion of beef exported in boneless form, with a corresponding decrease in the proportion of exports in bone-in/carcass form. The share of further processed products (beef burgers etc.) has not increased.

While the long-run trend has been a decline in live exports, there has recently been a resurgence in the live trade. The EC Commission fixes the level of export refunds for different categories of exports and adjusts the level from time to time, based on market and budgetary considerations. While there is some disagreement over the extent of the price advantage enjoyed by live exporters, there is no doubt that live exporters do now have a competitive advantage. From 1st January 1994 this problem is likely to be corrected by the reintroduction of the deseasonalisation premium during the period in which the premium applies. However, if the timing of payments is the same as 1993 the premium will begin to be paid in October 1994. Certain markets in North Africa and the Middle East require a proportion of their imports in live form, because of limited local infrastructure. Ireland has recently regained access to these markets, following their concerns in recent years about BSE problems mainly in the UK.

Given the priority which the Council considers should be attached to maximising employment the imbalance between live and beef exports is a matter of concern. While it is acknowledged that the live trade has a valid role to play in maintaining competition and balancing the market, it is inappropriate for export refunds for cattle and beef exports to distort competition between the two forms of the export trade.

The development of value-added processing has been affected by the operation of the CAP. The problems have been severest and at their most arcane in the beef sector (Kelly, 1992). The development of value-added processing in the food industry depends on a wide range of factors and is not limited just to problems associated with the CAP. For example, recent experience indicates a trend that major retail outlets in the UK and other EC markets may require that final processing is undertaken close to the markets. Furthermore, the concentration in low value-added products is not confined to the food industry (NESC, 1993).

Specific anomalies in the CAP which have adversely affected beef processors are:

(i) export refunds (the method of calculation of export refunds is such that processed beef exports are not competitive with unprocessed beef);

(ii) concessionary imports (the importation of processed beef from outside the Community from producers who do not have to pay CAP prices for their raw materials); and

(iii) national trade barriers which restrict trade in processed beef products.

In recent times, currency movements allied with the abolition of MCAs (which were introduced as an attempt to deal with currency fluctuations) have also caused problems for beef processors.

A number of anomalies which restricted the development of the beef industry in the past have been resolved. The resolution of what could be regarded as problems regarding the minutiae of the CAP has had a significant effect on beef exports. In particular the growth in exports of chilled boneless beef from 7% of beef exports in 1982 to 22% in 1992 is almost certainly due in large measure to the removal of the particular anomaly concerning the UK

Variable Premium (Kelly, 1992). Over time the reduction in the level of price support will diminish the impact of problems for processors associated with intervention. In 1993, Ireland has greatly reduced its reliance on intervention. This has been due in part to the restrictions on intervention under CAP reform, and in part to a much stronger marketing effort and investment by beef processors. Some of the remaining anomalies affecting beef processing can be solved. In particular, the Council recommends that the system of *export refunds* on processed beef could be reviewed so that proper account is taken of meat content.

The difficult international environment will pose considerable challenges for primary producers and processors alike. In this context, the development of alternative products and sources of income will acquire renewed significance. The following section discusses policy and performance in forestry, a significant alternative to mainstream CAP products.

5. FORESTRY

The area under forestry is approximately 7% of the land area of the State. The Government objective is to increase this to 10% by the turn of the decade. About 1% of the land area was under forest in 1922. The growth rates of Irish Forests are the highest in the Community and their yield is above three times the Community average. Forests in Ireland are free of the most serious pests and diseases that afflict the forests of other EC and third countries.

Some 90% of the productive forest area is under conifers. From an environmental, plant health and economic perspective, it is desirable to promote greater species diversity. The Government's aim is to increase broad leaf planting to 20% of the total planting. Wood production from Ireland's maturing forests will be about 2 million cubic metres in 1993, a fourfold increase on the 1980 level. Production in the year 2000 will be about 3 million cubic metres and should exceed 4.5 million cubic metres by 2010.

Over 80% of the forest estate is owned and managed by Coillte. Coillte turnover in 1992 was £42 million. The company's total expenditure amounted to £67 million including investments of £31 million, mainly for new planting and forest road construction. However, the balance in the forestry sector has begun to change. From the second half of the 1980s there was a marked increase in planting by farmers and other private landowners. This was due to the restrictions on the output and prices of traditional farm products and the promotion of forestry through attractive, EC supported grants and incentives.

The level of planting achieved since 1980 is set out in the Appendix. The level of planting in 1993, at 23,000 hectares, is a threefold increase on the levels attained in the early 1980s. Of significance also is the fact that private afforestation surpassed afforestation by Coillte in 1989. Due to the ownership structure the great bulk of private planting is afforestation, while about 4,000 hectares of Coillte's planting is reforestation of areas following clearfell.

Evaluations have concluded that investments in forestry in Ireland can yield annual rates of return ranging upwards from 4% net of inflation. However, while afforestation is a productive economic activity over a rotation of 35 or more years, it generates no revenue in the first 15 years after planting. Thus the expansion of forestry in Ireland is dependent on the availability of grants and incentives.

The exchequer has played the major role in funding the expansion of the forest estate in the past. Since 1989 EC structural funds have contributed substantial moneys for development:

TABLE 9.5

Exchequer Expenditure On Forestry

	Total £ millions	% funded by EC Structural Funds
1973-1988	£500	2.4%
1989-1992	£140	36.0%

Following CAP reform EC finance for afforestation will, from 1993 on, be provided from the FEOGA (Guarantee).

Under the Programme for Economic and Social Progress (PESP) there has been an ambitious target of doubling the yearly planting rate of the late 1980s to 30,000 hectares by 1993 and of maintaining this level annually until the year 2000. In implementing this target, particular care is taken to ensure the protection of fisheries, landscapes, areas of scientific interest and archaeological artefacts and sites. Hannan and Commins (1993) found that insensitive actions by forestry can arouse considerable local antagonism. The Council emphasises the need for forestry to be sensitive to the concerns of local communities.

Kearney et al, (1993) note that there is a large pool of land suitable for planting and apparently attractive incentives are available to encourage

planting. However, annual rates of afforestation are not meeting the policy targets. One factor that has been temporarily holding back the achievement of planting targets is the announcement of additional incentives for forestry under CAP reform. Farmers have been awaiting details of these incentives before investing. The details of these new incentives have now been announced. This should promote an acceleration of planting. However, Kearney et al (1993) identify deficiencies in public policy in relation to land use which hinder the achievement of the afforestation objectives. These are discussed below.

(i) Land Use

A key policy weakness identified by Kearney et. al. is the lack of a consistent policy to optimise land use. Several policies which have been formulated separately (in the areas of forestry, agriculture and social welfare) affect land use. Forestry policy in itself provides generous incentives for afforestation, but means-tested social welfare payments discourage efficient land utilisation. The incentives for afforestation can be offset by the provision of livestock headage payments, by compensations to leave land undeveloped in areas of scientific interest, and by the scheme to promote extensification of livestock farming. All of these separate policies interact at the point where the individual land holder is deciding what use to make of his/her land.

Policy makers have to pursue a number of different objectives (in particular economic development and income distribution) so that it is not surprising that there are tensions between different policy instruments. However, the Council strongly holds the view that there is need to achieve a much higher level of *consistency* among the policy instruments which affect land use and that the overriding priority should be the generation of additional employment. There is significant potential for further private planting, with forestry being the only realistic option for wealth creation on 1.5 million to 2 million hectares of land in rural Ireland. If this potential is to be realised it is important that the balance of incentives should not undermine the attractiveness of forestry.

(ii) The Processing Industry

The afforestation which has taken place in the past implies that there will be a growing level of raw material coming on-stream in the years ahead. This will in time absorb the existing capacity of the saw-milling, pulping and wood-panelling sectors. New investments are required in the processing and marketing sectors and supporting infrastructures.

A recent study of the sawmill sector stressed the need to promote sawnwood exports and to grow a balanced sawmilling sector by encouraging the development of large export orientated operations (Simons, 1991). The implementation of these main objectives is being actively discussed by the sector. The development of the smallwood processing sector is also crucial to allow the thinning and proper development of the forest estate and to provide profitable outlets for residues from the sawmill sector.

Employment Potential

The potential contribution that forestry can make to employment and income growth was explored by Kearney et al. At present about 7% of the land area of Ireland is under forestry. Kearney et. al. considered the effect of increasing this to 10%, 15% and 20% of the land area of Ireland. If 10% of the land were under forestry, the increased net labour requirement would be 9,600 man years, while there would be no reduction in agricultural income or employment.[85] At 15% of the land under forestry, there would be some reduction in agricultural output and employment, but the *net* increase in the labour requirement would be 24,000 man years. At 20% of the land area afforested, the net increase in employment (measured in man years) would be 36,600.

These calculations suggest that forestry can make a significant contribution to increasing employment. An important caveat is that this will not result in an equivalent reduction in measured unemployment. There is substantial under-employment in agriculture and a considerable proportion of forestry employment will reduce this under-employment, rather than reduce open unemployment. Nevertheless forestry has an important role to play in providing additional employment and income in areas with very limited alternative opportunities.

Experience over the last eight years has shown that a substantial afforestation programme can be maintained in Ireland. On the processing side, the main aim must be to ensure the proper development of the sawmilling sector, in particular fostering the growth of firms capable of exploiting export markets for sawnwood.

85 Note that these figures refer to a *mature* forest region in which there is ongoing felling and replanting. Employment in processing is also included in these figures.

Given the balanced development of the processing sector and continued attention to the development of EC forestry policies which support the afforestation programmes, forestry can make a valuable contribution to increasing employment and wealth in Ireland. It is now timely to formulate a national strategy for the industry.

6. FISHERIES

Given its status as an island economy, Ireland has a surprisingly underdeveloped fisheries sector. The sector's economic importance is at present limited largely by the existence of various structural and institutional constraints on the expansion of the sea-fishing industry, including low quota entitlements for some fish species and the obsolescent nature of parts of the fishing fleet. In particular, the absence of a modernised deep-sea fishing fleet has resulted in poor take-up of certain high-value quotas and a consequent preponderance of low-value species in the total catch.

By contrast, fish processing and aquaculture have become increasingly established as providers of employment over the last decade. The growth of fish processing reflects in part the effect of economies of scale resulting from the increased concentration of fish landings at the five state-owned Fishery Harbour Centres, which benefited from considerable improvement of harbours and other facilities during the 1980s. Prospects for further growth of fish-processing activities, however, are likely to depend on the degree to which the present obstacles to the growth of sea-fishing activity can be overcome.

The Irish aquaculture industry grew strongly in production terms during the 1980s and, though still at an early stage of development, has considerable potential as a high value sector whose growth is not limited by the existence of quota arrangements. However, Irish producers of farmed Atlantic Salmon, the most important sector of Irish aquaculture, suffered from a declining price environment in the 1980s caused by world over-production. In coming years there is a possibility that market conditions may dictate increasing concentration in the farmed Atlantic Salmon sector, as well as some reorientation towards aquaculture products, such as rope mussels, that are relatively scarce and therefore of high value. Moreover, if the industry as a whole is to develop on a sustainable basis, there is a need to find some means of redressing the various environmental and economic grievances that have been expressed in relation to aquaculture development, and there is also a need to resolve related problems surrounding the existing licensing framework.

Although, from an economy-wide perspective, the fishing industry is only a marginal activity in EC member States, its social and economic importance is brought much more sharply into focus in the context of the coastal regions which depend on it. In these regions the industry not only provides direct employment in landings, aquaculture and, in some instances, processing, but also sustains indirect employment in net-making, boat repair etc. In addition, the spending of the incomes produced by direct and indirect employment induces, through the multiplier effect, further increases in output and employment. Brophy et al (1991) estimate, for example, that fishing supports approximately 17% of the total work force in Donegal. This may be compared with a figure of roughly 1.5% for the national labour force.

The significance of fisheries in maintaining the social and economic fabric of these regions is underlined by the absence of significant alternative sources of employment. Tourism, for example, does benefit coastal regions to a certain degree, but its concerted development is made difficult both by problems of isolation and by the seasonal nature of the business. As a consequence of the dearth of employment opportunities, coastal regions suffer from above-average unemployment rates, high outward migration, and high dependency ratios. These and related factors such as inadequate infrastructure make the attraction of industrial projects to such regions a very remote possibility indeed.

Thus it can be concluded that there is considerable economic and social justification for policies that will ensure the successful development of the fisheries sector. The structure of this sector in terms of output and employment is sketched below. Some of the main impediments to its further growth are then outlined.

(i) Employment in Fisheries Sector

Table 9.6 shows estimates of fisheries employment in 1990. As may be seen, just over half of all jobs in the industry are in the fishing fleet and almost a quarter in processing. Full-time employment accounts for the majority of jobs in fish processing, whereas the reverse is true of aquaculture. This, however, may reflect different stages of development of the respective industries. Although employment in the fishing fleet predominates in the fisheries sector, it shall be seen below that a high proportion of this employment is part-time. This reflects the fact that, outside the main harbours, many small coastal communities conduct sea-fishing on a very small-scale basis to supplement other forms of income.

(ii) Sea-fishing and Processing

The employment trends over the 1980s in both the sea-fishing and processing industries are depicted in Table 9.7. While the numbers engaged in full-time sea-fishing remained roughly constant over the period, the number of part-time fishermen decreased noticeably. A striking feature of Table 9.7 is the rapid employment growth that occurred in processing. Over the period concerned, full-time and part-time processing employment increased by 71% and 68%, respectively.

TABLE 9.6

Employment in Fisheries 1990

Sector	Full-time	Part-time/ Casual	Total	
			No.	%
Fishing Vessels	N.A	N.A	7830.0	50.5
Aquaculture	1000.0	1550.0	2550.0	16.4
Fish Processing	2000.0	1620.0	3620.0	23.3
Ancillary	N.A	N.A	1500.0	9.7
Total			15500.0	100.0

Source: Department of the Marine.

TABLE 9.7

Employment in Fishing Related Industries in Ireland

Year	Fishermen		Processing	
	Full-time	Part-time	Full-time	Part-time
1980	3485	5339	1210	870
1981	3464	5276	1250	900
1982	3405	5101	1300	900
1983	3431	5141	1350	950
1984	3232	4574	1400	1030
1985	3262	4516	1470	1070
1986	3561	3809	1700	1230
1987	3800	3950	1800	1350
1988	-	-	1907	1439
1989	3380	4520	2079	1450

Source: Department of the Marine.

Quoted in: Brophy et al (1991).

Table 9.8 shows the distribution by species of the volume and value of the sea-fishing sector's output in 1988 and 1989. In volume terms, pelagic species (herring, mackerel etc.) accounted for the overwhelming proportion, 66%, of the sea-fish landed by Irish-registered vessels into Irish or foreign ports in 1989. Demersal species (whiting, cod etc.) and shellfish represented only approximately 21% and 14%, respectively, of the catch. However, when the composition of the total catch is examined in value terms, a very different picture emerges. While demersal species constitute only one-fifth of total volume, they provide 47% of the total value of the catch. Similarly, shellfish production is considerably more significant in value terms. This situation arises because of the low price of pelagic fish relative to other species.

TABLE 9.8

Volume and Value of Catch Classified by Species

Species	1988		1989	
	Volume %	Value %	Volume %	Value %
Demersal	19.6	52.9	20.6	47.1
Pelagic	70.3	24.1	65.7	23.6
Total Wetfish	89.9	77.0	86.3	70.7
Shellfish	10.1	22.9	13.7	29.3
Total All Fish	100.0	100.0	100.0	100.0

Source: Department of the Marine.

(iii) Aquaculture

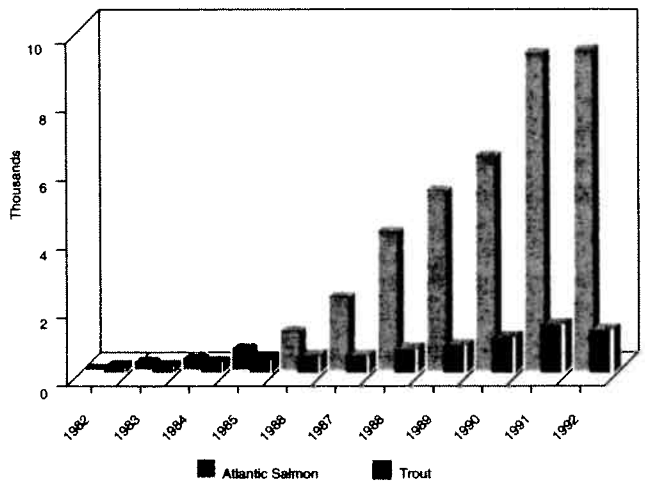
Irish aquaculture production grew strongly over the last decade from a very low base. The principal species farmed are salmon, trout, and shellfish. The volume of Irish farmed salmon and trout production is indicated in Figure 9.3. Over the ten-year period to 1992, salmon farming in Ireland moved from being an almost non-existent industry to one with a production of over 9000 tonnes per annum. Trout farming recorded a considerably lower, though still significant, rate of growth, increasing its output from just 200 tonnes in 1982 to over 1,200 tonnes by 1992. Shell-fish farming also became increasingly common, its output increasing from 5160 tonnes in 1980 to 16995 tonnes in 1991 (data: B.I.M., *Job Creation in the Aquaculture Sector, Programme for Development*, 1993-1997).

To put the impressive growth of Irish farmed-salmon production into perspective, however, it should be mentioned that the total world supply was

244,000 tonnes in 1990, of which one country, Norway, provided over 67%. Ireland's output of 6,300 tonnes ranked third behind Scotland, which provided over 34,000 tonnes. As indicated below, growth in world production of farmed Atlantic Salmon has created a difficult price environment for producers everywhere, including Ireland.

FIGURE 9.3

Irish Farmed Salmon and Trout Production 1980-1992



Source: Irish Salmon Growers Association.

Table 9.9 shows the composition of employment in Irish aquaculture from 1982-1991, based on data published by B.I.M. Although employment in shellfish production accounted for about 60% of total jobs in aquaculture, a much higher proportion of employment in the fin-fish sector was on a full-time basis. The majority of jobs, 60% in fin-fish production were of a full-time nature, compared with a relevant figure of less than 16% for shellfish production.

(iv) Conclusion on the Fisheries Sector and Problems Limiting its Future Development

Fisheries represents one of the few exploitable indigenous resources available to Ireland. As such it, should be included as part of any employment-generating strategy for the economy. However, the significance of fisheries extends far beyond its contribution to overall employment, given its role in preserving community life in isolated coastal areas where there are few, if any, alternative means of employment. Certain obstacles stand out, however, in the way of further development.

TABLE 9.9

National Aquaculture Employment

1982	560
1983	470
1984	781
1985	702
1986	773
1987	1293
1988	1669
1989	2035
1990	2508
1991	2612

Source: B.I.M. Job Creation in the Aquaculture Sector, Programme for Development, 1993-1997.

Irish sea-fishing, for example, has not realised anywhere near its full potential. It has been observed that although Ireland has 16% of total Community waters within 200 nautical miles of its baseline, it has less than 5% of the total catch in Community waters (Report of Common Fisheries Policy Review Group, 1991). Part of the reason for this is historical in that one of the criteria for allocating quotas relates to the past performance of the fishing industry in the EC member State under consideration. The Common Fisheries Policy Review Group concluded that "the low level of Irish landings during the 1973-78 base period resulted in correspondingly low quota allocation "keys" for Ireland under the Common Fisheries Policy (CFP)". It therefore recommended that Ireland's quota allocations be progressively increased to reflect the on-going development of Irish sea-fishing which was envisaged in the Hague agreement of 1976. It also identified a number of problems associated with access by foreign vessels to Irish waters. To correct these problems, the Review Group argued that Ireland should seek the extension of its exclusive coastal zone from 6 to 12 miles as well the elimination of token quotas, which it concluded serve no

function other than to guarantee permanent rights of access to non-Irish vessels in Irish waters.

As described earlier, the Irish fishing catch has a high concentration of the low-value pelagic species of fish. This fact suggests that an appropriate strategy for development of the sea-fishing industry would be one centred on increased production of the high-value demersal species and shell-fish. Exploitation of demersal stocks is limited, however, not by the level of quota entitlements as in the case of pelagic species, but by an inability to exploit existing quotas deriving from the dual structure of the Irish fishing fleet. While the pelagic fleet is now one of the most efficient in the Community, the demersal fleet is antiquated, with its activity consequently being confined to inshore waters and periods of good weather.

The constraints inhibiting the growth of aquaculture encompass a range of factors, including concerns about environmental damage, pest and disease problems, adverse market conditions for some fish species, and an unwieldy licensing system that is widely believed to deter investment in the industry.

O'Connor et al (1991) discuss the various environmental problems that have been associated with fish-farming activity, especially of the fin-fish variety. These concerns about environmental damage have arisen in relation to four main areas. First, organic waste from fish farms can result in pollution of sheltered marine inlets and entrophication of lakes. To control this problem, an investigation of water movement and waste degradation must be included in the Environmental Impact Assessment which is required as part of any licence application to produce 100 tonnes of fin-fish or more. Second, the chemical used to combat the spread of sea-lice on salmon can have a toxic effect on both fish-farm workers and shellfish in the vicinity of cages. Third, although there is no conclusive evidence on the subject, it is claimed that wild fish stocks are under threat as a result of inter-breeding with escaped farm fish, and that the collapse of wild sea trout stocks in the West of Ireland is attributable to infestation by sea-lice from salmon farms. O'Connor et al suggest that the potential significance of these factors could be reduced by developing techniques for producing triploid (non-breeding) fish and by ensuring sufficient fallowing and movement of salmon cages. Fourth, it is claimed that lines, buildings and other forms of aquaculture infrastructure detract from the scenic qualities of the coastal areas in which fish farms are located. As a result of all these factors, there has been growing opposition to aquaculture development both from fishermen in traditional fishing communities, who view aquaculture as a threat to wild fish stocks, and from individuals and organisations with an interest in environmental protection.

The above discussion points to the possible existence of negative production (and consumption) externalities, where the growth of one form of economic activity, in this case aquaculture, may impose uncompensated costs on producers engaged in another business activity, for example tourism or traditional fishing. However, in the case of tourism, it is likely that there are positive as well as negative interactions with aquaculture production. For example, O'Connor et al cite two cases of marine-based salmon farms along the West Coast being marketed as tourist attractions, with a modern visitors' centre and boat trips to sea-based cages. Spin-off tourism activity is already common in British commercial trout farms, and to some extent in Irish trout farms. The availability of regular sea-food supplies may also serve to strengthen tourism business in coastal areas. In addition, because of their high quality water requirements, aquaculture producers have a substantial economic incentive to seek controls on the discharge of pollutants into the sea, thus indirectly benefiting water-based tourism activities such as cruising, angling, etc.

Market conditions were extremely difficult for Farmed Atlantic salmon producers in all countries during the 1980s, with dramatically increased production leading to a fall in real producer prices of about 50%. A survey of fish-farm enterprises by O'Connor et al revealed that, because of very low prices and high mortality rates on some farms, the gross income from salmon farming in 1990 was negative, -IR£4.6 million. Claims that Norway was responsible for over-production resulted in the introduction by the EC of a minimum price for Atlantic Salmon imports, though it appears that this price is too low to afford a reasonable level of protection against the possibility of trading losses due to market dumping. For the coming years projections made by Landill Mills Associates indicate a scenario where supply shortfalls are likely to result in real prices growing by 2.5% per annum up to 1995, followed by a declining cost and price environment thereafter in which marginal producers may find it increasingly difficult to operate.

Finally, major problems arise in relation to the current operation of the licensing system for aquaculture, partly due to opposition from environmental, fishing and other interests, which often have legitimate concerns about the unintended environmental and economic consequences of aquaculture production. Because of such opposition, the operation of the existing legislation has become cumbersome, often resulting in long delays in the granting of licences. The 1991 aquaculture survey by O'Connor et al found that 23 fin-fish farmers and 16 shellfish operators had difficulty in obtaining insurance and/or finance because they did not have full licences. There are also a variety of other problems with the existing licensing framework. First, a licence is valid for 10 years and may be revoked by the

Minister for the Marine at three weeks notice (though only after due process). By way of comparison, fish farmers in Scotland and Northern Ireland benefit from indefinite leases. Second, the licence fee is based on set tonnage and, unlike the Scottish system, does not take into account actual production and fish prices. Fourth, although the licensing system seeks to facilitate fallowing of sites, which is an important element in disease and pest control, it is considered not to display sufficient flexibility in this respect. Fifth, where a licence is sought to produce 100 tonnes of fin-fish or more, EC legislation requires applicants to submit an Environmental Impact Assessment which, although necessary to safeguard environmental and economic interests, can be very costly.

The Council believes that reform of the current licensing system would represent a major step in securing a much higher employment and output contribution from the aquaculture sector. At the very least, the Irish aquaculture industry should be able to develop to the same scale as in Scotland. The cost of complying with EC environmental regulations should be examined to determine whether there is a case for some form of grant-aid.

The sea-fishing sector presents somewhat more difficult problems. It is clear that this sector's economic potential is restricted by the lack of an efficient and high-technology demersal fleet. However, any process of fleet removal must take place in the context of European Community fleet guidelines, which require a reduction in total fleet capacity of almost 5% by the end of 1996.

The vital economic contribution made by fisheries to the preservation of coastal communities has been acknowledged in the National Development Plan 1994-1999. A total fisheries expenditure of £146 million (constant 1993 prices) is envisaged over the period of the Plan, approximately 44% of which will be met from EC sources. The proposals outlined in the Plan should help to correct many of the structural weaknesses that characterise the industry at present and thus provide a firm basis for achieving sustainable increases in output and employment. Given its concern at the sea-fishing industry's present inability to exploit fully certain high value fish quotas, the Council welcomes, in particular, the proposal to renew the existing fleet through a process of vessel construction, modernisation and withdrawal of some existing vessels. Fleet renewal will take place in accordance with the EC guidelines on capacity referred to above. Other measures outlined in the Plan include investment in harbour infrastructure and facilities, construction and modernisation of aquaculture installations, and intensified development of fish processing facilities. It is also intended to establish a programme of marine research, to be conducted under the auspices of the National Marine Institute. The main objectives of this research programme will be to ensure the effective management and environmentally sustainable development of the fisheries sector, and to facilitate the transfer of new technology to the industry.

7. THE EQUINE INDUSTRY IN IRELAND

The equine industry in Ireland is comprised of the thoroughbred and non-thoroughbred sectors. The thoroughbred is mostly concerned with racing - flat and national hunt. The non-thoroughbred sector, now being termed the "Irish Sport Horse Sector", is involved in showjumping, eventing and general leisure riding. While the showjumping and eventing are the high profile elements of the sport horse sector general leisure riding sector provides the main market outlet.

Latest CSO figures put the total horse population at 63,000, of which 25,000 are thoroughbred with the remainder found under the general heading of sport horses.

(i) Potential of the Sector

The potential of the sector must be seen in the improvement in quality of the basic horse population together with added value at the training stage and the maintenance of employment. This has a direct link to exports both in numbers and value to very competitive markets. This will help to secure the future of the farmer/breeders who are primarily farmers while also contributing to tourism in general through the development of equine tourism - racing, trekking and riding schools.

(ii) Policies

Thoroughbred prices have suffered a significant downturn in the last 5 years. Prices of all types of bloodstock have suffered in a sluggish market. In an effort to seek out new markets for thoroughbreds, Irish Thoroughbred Marketing was established. It is a subsidiary of the Racing Board and is financed jointly by the Racing Board and the breeding industry. Three million pounds per year have been made available for a four-year period to support prize money and infrastructure. Plans are well advanced for the introduction of the Irish Horse-racing Authority to provide a centralised structure for the financing, fixture list and promotion of racing. The relevant Bill will be published this Autumn.

The sport horse sector, while experiencing difficulty, has not been as severely affected as the thoroughbred sector. The primary aim is to improve quality and the value added element. The first has been promoted in the last couple of years with the support of funds from the Operational Programme for Rural Development (1991-1993). Total funds were £8.2 million. The improvement in training and marketing of horses has been promoted by the development of regional marketing centres - Millstreet, Cavan and Goresbridge: the total grant aid to these centres (FEOGA and National) has been £2.6 million. It may also be useful to develop a small number of modest centres in other strategic locations over the next 5 years.

8. RURAL DEVELOPMENT

The limitations on expansion of mainstream agricultural enterprises arising from CAP and from the underlying trends in world markets point to the importance of looking to alternative farm enterprises as well as off-farm employment in order to maintain economic activity and population in rural regions. These issues are typically examined under the heading of Rural Development Policy. Given the extent of the external pressures on agriculture, together with the long-run decline in agricultural employment, the long-run future of many farm households will depend on successful diversification of on-farm activities and the development of opportunities for off-farm employment. The balanced development of the rural economy is equally vital to the future of the very substantial non-farming population of rural areas and to the viability and quality of life of communities outside the principal urban centres. It was in response to the significance of these issues that the Council decided to undertake a major project on rural development which is currently at an advanced stage of preparation. The Council will be publishing detailed conclusions and recommendations on rural development policies in the near future, at the conclusion of that project. In this Report, therefore, the Council confines itself to reviewing key issues to be addressed in developing policies for rural development.

There is evidence that while progress is being made to move beyond conventional forms of farm production, the pace of change is quite slow and the speed of take-up among farm enterprises is limited. An exception to this in which there is widespread interest, is agri-tourism.

The pattern of diversification also appears to be selective: those who are most likely to diversify are comparatively young, at an early stage in the family life cycle and relatively well educated. Access to capital is also a requirement for successful diversification. Therefore, those who are most likely to succeed in alternative farm enterprises are those who are also most likely to be successful in commercial agriculture.

An approach to future policy must also take account of past experience and in particular of the way in which rural development has moved on and off the policy agenda. Rural development was an important policy issue with reasonably well-developed policy strategies in the 1960s, but there was a fading of rural development from the policy agenda which reflected an unwarranted confidence in the capacity of the CAP to solve the low-income farm problem. This confidence was misplaced for reasons which the Council has discussed on a number of occasions, including the fact that many low income producers were unable to respond to the incentives offered by the CAP.The limitations on commercial agriculture have refocused interest in rural development. But the problem of economic marginalisation and depopulation in rural areas, which rural development seeks to address, predates the recent impetus for restructuring in commercial agriculture.

It follows that policy approaches to rural development cannot continue to be subsumed under the rubric of *agricultural* development. Rural development has its own rationale and needs a policy strategy which addresses the wide range of policy issues which determine the economic and social viability of rural communities. The Council believes that it is not appropriate to treat rural development as a residual in agricultural policy. It requires a broader approach which recognises the processes by which rural development is integrated into the wider issue of national economic development. It is for this reason that the Council has undertaken a major project in this area and its recommendations arising from the work will be published in the near future.

9. CONCLUSION

The agriculture and food sector is of central importance to the challenge of developing the economy. This sector offers the potential to develop the economy on the basis of indigenous resources. It is an export sector with strong linkages to the domestic economy.

There are opportunities to develop added value in some areas of the food industry, which offers the prospect of some increase in employment against the alternative, benchmark scenario of a decline in employment due to rationalisation in some areas. There are opportunities for increasing employment in the fisheries sector, in particular in the aquaculture sector. While recognising that environmental and other concerns must be protected,

the Council recommends that the difficulties associated with the licensing system for aquaculture should be addressed. There is potential for increasing employment in forestry: realizing this potential requires much greater *consistency* in national policies which affect land use. Continuous improvements in competitiveness are also necessary to safeguard as many existing jobs as possible. The development of the nation's wealth in these areas can provide resources to support employment in other sectors of the economy.

As the Council stated in *A Strategy for the Nineties*, there are great advantages to achieving an agreed global approach to the reform of agricultural support systems in the context of the general trade negotiations now underway. Restrictions on agricultural output[86] of the magnitude envisaged under the emerging GATT agreement are a matter of great concern on both sectoral and national grounds. Their resistance in the Irish context is therefore fully understandable. The benefits to Ireland from the boost to world trade and growth likely to follow on a successful outcome to the Uruguay Round are such that the implications for agriculture must be viewed in the context of the likely impact of the GATT arrangements as a whole. The Council's position on GATT and agriculture can be summarised as follows: Firstly, if the GATT round is concluded it is likely that the outcome will not be significantly different from the main elements of the draft Blair-House agreement and this would define broadly the trading environment in which agriculture will operate for the rest of this decade. Secondly, the Council recommends that Ireland should use its position within the EC to secure the most satisfactory outcome from a GATT agreement, including arrangements for implementation. Thirdly, if the final outcome of the GATT negotiations results in price or volume reductions to EC agriculture in excess of the CAP reform decisions, the EC must provide compensation for such losses, and the burden of adjustment must not be disproportionate to Ireland's economy. This is in accordance with the Council's support of the principle of cohesion.

Whatever the outcome of the GATT negotiations it is clear that the long-run trend is towards greater liberalisation. For this reason the competitiveness of agriculture is an increasingly important concern. The Council emphasises the need for effective policies in the areas of education, research and structural reform.

Culliton (1992) recommended a reduction in state incentives for the food industry. The Council agrees with this recommendation insofar as it relates

86 Note that the output referred to is priced at above world market prices.

to grants for fixed assets. The Council supports the reorientation of resources to intangible assets and the progressive movement from non-repayable grants to other repayable forms of finance.

The recent report of the Expert Group in the Food Industry offers a market oriented plan for the development of value-added. The report makes detailed recommendations on how to achieve this but the underlying theme of the report echoes many previous reports and plans on the food industry. Previous efforts to develop the industry have had some success although the industry remains very much commodity and support oriented.

The support driven nature of the industry has been a rational response to the incentives offered. In many cases intervention has provided a higher net return than commercial markets. These incentives are now changing due to CAP reform and the likely outcome to GATT negotiations. This change will present challenges to the industry. The Council considers that the inevitable changes must be implemented on a gradual basis to allow the industry to adjust. But the changes also mean that it is both essential and timely to make a major effort now to develop the industry in a market-based and value-added direction. The changes in the support environment mean that the incentive to develop in this direction is now much stronger. In addition, the *capacity* of the industry to develop is also stronger. A number of indigenous firms with significant scale and the ability to compete internationally have emerged in recent years. While it is inappropriate for the Council to comment on the specific financial recommendations in the Expert Group's plan for the industry, the afore-mentioned reasons suggest that a concerted effort to support the development of the food industry could produce significantly better returns than previous efforts in the past.

APPENDIX: FORESTRY

Planting 1980 to 1993

HECTARES

	State	Private	Total
1980	6,613	268	6,881
1981	6,994	275	7,269
1982	6,961	499	7,460
1983	6,827	311	7,138
1984	6,959	472	7,431
1985	6,288	764	7,052
1986	7,083	2,561	9,644
1987	7,915	3,213	11,128
1988	10,132	5,253	15,385

	Coillte	Private	Total
1989	10,057	8,594	18,651
1990	10,329	9,217	19,546
1991	12,006	11,385	23,391
1992	11,167	9,447	20,614
1993 (Est)	12,000	11,600	23,000

Note: Approximately 4,000 hectares of Coillte's annual planting is reafforestation of areas following clearfall.

CHAPTER 10

The Role of the Services Sector in Increasing Employment

THE ROLE OF THE SERVICES SECTOR IN INCREASING EMPLOYMENT

The purpose of this Chapter is to assess the role of the services sector as a potential source of employment growth in Ireland. Services now account for the largest share of employment and virtually all of the employment growth in developed countries. However, public policy has paid far more attention to the manufacturing and primary production sectors than to services development. Consideration of the services sector must feature as a core element in any employment strategy. The first section of this Chapter examines the principles concerning the development of services, while the second section reviews the statistical record on services employment in Ireland. Services may be traded (internationally or in the domestic market only) or non-traded. One internationally-traded sector that recorded very significant growth during the late-1980s is tourism. Chapter 11 therefore focuses on the economic potential of tourism activity, describing the recent evolution of the sector in terms of both policy and trends in visitor numbers, revenue and employment.

1. THE SERVICES SECTOR: PRINCIPLES

Traditionally, analysis has regarded employment in the services sector as a derivative of employment in the rest of the economy, and that it is indirect employment, supported by the manufacturing and agriculture sectors. For example, O'Malley (1993) estimates that manufacturing industry supports from 175,000 to 180,000 jobs indirectly in services. On the other hand, critics of this derivative view of services argue that typically manufacturing and agriculture experience declining employment in developed countries, while employment in the services sector continues to expand. Given this combination of employment trends it is argued that it is not valid to view the services sector as merely a derivative of economic activity elsewhere.

However, increasing specialisation of production may result in industrial and, to some degree, agricultural units purchasing services that were previously performed in-house. For example, services such as advertising, accountancy, consultancy and cleaning were in the past generally provided by manufacturing firms themselves. Increasingly, such services are bought in by firms which have sought to concentrate internal energies on their core businesses. Furthermore, large firms may establish subsidiary enterprises to carry out specific service functions. The net effect of these various trends towards increasing specialisation is that some employment previously attributable to, say, manufacturing will be located in the services sector. The scale of this effect should probably not be overstated, however. The growth of the service sector reflects improved efficiency of provision and the development of new service products, both of which can improve the competitiveness of the traded sector and facilitate an expansion in total employment.

In examining the role of the services sector in a small open economy such as Ireland, we need to distinguish the traded and non-traded sectors. The internationally-traded sector contains those activities which are subject to open international competition and includes manufacturing, agriculture and some services. The domestically-traded sector consists of activities which enjoy some natural protection from international competition and includes most market services and building and construction. The non-traded sector comprises activities which are effectively protected from competition, and comprises mainly public services. The internationally-traded sector is generally seen as being the key to growth in a small open economy. Within this framework it is clear that internationally-traded services can make an independent contribution to employment growth. This points to the importance of sectors such as tourism, which are both internationally-traded and highly labour intensive.

A more contentious issue is whether domestically-traded and non-traded services can make an *independent* contribution to employment growth. The Council has argued in the past that "those sectors of the economy which exclusively or predominantly serve the domestic market cannot be regarded as an independent source of sustained economic growth ... The demand for the goods and services produced by these sectors is a derived demand and the output they produce and the level of employment they provide are ultimately determined by the size of the exposed sector and the strength of the economic linkages between the exposed sector and the rest of the economy". The reason why the domestic sector is generally regarded as derivative is based on balance of payments effects. If output and employment in the domestically-traded and non-traded sectors are increased then, other things being equal, this will generate a demand for imports. If the output of the internationally-traded sector is unchanged, this may pose a balance of payments problem. On the other hand, if the internationally-traded sector expands, this will initially improve the balance of payments situation and it will be possible for the increase in output and employment in the traded sector to generate a derived expansion of output in the non-traded sector without posing a balance of payments problem.

O'Rourke (1991) has challenged this analysis of the traded and non-traded sectors. He argues that it is not valid to regard the non-traded sector as derivative. He argues that if the output of the non-traded sector were to expand via a shift in demand towards domestically-traded or non-traded services, the resulting increase in consumption of non-traded output could assist growth, and - on the basis that non-traded output generally is less import-intensive than traded output - would be unlikely to prompt a balance of payments problem. This outcome is possible provided such a switch does not lead to domestic inflationary pressures which themselves could damage the competitiveness of the internationally-traded sector. This can come about by a change such as an increase in demand for a non-traded sector output as a result of changing preferences, or more likely by a fall in the price of non-traded output. Public service output and employment can be viewed in this context. If there is an increase in demand for public services and an associated willingness to incur the required taxation, then it is possible to achieve an independent increase in output and employment in the non-traded sector. This assumes that investment levels and wage competitiveness are unaffected by the higher taxation, which clearly may not be the case. If the cost of public services fell and remained at the new, lower level over the long-term, it would be plausible to expect an independent increase in public service output and employment without giving rise to a balance of payments constraint.

However, this review of possible independent growth in the non-traded sector does not undermine the general validity of an approach which regards the traded sector as the engine of growth in a small open economy. For example, the attraction of mobile investment to Ireland generates direct employment as well as indirect employment resulting from the expenditure of those directly employed. It is valid to consider such indirect activity as being derived from the traded sector. If the internationally mobile activity had been attracted to somewhere other than Ireland then the indirect activity would also be located outside of Ireland.

Moreover, the distinction between internationally-traded and other services is being eroded. This is reflected in the growing share of services in flows of foreign direct investment. It is also evident in the extent to which activities in the manufacturing sector are dependent upon specialist services eg. information technology. The desire to cover international trade in services in the Uruguay Round of the GATT negotiations testifies to this trend. Finally, completion of the Single Market programme has dramatically altered the status of many formerly protected sectors and exposed them to overseas competition in the domestic market.

2. SERVICES EMPLOYMENT: THE STATISTICAL RECORD

(i) Service Sector Shares

To consider whether services employment in Ireland is relatively under-developed we will firstly examine the share of services in total employment. It can be seen from Table 10.1 that the share of services in employment in Ireland is not particularly low by EC standards; it is, for example, similar to Germany and Spain and considerably higher than Portugal. If the share of services is expressed as a percentage of *non-agricultural* employment, then the relative share of services for Ireland is considerably higher (Table 10.2). Expressed in this way the share of employment in services in Ireland is higher than in Italy, as well as in Germany and in Spain.

The share of market services in total employment lies in the middle of the range of EC countries. The share of market services in non- agricultural employment in Ireland is lower only than in the UK, the Netherlands, Belgium and Luxembourg. The proportion of employment in non-market services in Ireland (17%) ranks as eighth out of eleven EC countries. The shares of non-market services are in fact quite close for most countries, with France (25%) and Denmark (31%) being higher than most, while Ireland's share is similar to that of Spain (18%) and Portugal (18%). Although the share of non-market services in total employment does not appear particularly high in Ireland, its share of total output is the third highest in the EC, at 16.7% (see Table 10.2(ii)).

Table 10.3 compares the share of employment in various service categories in Ireland to other small countries with lower unemployment. A notable feature is that the share of employment in community social and personal services in Ireland is lower than in Scandinavian countries. Public services are a sub-set of community, social and personal services, so that this difference primarily reflects the higher public service employment in these countries. When the share of community, social and personal services is expressed as a share of non-agricultural employment, the gap between Ireland and the Scandinavian countries is considerably narrowed.

TABLE 10.1

Significance of Total Market and Non-Market Services as a Proportion of Total Employment and Output, EC Countries, 1989

(i) Shares of Total Market and Non-Market Services in Total Employment (%)

1989	Total Services	Market Services	Non-Market Services
Belgium	69.9	47.7	22.2
Denmark	66.2	35.3	30.9
Germany	56.6	36.7	19.9
Spain	56.5	38.6	17.9
France	65.1	39.8	25.3
Ireland (1990)	**56.8**	**39.7**	**17.1**
Italy	60.4	42.2	18.2
Luxembourg	65.1	52.0	13.5
Netherlands	67.0	50.9	16.1
Portugal	45.8	28.2	17.6
UK	68.7	48.6	20.1

(ii) Shares of Market and Non-Market Services in Gross Value-Added at Current Market Prices (%)

1989	Market Services	Non-Market Services
Belgium	52.5	13.0
Denmark[1]	46.1	22.2
Germany	45.9	13.2
Greece[1]	38.9	17.0
Spain	47.3	12.4
France	49.8	16.4
Ireland (1988)	**36.6**	**16.7**
Italy	48.9	13.3
Luxembourg	49.3	12.8
Netherlands	50.8	12.0
Portugal	42.7	13.3
UK	49.7	15.1
EC (12)	48.2	14.3

1 These data relate to gross value-added at factor cost, not at market prices.

Source: (i) Eurostat National Accounts 1984-1989, Volume 2C. Irish Data: Department of Finance databank.
(ii) As for (i), but Irish data also from Eurostat.

TABLE 10.2

Share of Services in Total Non-Agricultural Employment

1989			
	Total Services	Market Services	Non-Market Services
Belgium	70.7	48.2	22.5
Denmark	71.0	37.9	33.1
Germany	58.7	38.1	20.6
Spain	62.2	42.5	19.7
France	67.9	41.5	26.4
Ireland (1990)	**66.5**	**46.6**	**20.1**
Italy	64.2	44.9	19.3
Luxembourg	67.7	54.1	14.0
Netherlands	72.2	54.9	17.3
Portugal	56.4	34.7	21.7
U.K.	70.0	49.5	20.5

Source: OECD Labour Force Statistics 1969-1989. The figures for market and non-market services have been calculated in conjunction with the information in Table 10.1 and should be read as indicative only. Irish data: CSO Labour Force Survey and Department of Finance.

TABLE 10.3

(i) Share of Service Sectors in Total Employment

1988				
	Wholesale and Retail Trade	Transport, Storage and Communication	Finance and Business Services	Community, Social and Personal Services
Ireland	17.9	5.9	7.8	24.9
New Zealand	19.9	7.1	9.9	26.4
Switzerland	20.8	6.1	10.4	21.9
Denmark	14.5	7.4	9.7	34.4
Norway	18.1	8.4	8.0	32.4
Sweden	14.2	7.0	8.0	37.4

(ii) Share of Service Sectors in Non-Agricultural Employment

1988				
	Wholesale and Retail Trade	Transport, Storage and Communication	Finance and Business Services	Community, Social and Personal Services
Ireland	21.2	7.0	9.2	29.4
New Zealand	22.2	7.9	11.0	29.5
Switzerland	22.0	6.5	11.1	23.3
Denmark	15.4	7.9	10.3	36.5
Norway	19.3	9.0	8.5	34.7
Sweden	14.8	7.3	8.3	38.9

Source: OECD Labour Force Statistics 1969-1989.

(ii) Growth of Services Employment

Over the period 1973 to 1990, the average annual rate of growth of total services employment in Ireland was 1.7% (see Table 10.4). This places Ireland as fourteenth out of the sixteen OECD countries for which we have data. The non-European OECD countries enjoyed considerably faster growth in services employment at this time, as reflected in the performance of the United States (2.7% p.a.), Canada (2.9% p.a.), and Australia (2.9% p.a.). The same was true of the performance of some of the Scandinavian countries, eg. Norway (2.5% p.a.) and Finland (2.3% p.a.). Within the EC, Italy and Greece recorded the fastest growth in services employment, both at 2.6% per annum. The growth of services employment in Ireland during 1973-1990 (1.7% p.a.) fell far short of these levels and was below both the EC and OECD averages (2.0% p.a. and 2.4% p.a. respectively).

There was considerable variation in performance over this seventeen-year period. During the period 1973 to 1979, services employment in Ireland grew by 2.7% per annum. This ranks Ireland as sixth out of the sixteen countries examined, below only the United States, Canada, Italy, Norway and Sweden. By contrast, during the 1980s, the increase in services employment in Ireland was very low compared to other countries, at 1.2% per annum. This represented lower employment growth than in any of the other countries for which we have data.

TABLE 10.4

Total Services Employment
Average Annual Rate of Employment Growth (%)

	1973-90	1973-1979	1979-1990
Australia	2.9	2.2	3.3
Canada	2.9	3.6	2.5
US	2.7	3.2	2.4
Italy	2.6	2.7	2.5
Greece	2.6	2.2	2.9
Norway	2.5	4.0	1.7
Finland	2.3	2.2	2.3
Japan	2.1	2.2	2.0
Sweden	2.0	2.9	1.5
Spain	2.0	0.9	2.6
Denmark (76-90)	2.0	N.A	1.7
UK	1.8	1.4	2.0
France	1.8	2.1	1.6
Ireland	**1.7**	**2.7**	**1.2**
Germany	1.6	1.5	1.7
Belgium	1.5	1.9	1.3
Netherlands	N.A	1.8	N.A
EC	2.0	1.8	2.1
OECD	2.4	2.5	2.3

N.A: Not available.

Note: Countries are ranked on the basis of employment performance, 1973-1990.

Source: OECD Historical Statistics, 1960-1990, Table 1.11. Irish data: Department of Finance databank and CSO, Labour Force Survey.

Over the period 1970 to 1990, employment in *market services* in Ireland grew by 1.6% per annum (see Table 10.5). This places Ireland in the middle of the range of EC countries for which data are available. The most rapid growth in market services employment within the EC was achieved in Italy (2.8% p.a.). Italy's performance was, however, quite exceptional by EC standards, and all other EC countries fell into the range of 0.8% p.a. - 1.8% p.a. Market services employment growth was significantly stronger in *non-European*

OECD countries than in the EC, as reflected in the performance of Canada (3.3% p.a.), the United States (3.1% p.a.) and Australia (3.0% p.a.).

TABLE 10.5

Employment In Market Services
Average Annual Rate Of Employment Growth (%)

(a) EC Countries

	1970-89	1970-80	1980-89	1985-89
Italy	2.8	2.6	3.0	1.8
UK	1.8	1.2	2.5	3.1
France	1.7	2.0	1.4	2.3
Ireland[1]	**1.6**	**1.7**	**1.5**	**2.9**
Belgium	1.4	1.3	1.4	2.6
Netherlands	1.3	1.6	1.0	2.3
Germany	1.0	0.9	1.1	2.2
Denmark	0.8	0.6	1.1	1.4
Spain	N.A	N.A	1.2	4.8
Portugal	N.A	N.A	1.4	N.A

(b) Non-EC Countries

	1970-90	1970-79	1979-90
Canada[3]	3.3	4.0	2.7
USA[2]	3.1	3.3	3.0
Australia	3.0	2.8	3.2
Japan	2.4	2.4	2.3
Norway	1.8	2.4	1.3
Finland	1.2	0.9	1.5
Sweden[3]	1.1	0.7	1.4

1 Data for Ireland cover the period to 1990. The sub-periods used for Ireland are: 1970-90; 1970-80; 1980-90 and 1987-90. For explanation as to why the last of these periods was used, see text.

2 US: 1970-1987 and 1979-1987.

3 Canada and Sweden: 1970-1989 and 1979-1989.

Note: (a) Because of the different sources used, direct comparisons between EC and non-EC countries must be treated with caution.
(b) Countries have been ranked on the basis of the growth in market services employment 1970-1989/90.

Source: (i) Italy, Greece, Spain, Portugal, France, UK, Belgium, Netherlands, Germany, Denmark: Eurostat National Accounts, 1984-1989, Vol. 2C, Tables 5 & 6, p.34. Irish data: Department of Finance Databank.
(ii) Other countries: calculated by aggregating the relevant sectors from OECD International Sectoral Databank and OECD National Accounts, Vol. 2 (see Appendix 4 for details).

The pattern of employment growth in market services in Ireland over the past two decades has been less volatile than that of total services. While there was a recession-induced slowdown during the first part of the 1980s, the growth in market services employment was, on average, broadly similar during the 1970s and 1980s (1.5% p.a. in 1980-90 compared with 1.7% p.a. in 1970-80). It was noted earlier that the growth in employment in *total* services was lower in Ireland than in any other country examined during the 1980s. This was *not* the case for *market* services. During the 1980s the growth of market services employment in Ireland (at 1.5% p.a.) compared quite favourably to other EC countries, although it remained below the rapid growth rates achieved in non-European countries, such as Australia (3.2% p.a.) and the US (3.0% p.a.).

Over the period 1970 to 1990 employment in non-market services in Ireland grew by an average of 2.1% p.a. (see Table 10.5). This lies towards the upper end of the EC range. Within the EC, the highest rates of growth of non-market services were experienced by Spain (6.9% p.a.) and Denmark (3.4% p.a.). Outside the EC, relatively high rates of growth in "Government Service" employment were recorded in the Scandinavian economies, while the growth of "Government Service" employment in the US and Japan (but not Australia) was low by European standards.[87]

87 Employment in "Government Services" is used here as a proxy for non-market services.

TABLE 10.6

Non-market Services
Average Annual Growth Rates of Employment (%)

(i) EC Countries

	1970-89	1970-80	1980-89	1985-89
Spain	6.9	8.4	5.2	4.8
Denmark	3.4	5.4	1.2	0.9
Italy	2.2	2.7	1.6	1.1
Ireland	**12.1**	**4.2**	**0.2**	**-1.0**
Germany	2.0	2.6	1.4	1.5
France	1.9	2.1	1.7	1.0
Belgium	1.4	2.4	0.3	0.0
Netherlands	1.1	1.7	0.4	0.2
UK	1.1	1.6	0.5	1.8
Portugal	N.A	N.A	1.8	1.6

(ii) Non-EC Countries[3]

	1970-90	1970-79	1979-90	1985-90
Norway	3.7	5.3	2.5	2.1
Finland	3.5	4.7	2.5	1.9
Sweden	2.9	5.0	1.3	0.3
Australia	2.9	3.3	2.6	1.9
US[2]	1.1	1.1	1.1	1.8
Japan	1.1	2.3	0.2	0.0

1 Irish data cover the period 1970-1990. The relevant sub-periods for Ireland are: 1970-90; 1970-80; 1980-90 and 1985-90.

2 US data cover the period to 1989. The sub-periods are: 1970-79; 1979-89 and 1985-89.

3 Non-EC data relate to employment in "Government Services". See Appendix 4 for differences between this and the somewhat wider concept of "Non-Market Services" used for the EC.

Note: Countries are ranked on the basis of the increase in employment, 1970-1989/90.

Source: (i) Eurostat National Accounts, Vol. 2C, 1984-1989. Irish data: Department of Finance databank.
(ii) OECD International Sectoral Databank and OECD National Accounts. See Appendix for details of the definition used.

All countries experienced a slowdown in the rate of growth of non-market service employment during the 1980s, except the US which maintained a constant (low) growth rate of 1.1% p.a.[88]

The *extent* of the slowdown was significantly more marked in Ireland than in other countries, however, and became increasingly pronounced as the decade progressed. During the second half of the 1980s, employment in Ireland's non-market service sector fell sharply, by an average of 1.0% p.a. Ireland was the only country to register a *decline* in non-market service employment at this time. The pattern in most EC countries during these years was for modest growth in non-market service employment, of the order of 1-1.5% p.a. This decline was associated with the necessary fiscal adjustment in the 1980s, correcting the unsustainable fiscal expansion of the late-1970s, which in turn was associated with a significant rise in public service employment.

(iii) Internationally-Traded Services

As noted earlier, market services may be traded internationally or domestically. A key factor determining the traded status of a service is its value relative to transport costs. However, in some instances non-tradedness may be a consequence of government regulations on market entry.

Data on trade in services as a proportion of total trade in goods and services in 1989 show that Ireland had the lowest proportion of services exports in total exports within the EC. Only 9.9% of Ireland's total exports in 1989 were in services, while the corresponding proportion for the Community as a whole was 20%. For all EC member States, exports to non-EC regions have a proportionately higher services element than do intra-EC exports. This suggests that successful development of the Irish internationally-traded services sector may depend on the future growth prospects of non-EC markets. Third, imports of services to Ireland account for a comparatively low proportion of both total imports and imports from outside the EC.

However, when trade in services is expressed in terms of national income, the data show that export of services in 1989 represented 6.5% of GDP in Ireland, compared to 5.7% for the EC as a whole. Services imports

88 Curiously, the US data show an *increase* in this growth rate in the second half of the 1980s, to 1.8% p.a. in 1985-90. This contrasts markedly with the international trends and leaves the US with a relatively *high* rate of growth for this period.

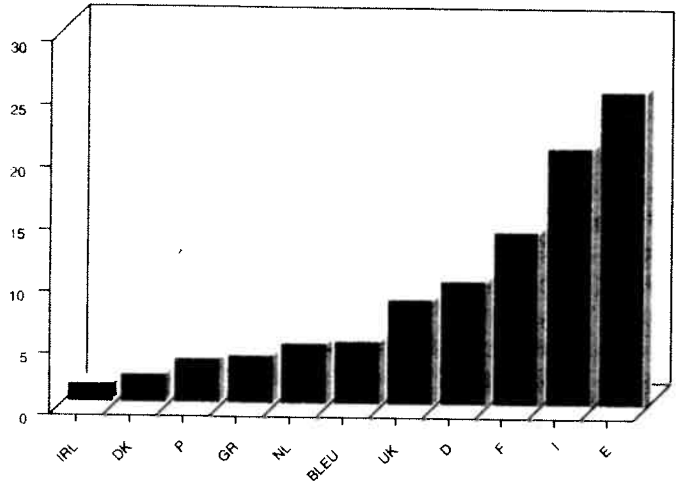
represented 8.25% of GDP in Ireland, compared to 5.25% for the EC as a whole. Given that Irish trade performance is dominated by the manufacturing sector, comparative performance in trade in services may better be assessed in terms of the GDP comparison. This suggests that Ireland is reasonably successful in exporting services but relatively poor at servicing domestic demand for internationally-traded services.

Figure 10.1 (i)-(iii) shows Ireland's intra-EC export shares, averaged over the period 1987-89, for three internationally-traded services viz. tourism, banking and business services. During the period under consideration, Ireland had the lowest share of intra-EC export markets for each of these categories of services. In tourism, for example, Ireland - despite having a relatively high share of national income arising in tourism - had only 1.5% of the intra-EC export market, compared with shares of 8.5% for the UK and 25.3% for Spain. An even lower Irish export share, 0.2%, was recorded for banking and for business services. While modest market shares are perhaps to be expected given Ireland's small geographical size, it is noteworthy that other small European countries have managed to establish very significant market niches for some types of services. In the EC business services market, for example, the Belgo-Luxembourg Economic Union and the Netherlands had export shares of 26% and 23%, respectively. The Belgo-Luxembourg Economic Union also had a high market share, almost 18%, of banking services. Even though a strategic European location and a special banking regime can explain part of this impressive performance, the evidence seems to suggest that Ireland, even allowing for its small size and peripheral location, has the potential to develop a greater share of key services markets.

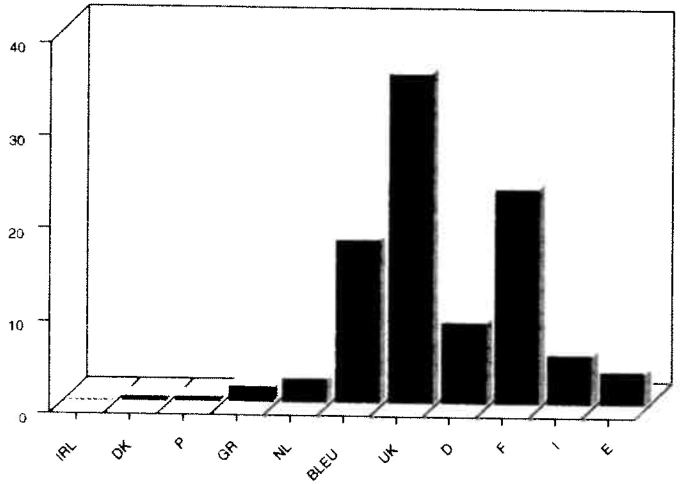
FIGURE 10.1

Member States' Shares of Intra-ec Export Markets in Tourism, Banking and Business Services Average 1987-1989

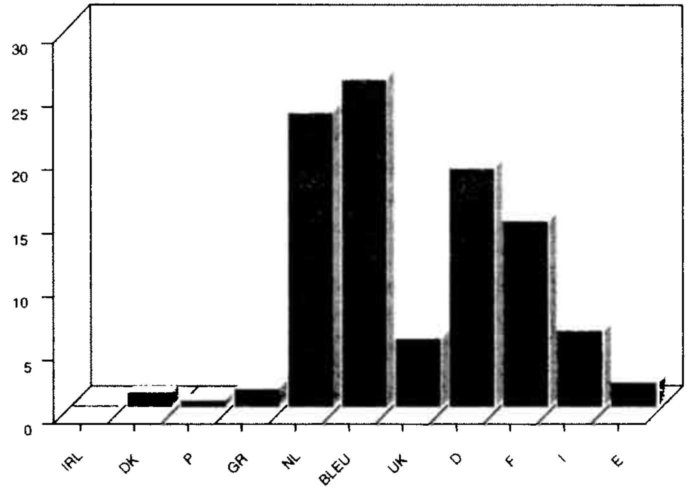
(i) Tourism



(ii) Banking



(iii) Business Services



Note: BLEU = Belgo-Luxembourg Economic Union.

Source: European Economy, Supplement A, Recent Economic Trends, No. 5, May 1993.

3. FURTHER ISSUES CONCERNING THE SERVICES SECTOR

The possible channels through which the services sector could be viewed as making an independent contribution to employment and output were set out in Section 1. Rather than being constrained by the performance of the traded sector, internationally-traded services such as tourism and, increasingly, business and financial services can, via improvements in their quality and cost competitiveness, contribute to sustainable increases in output and employment. Another key factor is growth in overseas demand for such services, which reflects the level of economic activity in the economies concerned. Moreover, secular rises in average living standards and evolving patterns of consumer preferences may stimulate an expansion of those non-traded service industries catering to final consumer demand in areas such as recreation or leisure activities. The latter trend has, in general, been a well-observed phenomenon as economies enter higher stages of development.

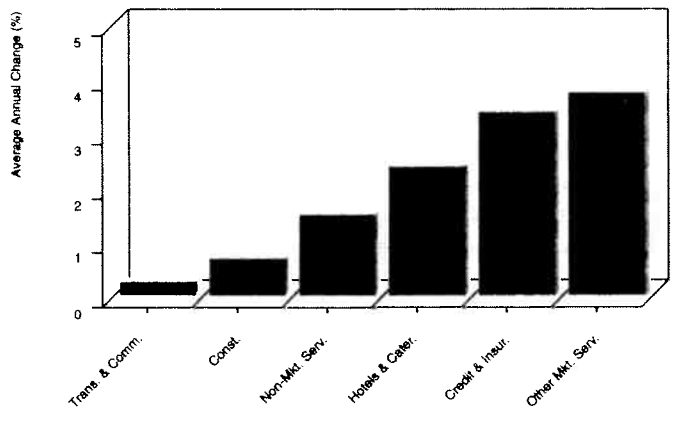
Whether non-traded or domestically-traded support services for industry also function as a primary source of job creation is, however, a much more ambiguous issue. Nevertheless, as indicated previously, development of new and more efficient support services may enhance the competitiveness of the traded sector, thereby facilitating growth in total employment. In this context the Council wishes to draw attention to the importance of the efficiency and effectiveness in all support services, including the public services, for the performance of the economy and of employment. This has been discussed in more detail in Chapter 4. The availability of an efficient infrastructure of public services enables economic activity in all sectors to develop and to provide a basis for increased employment. It therefore constitutes one of the most important contributions which the services sector can make to employment growth.

Given the foregoing comments on the extent of the services sector's ability to contribute to employment growth, the case for its intensified development is founded on a number of arguments. To begin with, an international trend over the past 10-20 years has been for employment growth to be located disproportionately in the services sector. The European Community, for example, experienced service-sector employment growth of almost 12 million during the 1980s, at a time when industrial and agricultural employment fell by about 8 million (Commission of European Communities, 1992). Over the long-run period 1970-1989, the share of services in total employment increased significantly in all major trading regions, from 44% to 61% in the European Community, from 58% to 71% in the United States, and from 44% to 58% in Japan. Moreover, there is nothing to suggest that a significant deceleration in services employment growth will occur in years ahead. As Table 10.3 shows, the compound annual rate of services employment growth in neither the EC nor OECD has altered markedly since 1973. It should also be borne in mind that services employment in the EC has not grown as rapidly or achieved quite the same degree of predominance as in the United States, suggesting that considerable scope for further development still exists (see Table 10.3 for employment growth rates).

For an economy characterised by a very large labour surplus, further growth of services offers a number of advantages that may not be present to the same extent in other areas of the economy. First, although the use of capital and the influence of technology tends to vary widely according to the type of service being provided, the services sector is generally labour-intensive. Thus, output growth in services will generally contribute more than other sectors to employment levels. Second, because of lower capital requirements in comparison with other sectors of economic activity, economies of scale tend to be of less importance and barriers to market entry correspondingly weaker. For these reasons, the responsiveness of employment in this sector to policy changes may be of a higher magnitude than that obtaining elsewhere in the economy.

FIGURE 10.2

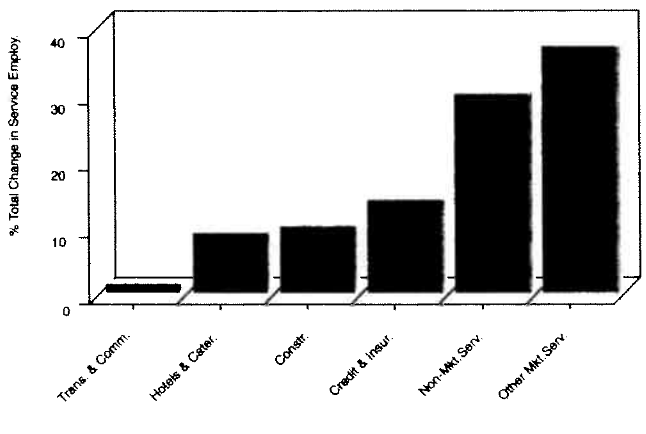
Growth of Full-time Equivalent Employment in Service Activities in the Community 1980-1989



Excludes Gr. and Irl.

FIGURE 10.3

Contribution of Activities to Overall Growth of Employment in Services In the Community 1980-1989



Excludes Gr. and Irl.

However, unlike manufacturing, the services sector tends to display a wide variation in the type of employment provided and skill levels required. Services are, for example, commonly associated with a greater incidence of part-time and other atypical forms of employment. Within the European Community, 18% of those employed in services in 1989 worked on a part-time basis. There is also a tendency for the incidence of part-time work to increase in line with the share of services in total employment across Community countries (Commission of the European Communities, 1992). Nevertheless, even when expressed on a full-time equivalent basis, significant growth in the share of services in the total volume of EC employment is still evident.

Employment in services generally reflects extremes in terms of skill levels. Some service functions, such as in distribution or transport, may require only moderate skill attainments, while others, particularly those involving the use of new technology, may need high-level training. Given this broad division of skills, it is necessary to establish which categories of services present potential for employment growth within the EC. Obviously, those service industries that are flourishing internationally are likely to be those that will provide the bulk of extra services employment in Ireland in the future, although it must be noted that, as in manufacturing, developing countries provide a growing source of competition for internationally-traded services.

Figure 10.2 shows the growth of full-time equivalent services employment in the Community over the period 1980-89. As may be seen, those sectors recording the highest average annual growth rates were 'other market services', credit and insurance, and hotels and catering. The 'other market services' category comprises activities ranging from entertainment to hairdressing. Both the credit and insurance category and, to a lesser extent, 'other market services' could be described as having a relatively high skills content on average. Two service industries with a lower skills element, transport/communications and distribution, displayed a much slower pace of growth over the 1980s.

Figure 10.3 illustrates the contribution which these services activities made to the total increase in services employment that occurred in the EC during the 1980s. Three categories - other market services, non-market services, and credit and insurance - contributed approximately 75% of the total increase in service jobs. Although credit/insurance and hotels/catering registered stronger average annual growth rates than did non-market services (Figure 10.2), they produced fewer absolute gains in employment because of their smaller size.

Given that the areas most likely to support increased services employment can be identified, it is necessary to consider what role public policy can pay in assisting the development of services. Irish public policy has generally exerted a certain degree of bias in favour of industry and against services. This may be seen from a brief consideration of three areas of public policy that influence economic performance and employment-creation viz. taxation, grant-aid and training provisions.

The operation of the tax code has not resulted in neutrality between the services and manufacturing sectors. A significant source of non-neutrality results from the present structure of Corporation Tax. Only a limited number of services, including eligible activities in the International Financial Services Centre and Shannon region, benefit from the 10% rate of Corporation Tax applying to manufacturing. In addition, various tax-related investment incentive schemes are not available in respect of investment in the majority of service activities. Income tax relief under the Business Expansion Scheme, for example, is only available in respect of some service activities, such as non-accommodation tourism, and those that have received grant-aid from an industrial development agency.

Some narrowing in the extent of differential tax treatment of services and manufacturing has occurred in recent years. For example, the services sector has benefited from the reduction in the standard rate of corporation tax from 50% to 40% since 1988 although the sector continues to face a substantially higher rate of corporation tax than that applied to manufacturing firms. The extent of tax relief available to employees investing in their employer's company, including those engaged in services, has been increased significantly. The 1993 Budget and Finance Act also lowered the rate of VAT to be levied on labour-intensive service industries from 16% to 12.5%, using the 'parking rate' facility available under the EC VAT Rates Directive. In addition, service and manufacturing companies supplying inputs to exporting firms now benefit from a zero-rate of VAT on such inputs.

While some improvement has occurred in the tax treatment of the services sector, other biases are evident in the operation of various training schemes. Training Activity and Apprenticeship Grants funded under the Levy Grant Scheme, for example, are not available to service-sector companies. The Training Support Scheme and the Training Industry Grants benefit some types of services, but only those that are categorised in the internationally-traded sector or that involve physical distribution activities.

A similar orientation towards the manufacturing sector emerges with respect to IDA grant assistance, which, although generally available to manufacturing, is confined within the services sector to specific activities which have been designated and which are internationally-traded.[89] Given their emphasis on skilled labour and lower capital requirements generally, support for internationally-traded service activities is predominantly in the form of employment grants, with the key criterion determining eligibility being the potential to produce export earnings.

Thus it can be concluded that some of the principal policy instruments that are designed to support employment growth are limited in their approach to the needs of the services sector. Moreover, the public assistance that has been provided to services activity is oriented towards the specific activities that have been designated as being within the internationally-traded sub-sector. In general, the Council believes that this is in keeping with the characteristics of much service sector activity. For example, as noted earlier, lower capital requirements and fewer economies of scale suggest that initial grant assistance is less crucial to the success of a services operation than of a manufacturing enterprise. For this reason, start-up assistance to services may carry higher deadweight costs than those associated with comparable support for industry generally. Related to this, there is also the problem of potentially large displacement rates. Given that many services cater exclusively to the domestic market and given low entry barriers, grant assistance may have the principal effect of conferring an unfair competitive advantage on new entrants, resulting in considerable market displacement of existing firms and hampering the objective of achieving net gains in employment. The Council believes that it is appropriate to concentrate state assistance to services within the internationally-traded sub-sectors.

However, the Council believes that support for services development should play a more central role in future strategies for employment growth, in a number of respects. Firstly, public policy could support a more competitive environment in domestically-traded services, facilitating entry and minimising unit costs through eliminating restrictive practices, barriers to entry and legal monopolies. The Competition Act provides a framework within which this can be achieved. The resulting greater efficiency and concern with market trends would represent an improvement in the competitiveness of the economy generally, especially of the internationally-traded sector which consumes domestically-traded services as an input. The Council's recommendations on the development of competition policy are set out in Chapter 4.

89 See Chapter 8 for details of internationally-traded services qualifying for IDA assistance.

Secondly, there is a strong case for providing supports for enterprise development - in areas such as managerial capacity and business and financial planning - to those contemplating establishing enterprises in the services sector on the same basis as in manufacturing. This does not imply that public resources should be made available in the form of grants for all enterprises equally, but rather that the merits of a strong and dynamic services sector, even in those activities which are not internationally-traded, is in the interests of the economy and of competitiveness. The Council notes that the newly-established County Enterprise Partnership Boards will have a remit in this regard.

Thirdly, the greater exposure of services activity to international competition, and therefore the scope for developing services exports as well as the prospects of greater competition from overseas, require an appropriate reorientation of policy. For example, the definition of internationally-traded services applied in various programmes and policies should be kept under review and adapted as necessary in the light of changing market circumstances. The thrust of public policy in respect of the expanding areas of internationally-traded services should reflect the same principles as apply in the case of industrial policy at present:

- to develop the capacity of indigenous firms to manage and grow successful companies, including the development of expertise in marketing, research and development and application of new technology;
- to address gaps in the availability of finance on reasonable terms for the establishment and development of businesses, as discussed in Chapter 12;
- to facilitate development of export markets, through support for collaborative efforts in marketing and product development;
- to encourage import substitution and better linkages between indigenous service providers and the foreign-owned sector of industry.

The implementation of the approach will require an appropriate allocation of resources by the relevant promotional agencies which, in turn, will require the development of better information about service areas with the scope for employment expansion, including areas not currently covered adequately by official statistics or by representative or sectoral organisations. However, there may be a need for special institutional arrangements to address particular needs. For example, the accreditation of institutions providing

English language tuition has already been identified as an initiative which would secure and expand employment opportunities. Similarly, the question of Irish participation in regional development banks and similar agencies which fund overseas consultancy projects needs to be considered as a means of improving opportunities for the export of Irish business services. The Council notes that a Task Force on Services is preparing a report which is likely to identify further policy issues of this kind.

The Council's overall conclusion on the services sector is that it will be the principal source of employment growth in the years ahead. While much of this growth will arise from the evolution of economic activity in line with long-run trends in income levels and in technology without the need for special assistance, the Council believes that the growing internationalisation of services activity requires an appropriate set of public policy responses to strengthen the capacity of indigenous service firms to survive and expand to meet the emerging opportunities. However, the primary condition for successful services development, reflecting their relative labour intensity, is the achievement of the Council's objectives for development of a more competitive society across the full range of the strategy outlined in Chapter 4.

CHAPTER 11

Tourism Policy

TOURISM POLICY

The strong economic performance of tourism in recent years, coupled with chronically high levels of unemployment in the general economy, has increased emphasis on this sector as a vehicle for attaining fast employment growth. Tourism activity has a number of desirable traits from the point of view of an employment strategy, including its capacity to generate foreign-exchange earnings, its generally high labour intensity, and the use made of indigenous resources. Although somewhat neglected, from a policy perspective during the first part of the 1980s, the sector was identified by the *Programme for National Recovery* (1987) as an area of considerable employment potential and a commitment was given to its development. Later years have seen this policy momentum continue to grow. The *Programme for Economic and Social Progress* reaffirmed the commitment made in the PNR to tourism development, setting an employment generation target of 15,000 additional jobs for the sector over the period 1991-93, to be achieved by an increase in overseas visitor numbers of 1.4 million. More recently, the report of the Tourism Task Force detailed a package of investment and promotion measures designed to produce a 50% increase in real foreign-exchange earnings and 35,000 extra jobs over the coming five years. The potential of the tourism sector has been further identified in the Programme for Partnership Government.

These optimistic assessments of the industry's potential are undoubtedly influenced by the remarkable revival, described in more detail below, in the fortunes of overseas tourism to Ireland since 1986. The present situation is in sharp contrast to the background against which the previous NESC study on tourism policy (NESC Report No. 52) was set. Then the industry had been characterised by falling real revenues and declining average length of stay of visitors. Tourism's performance remained unimpressive into the mid-1980s. Its growth in recent years is attributable to a variety of factors, notably the impact of low inflation and a stable exchange rate within the EMS on our competitiveness as a holiday location, some liberalisation of air routes, and substantial growth in tourist numbers from continental Europe, reflecting improved marketing.

The next section reviews the main trends in visitor numbers and revenues over the last decade. The primary focus will be on overseas tourism to the Republic of Ireland. The two remaining types of tourism, cross-border and domestic, appear to offer some limited prospects of development. Although not insignificant, the number of cross-border visitors is small in relation to total visitors and it is arguable in any event that these are motivated principally by commercial or family reasons, rendering them largely unsusceptible to promotional measures. Domestic tourism (i.e., holidaying by Irish residents within the geographic area of the Republic), on the other hand, has a significant role to play in effecting a redistribution of income and jobs between regions, and it also offers substantial scope for import substitution. The potential significance of domestic tourism has been constrained by the long-run and continuing shift in the preferences of Irish holiday-makers towards foreign destinations. The development of domestic business has the potential to provide a major boost to the industry, supporting demand for labour- intensive services. In particular, short break domestic tourism is important because of the scope which it affords for tackling the problems associated with a high seasonal concentration of visitors.

The Council's principal concern is with the employment contribution that tourism can make and not least the type and quality of such jobs. Estimates of tourism-related employment and its structural composition are examined below.

Section 2 considers the economic rationale for State investment in tourism and Section 3 traces the evolution of policy towards this sector in recent years. Given that public resources devoted to tourism could be used for other areas of industrial development, the question must be asked whether these returns, in terms of quantity and quality of jobs, justify the costs involved. Some general EC developments affecting tourism are also briefly described.

1. TOURISM TRENDS

(i) Trends in Overseas Tourism

Table 11.1 depicts the strong growth that has occurred in the numbers of overseas visitors and the doubling of holiday visitors to Ireland since 1986. This favourable performance differs markedly from the situation in the early to mid-1980s, when visitor numbers were occasionally stagnant or declining. Over the six year period to 1992, an increase in overseas tourism of 1.3 million was recorded, indicating a compound growth rate of 9.48% per annum. This period witnessed a doubling of holiday visitors. Growth was strongest up to 1990. The following year saw a slight decline in overseas tourism, with a fall of over 90,000 in North American visitors, probably due in large part to the onset of the Gulf War, being partly offset by growth in visitors from Continental Europe. There was a resumption of growth in 1992, albeit at a slower pace than in previous years. Visitor numbers for the first half of 1993 show an increase of 6% over the same period last year.

Of course, the objective for policy-makers should not simply be one of maximising the number of visits. At one extreme, a declining average expenditure per visit could mean that growth in numbers had little impact on real tourism receipts. Factors such as area of origin, purpose of visit and duration of stay are, as shown below, significant determinants of average expenditure. For this reason, the report of the Tourism Task Force pointed to the need to target promotions on specific sub-sectors of overseas tourism, i.e., the high spending categories.

Table A.1 (see Appendix) provides a view of the geographic composition of overseas tourism. It can be seen that our main source markets have not exhibited equally strong growth during the recent period of expansion. While visitor flows from North America increased only marginally, British arrivals increased by 62% over 1986-92 and European visitors by a phenomenal 162%, reflecting the impact of a shift in marketing and reduced air fares. It is worth noting that in 1983, the year in which data on area of residence first became available, Britain provided the overwhelming majority of visitors to Ireland, 63%, while continental Europe and North America accounted for about 16% each. By 1992, however, Britain's share had fallen to 56% and Continental Europe, now supplying 27% of visits, had pushed North America into third place (on 13%).

Foreign tourism can also be classified by purpose of visit. Such a classification is presented in Table A.2. A striking development in recent times is the rapidly increasing proportion of visits attributable to holiday-makers and the almost corresponding decline in the share accounted for by visits to relatives. Business travel, although rising in absolute terms, has failed to maintain its relative position. Despite the favourable performance of holiday tourism, Ireland still ranks behind many other countries in terms of its ability to attract recreational visitors. This is illustrated by Table A.3. All of the countries listed there have a greater share of holiday tourism in total visits, though the figures for the UK and Japan probably include other types of visits as well.

Instead of focusing on tourist numbers, one can examine differences in total nights or average length of stay (see Tables A.4 and A.5). European visitors (excluding the UK) have the longest average duration of stay, followed closely by North American tourists. As in the case of visitor numbers, the British and North American shares in total nights have fallen since 1987. In terms of purpose of visit, there are no significant differences in length of stay between holiday-makers and those visiting relatives. Business visitors, not surprisingly, have a very short duration of stay.

TABLE 11.1

Overseas Visits To Ireland

Year	Total (000)	% Change
1980	1,678	—
1981	1,668	-0.6
1982	1,757	5.3
1983	1,779	1.2
1984	1,873	5.3
1985	1,912	2.1
1986	1,813	-5.2
1987	2,039	12.5
1988	2,345	15.0
1989	2,732	16.5
1990	3,067	12.3
1991	2,997	-2.3
1992	3.122	4.2

Source: CSO, Statistical Bulletin, various issues.

(ii) Revenue from Overseas Tourism

Excluding passenger fare receipts of Irish carriers, Table 11.2 shows that the pattern of change in real tourism revenue from overseas has been one of considerable fluctuation in the first half of the 'eighties, followed by substantial gains in the four years to 1990 when receipts grew at a compound annual rate of 13.3%. The growth rate in the latter period was not far off that required to achieve the targets set in the Operational Programme for Tourism 1989-93. In the event, the external environment disimproved markedly in 1991, leading to a slackening of growth to 4%. The 1992 figures indicate a slight disimprovement in real terms.

The changing pattern in the share of revenue derived from Ireland's main markets, displayed in Table A.6, is broadly similar to that observed for tourist numbers. The British market is still the most important, though only just. Continental European visitors, however, have increased their share of receipts dramatically from around 21% in 1986 to 36% in 1991, displacing North America as our second most important source market.

A comparison of the data contained in Tables A.6 and A.1 reveals that Britain's share in total receipts is less than its share in total visitors, and vice versa for Europe and North America. These differences reflect the divergent average expenditures incurred by the various categories. The average expenditure of North American visitors is substantially higher than that of British or other European visitors (Table A.7). A relatively short duration of stay, plus the likelihood of low accommodation costs stemming from a high proportion of visits to friends/relatives, probably explains the low average expenditure of British travellers to Ireland (see Table A.4).

TABLE 11.2

Revenue[1] from Overseas Visitors at Current and Constant (1985) Prices

Year	Revenue at Current Prices £m	Revenue at Constant Prices (1985) £m	% Change at Constant Prices
1980	228	328	—
1981	250	331	0.9
1982	297	359	8.4
1983	328	369	2.8
1984	373	392	6.2
1985	443	443	13.0
1986	417	401	-9.5
1987	483	451	12.5
1988	566	517	14.6
1989	661	580	12.2
1990	778	661	14.0
1991	835	687	3.9
1992	841	672	-2.2

1 Excluding carrier receipts.

Source: CSO, Statistical Bulletin; Secretariat Calculations.

Data on expenditure may also be classified according to reason for journey. Table A.8 confirms the increasing importance, referred to earlier, of holiday tourism to Ireland. It may also be observed that average expenditure is highest for this category of visitor (Table A.9). Particularly noticeable from Table A.9 is the high expenditure per business visitor. Given its generally short duration (see Table A.5), it can be concluded that business travel has a very high expenditure intensity. Deegan and Dineen (1991) draw attention to the smaller than expected disparity between average expenditure by holiday-makers and by those visiting friends/relatives, suggesting that this does not sufficiently reflect the low or negligible accommodation costs in the case of the latter category. For this reason, they conclude that visiting friends/relatives may spend more on food, drink and other tourism products.

(iii) Contribution to Balance of Payments

Below we show the contribution made by tourism to Ireland's balance of payments position over recent years.

TABLE 11.3

Ireland's Tourism and Travel Balance

Year	Out-of-State Tourism[1] £m	Fare Receipts of Irish Carriers £m	Net Expend. by Irish Visitors Abroad[2] £m	Balance £m	% of GNP
1985	518	167	402	283	1.8
1986	492	157	511	138	0.8
1987	564	167	556	175	0.9
1988	655	187	630	212	1.1
1989	751	232	698	285	1.3
1990	870	261	701	430	1.8
1991	939	279	699	519	2.1
1992	947	281	797	431	1.6

1 Revenue from overseas plus cross-border visitors.

2 Expenditure by Irish visitors abroad inclusive of fare payments minus passengers fare payments to Irish carriers.

Source: CSO, Statistical Bulletin; National Income and Expenditure.

Clearly, the impact has been a positive one, both in absolute terms and as a percentage of GNP. To determine the relative importance of out-of-state tourism in Ireland compared with some other OECD countries, Table A.10 indicates how tourism receipts vary internationally in relation to two aggregates viz. GDP and exports of goods and services. Austria is a clear outlier on each of these measures. Ireland ranks near the top of the table in terms of overseas tourism revenue as a percentage of national income. The

share of tourism receipts in Irish exports is relatively low compared with Greece, Spain (Spain has 60 million visitors annually) and Portugal, for example. This is probably explained by the scale of the tourist industry in these countries and by the existence of a strongly export-oriented overseas manufacturing sector in Ireland, which is characterised by exceptional productivity and a certain degree of transfer pricing.

(iv) Trends in International Tourism

Table 11.4 illustrates the trends in real foreign tourism receipts across a range of OECD countries for the period 1987-1991. Particularly striking are the strong performances of North America and Australasia - Japan, both of which managed to achieve increases of approximately 80% in real revenue. Within Europe, the results were rather mixed. Ireland and France exhibited exceptional growth in income from overseas tourism and were clearly ahead of any other European country in this respect. More moderate growth was evident in the case of Austria, Portugal, the Netherlands and Denmark. Other areas, notably Turkey and Belgium - Luxembourg, made progress initially but failed to sustain it. In the case of the United Kingdom, tourism receipts were erratic and by 1991 had in real terms declined below their 1987 level.

It may also be observed from Table 11.4 that two notable holiday destinations, Spain and Greece, fared very badly in the period under consideration. Although it is a matter of conjecture, this poor performance might be a reflection of an increasing concern with environmental factors and a desire by some holiday-makers to avoid sun-spots traditionally associated with mass tourism.

Table 11.5 provides a comparison of trends in the number of nights spent by foreign tourists in all forms of accommodation. Interestingly, while Ireland registered a 75% increase in total bed-nights, the corresponding figure for France was 12%. This would suggest that Ireland's gains in real revenue came about mainly through increases in quantity, whereas France succeeded in attracting higher spending visitors.

Figure 11.2 shows the growth rates of European tourism. While strong growth is evident for most years, it is clear from what has been said above that not all countries have benefited equally from this process. For this reason, it is likely that Ireland's impressive tourism performance cannot be attributed solely to external factors but also to development of the tourist product, more effective marketing, improved access and better capacity within the industry.

TABLE 11.4

Trends in International Tourist Receipts in Real Prices
1986 = 100

Country	1987	1988	1989	1990	1991
Austria	104.5	114.0	126.5	131.7	136.2
Belgium/Luxembourg	111.9	124.4	116.0	114.2	111.1
Denmark	102.5	105.1	104.1	123.1	129.6
Finland	113.5	122.1	121.2	117.1	121.3
France	102.7	115.1	140.4	144.1	153.2
Germany	100.6	106.9	112.5	117.2	116.0
Greece	100.8	102.7	84.9	88.4	87.6
Ireland	**106.4**	**120.9**	**134.0**	**150.3**	**156.3**
Italy	102.5	99.9	95.5	129.4	117.4
Netherlands	100.7	103.7	116.9	116.0	129.3
Portugal	120.2	127.2	137.5	143.6	138.4
Spain	103.7	105.3	97.6	89.2	89.3
Turkey	134.2	179.0	169.6	161.1	127.8
UK	108.6	103.5	106.8	110.0	95.1
Europe	**104.8**	**109.4**	**113.3**	**118.6**	**116.7**
North America	108.3	128.7	148.6	166.1	177.3
Australasia-Japan	128.6	169.5	168.4	188.3	180.8
OECD	106.5	116.1	123.7	132.5	133.6

Source: OECD, 1993, Tourism Policy and International Tourism

In Figure 11.3 we chart the recent growth rates of American tourism to Europe. As can be seen, substantial reductions in total European arrivals from the US were recorded in 1986 and 1991, which serve to illustrate how sensitive this market is to international security tensions. Furthermore, growth fluctuated considerably in the intervening years. As indicated previously, Ireland has not fared well in attracting American tourists over recent years. Unless there is significant growth in the market overall, this problem may be difficult to rectify.

TABLE 11.5

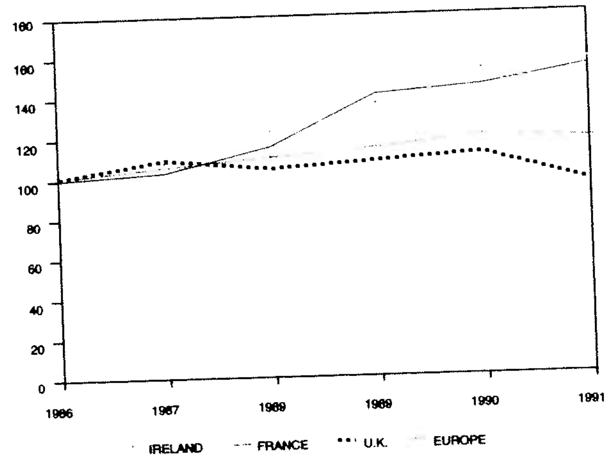
International Comparison of Number of Nights Spent by Foreign Tourists in all Forms of Accommodation
1986 = 100

Country	1987	1988	1989	1990	1991
Austria	100.3	102.5	111.2	111.0	116.7
Belgium	102.1	107.3	123.5	130.8	-
Denmark	96.3	95.4	100.7	109.7	122.6
France	102.3	91.9	105.5	109.5	112.0
Germany	104.6	108.3	120.7	125.3	119.5
Greece	100.9	98.1	96.4	102.4	86.1
Ireland	**119.2**	**138.1**	**165.2**	**177.5**	**175.4**
Italy	93.6	93.0	87.5	85.3	88.0
Netherlands	-	90.6	101.6	118.0	123.3
Portugal	102.6	106.6	109.3	116.0	131.6
Sweden	98.8	99.2	105.7	91.7	78.9
Switzerland	99.0	98.6	102.9	105.6	105.9
Turkey	140.3	196.5	200.0	223.7	163.5
UK	112.7	109.3	118.4	124.2	114.3

Source: OECD, 1993, Tourism Policy and International Tourism

FIGURE 11.1

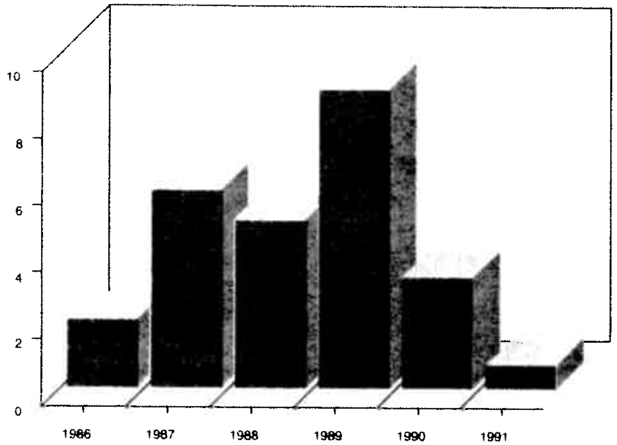
Trends in European Real Tourism Receipts (1986 = 100)



Source: OECD, 1993, Tourism Policy and International Tourism.

FIGURE 11.2

Annual Growth Rates[1] of Number of Arrivals of Foreign Tourists at Frontiers in Europe[2] (%)

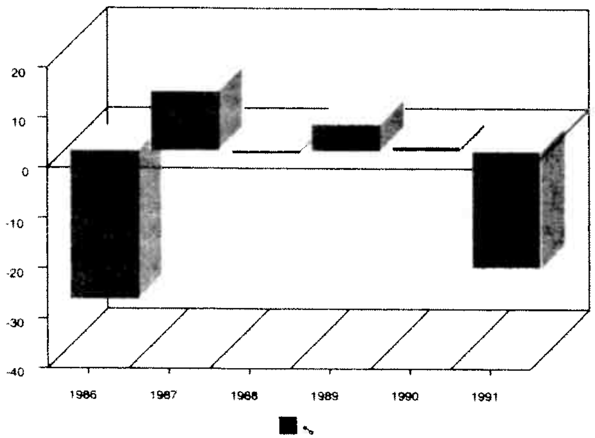


1 Percent Change 1986/85 etc.

2 For countries with data available over the period 1985-1991.

FIGURE 11.3

Annual Growth Rates of Number of Arrivals in Europe from the United States



Source: OECD, Tourism Policy and International Tourism, various issues.

(v) Domestic Tourism

Spending by Irish residents on visits within the geographic confines of the Republic of Ireland constitutes around 25-28% of total tourism revenue. Particularly strong growth in domestic tourism expenditure is evident for 1987 and 1990.

TABLE 11.6

Domestic Tourism Revenues in Constant 1990 Prices

Year	Domestic Tourism Revenue £m	% Change	As % of Total Tourism Revenue
1985	316		28.1
1986	246	-22.1	25.1
1987	320	30.1	28.5
1988	334	4.4	27.0
1989	342	2.4	25.0
1990	413	20.8	26.6

Source: Tansey Webster (1991), Table 2.

Much of domestic tourism revenue may not represent a gain to the national economy, if it essentially involves a redistribution of expenditure between those regions of the country which are net importers of tourism and those which are net exporters. Such a statement must be qualified in two respects however. First, expenditure on a domestic holiday in many cases will substitute for a foreign holiday. Such expenditure represents a form of import substitution and represents a net gain to the economy. Second, Deane (1987) has observed that the import content of tourism is low. Thus expenditure by Irish residents on domestic holidays, as opposed to spending on other consumer goods and services, represents a boost to domestic demand in a way which is strongly supportive of employment, and which gives rise to additional foreign-exchange savings.

(vi) Employment and GNP Impact

Estimating the employment and GNP contribution of tourism is a notoriously complex task. Tourism is not a precisely defined industry but rather a disparate collection of goods and services. All estimates of tourism-related employment are therefore somewhat imprecise. In providing such estimates, account must be taken not only of direct expenditure on tourism, but also of indirect purchases made by tourism operators from sub-supply firms and induced expenditure resulting from the spending of higher incomes. The total impact on GNP and employment can be assessed using expenditure multipliers derived from an input/output model. Henry (1991) has provided estimates of these, which Tansey Webster have used to calculate employment and GNP effects. These are presented in Table 11.7.

TABLE 11.7

Impact of Tourism on Ireland's GNP and Employment, 1985-1992

Year	GNP Impact (% of GNP)		Employment Contribution (000)
	Domestic	Foreign	
1985	1.4	4.3	-
1986	1.1	4.0	-
1987	1.3	4.1	59
1988	1.4	4.5	65
1989	1.3	4.9	73
1990	1.5	5.1	82

Source: Tansey Webster (1991)

Breathnach (1992) has used CERT data to provide a structural breakdown of employment in the hotel sector and in the miscellaneous tourism sector (see Tables A.11 and A.12). As can be seen, these highlight a predominance of atypical work forms in tourism. Almost 48% of employment in hotels, for instance, is of a part-time, seasonal or casual nature. In fact, outside the full-time employment category, casual work predominates. Another feature of the data observed by Breathnach is the high proportion of females in the hotel workforce: women account for 79% of part-time permanent workers, 88% of part-time seasonal workers, and 59% of full-time employees.

Similar patterns to those outlined above may be discerned in the case of work forms in the miscellaneous tourism sector. Here, however, the representation of women in the work force is somewhat less than in the case of the hotel industry. The development of a less seasonal tourist industry would support an expansion of employment and an improvement in the security of employment.

2. STATE INVOLVEMENT IN THE TOURISM INDUSTRY

Apart from subsidies for and direct expenditure on promotion, there are undoubtedly many ways in which public policy impinges upon the development of the tourism sector. At the most general level, the conduct of macroeconomic policy will, as in the case of any traded product, affect the demand for tourism through inflation and exchange rate channels. Similarly, infrastructural investment in roads and ports can enhance competitiveness by lowering transport costs and can also succeed in opening up previously inaccessible areas of potential tourist interest. Labour market policies influence the cost competitiveness and quality of the tourism product. Public monitoring and regulation of standards in the interests of customer can help to prevent a general dilution of quality, the latter being, in an important sense, a public good for all tourism operators. Also of significance is competition policy, especially in relation to transport.

The above forms of intervention are relatively uncontentious. As a recent OECD report observes, however, budgetary pressures and an emphasis on free-market solutions have in recent times led a number of countries to question the State's role in *direct* promotion of tourism. In the case of Ireland, some segments of the industry appear to be quite profitable. Why then is State assistance deemed necessary for continued growth in real revenues and employment?

One possible answer to this question lies in the fragmented nature of the industry. The tourist product is provided by numerous organisations of varying size and nature - sea and air carriers, hotels, guesthouses, hostels, travel agents, theatres, sports clubs, etc. Some of these rely only partly on tourist business. Furthermore, because of its exceptional seasonality, tourist development is not very profitable; thus funds for marketing are limited. The costs of promotional campaigns for an individual operator are therefore likely to be very substantial, while the benefits are of a diffuse nature, flowing not only to the individual company but many of its immediate competitors as well. As such, a type of market failure exists, leading to sub-optimal investment in tourism promotion. While there are obvious opportunities for collective effort by sectors of the industry in developing and promoting tourism products, there is also a role for public support for the development of the capacity for collective action, as well as direct involvement in promotion.

There is a case for the national tourist authorities to obtain a greater level of promotional funding by the industry itself. The State is well positioned to act as a central co-ordinator in such circumstances, perhaps taking the lead by supplying venture capital, matching grants, etc. In some countries, notably France, the State's role centres heavily on such a co-ordination function (OECD, 1993, Tourism Policy and International Tourism).

A related justification for State involvement in tourism promotion that is sometimes advanced is that it creates a favourable image of the country abroad which may have a beneficial impact on exports in general. The case of Sweden is notable in this regard. It recently abolished the Swedish Tourist board and created a new organisation, Image Sweden, concerned with general promotional activities.

Apart from its national implications in terms of foreign-exchange earnings and employment, tourism, domestic and foreign, has a very important regional dimension in that the gains flow disproportionately to regions with below-average incomes. Table 11.8 provides a comparison of the regional distributions of tourism income and population in 1990. The western regions, containing 38% of the population, receive 53% of tourism income. Tourism receipts are relatively high in regions with low incomes per head.

TABLE 11.8

Regional Distribution of Income from Tourism (1990)

Region	% of Tourism Income	% of Population
East	29.8	40.9
Midlands	7.2	10.2
South East	9.6	10.9
South West	22.1	15.1
Mid West	9.7	8.8
West	12.8	8.3
North West	8.7	5.9

Source: Tansey Webster and Associates (1991) and Census of Population 1991.

Quoted in: Breathnach (1992).

As Deane (1987) observes, tourism has certain attributes which make it attractive to Government as a regional policy instrument. First, it is a labour-intensive industry. Second, many of the poorest rural areas are those of outstanding natural beauty. Third, entry into many forms of tourism employment does not require extensive prior training (of course training during employment may be necessary for the long-run development of the industry). Fourth, many tourism enterprises are of a relatively small size. This suggests that scale economies may not always be very important. Furthermore, the development of indigenous industry or attraction of overseas direct investment may not be a viable proposition in the case of rural areas which are isolated or lacking in infrastructure.

Deegan and Dineen (1991) also point out that although the direct employment provided by tourism, for example in the accommodation sector, may sometimes be poor, the indirect and induced employment, for example in the food sector, may be of a higher standard. In addition, income from tourism may supplement income from other activities as in the case of agri-tourism. Breathnach's analysis also indicates that part-time tourism employment was preferred by many female workers because it is a convenient way of supplementing family income. Finally, tourism contributes to higher living standards for the inhabitants of many rural areas by resulting in the provision, albeit perhaps for only part of the year at present, of transport, shopping, sporting and other facilities that might not otherwise be economically viable. It may thus prevent a process of cumulative decline. Indeed, tourism's role in the preservation of rural communities is arguably valued not only by their inhabitants, but by the population in general.

The above discussion is framed within employment and income terms. There are, of course, other justifications for State tourism investment and promotion based on less tangible factors, such as a desire to share one's country and culture with citizens abroad. Given the Council's central concern with the problem of high unemployment, however, such considerations are of secondary importance in its analysis.

3. TOURISM POLICY

As indicated at the outset of this chapter, the targeting of tourism as an area of high employment potential is fairly recent, dating back principally to the Programme for National Recovery (1987). Nevertheless, it is instructive to review what the Council has previously recommended in this area, in NESC Report No. 52, "Tourism Policy", published 13 years ago.

In 1980 the Council presented a package of measures designed to produce a more focused approach to marketing and promotion, to deal with the problems created by seasonality and to improve industry training. In the marketing area, for example, it was argued that a greater emphasis should be placed on value-added or revenue instead of more tourist numbers. This reflected the Council's view that the encouragement of mass tourism may entail not only a high proportion of low spending visitors but also large costs in terms of congestion, environmental damage and wear-and-tear of facilities. A targeting of specific high expenditure sub-sectors, for instance holiday tourism, was the preferred policy option. The possibility of a relative shift to advertising in the promotion budget was also mooted.

To mitigate the significant costs associated with seasonality, measures such as a greater degree of staggering of school and industrial holidays, differential pricing arrangements and an extension of the tourist season by introducing special events were all advocated. As regards the institutional support structure for tourism, the Council found merit in the consultant's proposal for the disbandment of the Regional Tourism Organisations and their reorganisation as regional operations within Bord Failte.

While there have been significant policy changes since publication of the Council's proposals in 1980, many of the concerns expressed in Report No. 52, such as the need to lengthen the tourist season and to provide adequate conference facilities, were repeated by the Tourism Task Force only recently. The fact that tourism was not perceived as a potentially important growth industry in the early 1980s probably accounts for much of this neglect.

The first general statement of Government policy in this area was the 1985 White Paper, Tourism Policy. Against a background of funding constraints, the White Paper downplayed the role of public expenditure in financing promotion and capital development schemes, arguing instead that "forward movement in tourism must be in entrepreneurial capacity rather than in additional Government funding". The stated aim was "to provide a framework within which individuals can undertake new tourist enterprises".

One interesting feature of the Paper is that it viewed the potential for import substitution in Irish tourism as being very limited and accordingly argued against spending additional resources on *general* promotional campaigns aimed at encouraging Irish holiday-makers to switch to the domestic market. The role of niche marketing in a domestic context was recognised, however, in particular youth, sports and short break holidays. The White Paper also emphasised the need for greater flexibility in the use of resources and staff by tourism agencies and firms in order to respond rapidly to market movements caused by seasonal factors and currency fluctuations. Nevertheless, the Paper was in general fairly pessimistic about the medium-term prospects of overcoming the seasonality problem and argued that more immediate results could be obtained from efforts to build up the shoulder season (April-June and September-October).

The next step in the evolution of tourism policy was the Programme for National Recovery (1987). This envisaged a doubling of foreign visitors and

an increase in foreign revenue of £500m over the period 1988-1993. As indicated in Section 1 (ii), however, while considerable progress was made in this respect between 1988 and 1990, external factors inhibited the momentum of development thereafter.

The targets set by Government for tourism were to be achieved in part through a substantial infusion of EC Structural Funds, primarily from the European Regional Development Fund but also including the Social Fund. The National Development Plan, presented to the EC Commission in early 1989, laid emphasis on tourism as a sector capable of contributing to income creation and thereby facilitating the Community's objective of promoting economic and social cohesion. Following on from this, the Operational Programme for Tourism 1989-93 detailed the particular types of investment in the sector that would benefit from EC assistance.

The total cost of the above programme was estimated at £300m in 1989 prices, with 49% of funding coming from the EC and 40% from the private sector. The remainder was to be provided from public sources. Three sub-programmes were drawn up, one for tourism development by public authorities/agencies, a second for product development and marketing by the private sector, and a third outlining training measures for the industry. Specific yearly performance targets for employment and revenue were set at both national and regional level.

The basis for the programme was a detailed analysis of the distinctive strengths and weaknesses of Irish tourism. These were identified as follows:

Strengths

- a reputation for friendliness/hospitality
- relatively unpolluted environment
- strong cultural and natural heritage
- varied accommodation base of fairly good standard

Weaknesses

- lack of price competitiveness, due partly to high taxation on petrol[90] and drink

90 Although the tax on petrol in Ireland is relatively high, Irish excise duty rates are among the lowest in the EC.

- inadequacies in internal and access transport
- poor marketing
- gaps in product range, compounded by variable quality

One important aim expressed in the programme was that the planned growth in tourist numbers should be composed chiefly of pure holiday-makers and business visitors rather than those visiting friends or family. Investments were to be channelled towards the penetration of niche markets such as activity and special interest holidays. Areas identified for development included angling, sailing, equestrian activities, genealogy, clan rallies and English language instruction.

Obviously the specific investment measures proposed in the Operational Programme could constitute only one element in tackling the above-mentioned problems associated with Irish tourism. As indicated previously, general Government policies are also of importance, especially in relation to competitiveness. It is also worth noting that a number of other elements of the National Plan contained proposals likely to benefit tourism. The programme designed to deal with the problems of Ireland's peripherality, for example, provided for improvements in the Primary Road Network and passenger terminal facilities at Dublin, Shannon and Cork airports. Funds were also provided under the Operational Programme for Sanitary and Other Local services to aid in the restoration of historic buildings and similar public works.

Considerable focus to tourism policy was given by the Report of the Tourism Task Force, published at the end of 1992. The main conclusions and recommendations may be summarised as follows:

(a) **Institutional Framework:** The Task Force recommended the establishment of a Tourism Council of Ireland under the aegis of the Minister for Trade and Tourism. This body would assume responsibility for drawing up development plans for the sector and for close monitoring of the results. A strengthening of the tourism division within the then Department of Tourism, Transport and Communications was also proposed.

(b) **Product Development Companies:** An innovative proposal was for the establishment of six companies, endowed with a minimum capital of £1 million each over a three year period, to promote activity holidays in areas such as golf, angling, education/culture, etc. It is believed that these will attract a higher proportion of

holiday-makers than is currently the case, thus adding substantially to gross revenue. Some industry funding of the companies is also envisaged.

(c) **Seasonality:** Besides adding to revenue and employment, an objective of the Product Development Companies is the promotion of year-round tourism through activities that are non-weather dependent. The Task Force also drew attention to the role played by arts and culture festivals in extending the tourist season.

(d) **Structural and Cohesion Funds:** A total tourism investment of £548m was proposed, £20m of which was intended to go towards the building of a national conference centre. The lack of such a facility at present seriously inhibits the expansion of business travel, which as indicated earlier has a high expenditure-intensity. Business travel can also help alleviate the problems created by seasonality. The Task Force therefore suggested the development of smaller 100-500 seat convention and conference facilities located throughout the country.

A major concern articulated by the Task Force was the development of access transport. It therefore restated Ireland's case for substantial cohesion funding of mobile transport assets such as super ferries and airline fleets. One of the Cohesion fund's primary aims is the development of trans-European transport networks, viewed by the EC Commission as a prerequisite for the efficient functioning of the internal market. There is reluctance, however, on the part of the EC authorities to extend such assistance to mobile assets as distinct from fixed infrastructure such as railways, roads and bridges. Part of the reasoning behind this lies in the view that such assets are not only mobile in a physical sense but in a financial one as well (Crowley, 1992). Presumably there is also the view that such assistance could constitute an operating subsidy and cause a distortion in competition. The fact remains, however, that with the completion of the Channel Tunnel Ireland will, as a holiday destination, be placed at a further disadvantage in relation to its European competitors.

(e) **Taxation:** The Task Force presented three main proposals in this area, subject to the extent of available fiscal policy flexibility. To reduce the costs associated with car hire, a vehicle registration tax deferral scheme was suggested, subject to appropriate monitoring to ensure cost reductions are passed on to holiday-makers. Also recommended was the reintroduction of accelerated capital allowances for investments in the tourism industry. While this would normally be seen as creating a bias in favour of capital, the Task Force argued that capital investment in tourism does not displace labour but rather creates the essential conditions for its employment. Put differently, because tourism is highly labour-intensive, the output effect resulting from a fall in the price of capital will induce a substantial increase in employment. A third proposal in this area was for the introduction of a double tax allowance for additional expenditure above 1992 levels on marketing and training by tourism firms, which the Task Force viewed as being too low at present.

The Finance Act, 1993 effectively relieved cars in the short-term car hire fleet of vehicle registration tax, as long as they remain in the fleet. It should be noted that the other taxation recommendations run counter to the general approach to taxation policy set out in Chapter 7.

Many of the Task Force's recommendations have been adopted as part of a new Operational Programme for Tourism proposed in Ireland's National Development Plan 1994-1999. The new Programme aims to achieve an increase of 50% in real foreign tourism revenue by the end of 1999. In order to achieve this goal and also to produce more favourable employment and investment conditions in the industry, an integral element of the Programme will be measures to secure a significant reduction in the seasonal concentration of visitors of Ireland. In more precise terms, the Government envisages two-thirds of visitors to Ireland holidaying outside the peak July-September period by 1999, compared with a current figure of about 60%.

Two broad sets of tourism measures have been ear-marked for Structural Fund assistance by the Plan viz. measures to improve the product base and a major expansion of marketing. Product development measures will be focused on meeting the demands of high spending niche markets that are non-seasonally dependent, such as those for culture and heritage, convention business, and specialist activity holidays. The new Programme also provides for a major conference centre, with the capacity to accommodate 2000 delegates, to be built in Dublin at a projected cost of £50 million. It is proposed to complement these measures with additional marketing expenditure of £13 million over the period of the Plan. Total expenditure on the Tourism Programme between 1994 and 1999 is projected at £583[91]

91 This estimate does not include expenditure on tourism training, which will be allocated under the human resources heading of the Plan.

million (constant 1993 prices), with 53% in the form of EC aid and the balance coming from public sources and private-sector matching finance. In addition, the tourism sector will also benefit from measures undertaken as part of other operational programmes. For example, improvements in water and sanitary services will help promote activities such as angling and cruising, while investment in upgrading and developing the national rail network should improve the accessibility of ports and airports. Investment in county and regional roads should also ensure that more rural communities than hitherto can share in the benefits from an expansion of tourism activity.

Apart from providing structural fund assistance to tourism projects, the EC Commission has in recent years sought to formulate its own policies for tourism. In 1992 EC tourism Ministers sanctioned a three year Community Action Plan for Tourism with emphasis likely to be on projects which promote alternative tourism and the exchange of information between member States. There are also programmes that affect tourism development indirectly. ENVIREG, INTERREG and LEADER provide funds for activities such as reducing coastal pollution, developing cross-border tourism and developing rural tourism in local areas. Training and exchange initiatives such as COMETT and ERASMUS are also open to the tourism sector.

4. SUMMARY AND CONCLUSIONS

In contrast to the first half of the decade, the late 1980s witnessed strong growth in overseas visitor numbers and real revenue. This growth was accompanied by a changing composition of overseas tourism, with the continental European market assuming increasing importance and the North American market failing to maintain its share in either total visitors or revenue. Ireland also managed to attract a higher proportion of holiday-makers, though it is still less successful than other countries in this respect.

Government policy towards the industry has taken on a more active role since 1987. This contrasts with the stance adopted in the White Paper (1985), which saw the scope for increased public expenditure in particular as being very limited. Of course, the increased availability of Structural Funds has been one factor facilitating this more active role.

In charting the future direction of policy, a number of issues need to be addressed. In particular, the problem of seasonality must be overcome. This will serve to increase the number of permanent, full-time jobs in the sector and thus help to allay concern about the quality of employment generated by the sector. Moreover, without reducing seasonality there appears to be little point in undertaking extensive capital investments in facilities and transport infrastructures which are likely to remain under-utilised for significant portions of the year. For these reasons, the question of the relative emphasis to be placed on promotion/marketing versus capital investment needs to be considered.

Policy-makers will also need to consider whether resources should be used to promote balanced tourism development throughout the country or whether these are best concentrated in a small number of areas with high economic potential. As Table 11.8 implies, some regions seem to have a comparative advantage in attracting tourists, a factor which might limit the benefits of policies which result in a wide dispersal of resources.

The tourist industry provides one of the most positive areas for increased employment. The doubling of incoming holiday-makers since 1987 has been accompanied by a marked increase in employment, estimated at over 30,000. The multiplier effect of the industry on the economy generally is very significant, in that the inputs to the industry are virtually all indigenous. This effect on the domestic economy is vividly illustrated by the fact that foreign visitors amount to 3 million or an addition in spending power for part of the year of nearly 90% of the total population.

Development of the tourist industry must, therefore, have high priority in any strategy to increase employment up to the year 2000. The Council recognises that while public policy and agencies have a role to play, the primary responsibility for the development of the tourist industry, as in the case of all other industries, rests with the private firms, agencies and people engaged in the industry, who will be the main beneficiaries of its development. State aids and agencies should play only a supporting role. Within this general approach, the Council recommends that the balance of assistance from public resources should be altered so as to direct resources to improving and developing the product and to a greatly expanded marketing programme involving the EC, the private sector, the carriers and the public agencies, with particular emphasis on the role of Bord Failte, the principal promotion agency.

Among the elements of the strategy for the development of the tourism industry which could create over 35,000 extra jobs to the year 2000, based on the job creation experienced since 1987, are as follows:

(a) Tourist products must continue to be improved and expanded to provide interest and activity for tourists. The National Development Plan proposals for a further expansion of the product

base are therefore a welcome step in this regard. Our attractive natural environment must be supplemented, given our climate, by facilities which cater for the interests of visitors in our antiquities, artistic and architectural heritage, history, golf, equestrian pursuits, angling, hill-walking, nature trails, conferences, etc.

(b) Expansion of tourist products as outlined at (a) will provide a basis for reducing the seasonality of our tourism, which is a major restraint on employment and investment in the industry. New product facilities will provide a basis for marketing Ireland outside the summer season.

(c) Access must continue to be improved both as regards fares and services. The success of the common airfare rating of London and Dublin from Australia - a doubling of visitors in 3 years - shows how long-haul air travellers can be attracted to visit Ireland. There is large untapped potential in markets such as South Africa, South America and the Far East if similar attractive fare structures can be arranged. Access must also be improved by better and faster ferry services particularly in the context, when the Channel Tunnel opens, that Ireland will be the only Island member of the EC. Improved access from North America and better marketing there is crucial. Over 7 million visitors come from North America to Europe, 3 million to Britain; Ireland only receives 400,000.

(d) Public policy should accord a high priority to quality control. This should encompass enforcement of minimum standards in some areas, such as hygiene, and a product categorisation system which provides consumers with a reliable basis for choosing their desired mix of quality and price.

(e) The major expansion of marketing envisaged under the National Development Plan should improve Ireland's attractiveness as a tourism destination to interest groups such as those interested in golf, heritage, equestrian activity, etc. It is essential that this support be focused. The National Development Plan's proposal to assist such activities is welcome. It has, for example, been suggested that more marketing staff are necessary in potential markets where there currently are no staff.

(f) The combination of better access fares and facilities and marketing directed at segments of the market provides the essential basis for more packaging of holidays; only 27% of visiting holiday-makers are now packaged. Packaging helps to reduce the cost of access. which is high for an individual holiday because of our location.

(g) Measures should be taken to combine the promotion of Ireland by all State agencies into a single image of a country which is good to invest in, and to buy from, and to visit.

(h) The efforts of all involved in the industry will now be combined in a common and concerted programme through the National Tourism Council, advocated by the Task Force on Tourism, which the Minister for Tourism and Trade has established.

(i) The high cost of car hire is an impediment to growth of tourism and special measures are justified to reduce this cost in the peak season.

(j) Accommodation should continue to be improved and in certain categories expanded. While customer product and price preference should determine the range of accommodation provided, *there is a role for quality assurance in the interests of consumer protection.* There is need for a supply of budget hotels in areas now lacking adequate accommodation for tours. Support might be made available for upgrading existing accommodation and on a limited basis in certain areas, for new budget hotel accommodation.

(k) The overall strategy for tourism should be to increase tourism earnings and employment. Towards this end, an improvement in the quality of tourism, to be achieved by targeted marketing at selected interest groups, is just as important as a numerical increase in tourists.

Generally, the tourism sector has shown since 1986 its ability to create employment. It has been given the task of creating a further 35,000 jobs over the next five years. All public expenditure from EC and national funds should therefore be judged against the primary criterion of job creation and maintenance. The potential to attract more visitors to Ireland is already there in the growth of international tourism and in the success in attracting new visitors in recent years. The measures outlined above are directed to this end. Special attention needs to be given to the North American market because of its higher contribution to European inward tourism. Elsewhere in this regard the Council recommends a selective increase in public expenditure where this would support private sector initiatives with clear potential for employment; increased expenditure, both public and private, on tourism marketing and product development is one area where the returns in employment are clearly evident.

APPENDIX

TABLE A.1

The Distribution of Overseas Visits to Ireland by Area of Residence

Year	Total (000)	Area of Residence							
		Great Britain		Other Europe		USA & Canada		Other Areas	
		(000)	%	(000)	%	(000)	%	(000)	%
1983	1,779	1,129	63.5	298	16.7	292	16.4	60	3.4
1984	1,873	1,188	63.4	298	15.9	324	17.3	63	3.4
1985	1,912	1,104	57.7	326	17.0	404	21.1	78	4.1
1986	1,813	1,084	59.8	326	18.0	327	18.0	76	4.2
1987	2,039	1,209	59.3	382	18.7	383	18.8	66	3.2
1988	2,345	1,465	62.5	398	17.0	401	17.1	82	3.5
1989	2,732	1,668	61.0	538	19.7	417	15.3	109	4.0
1990	3,069	1,786	58.2	731	23.8	434	14.1	118	3.8
1991	2,997	1,729	57.7	824	27.5	342	11.4	102	3.4
1992	3,122	1,758	56.3	855	27.4	398	12.7	111	3.5

Source: CSO, Statistical Bulletin, various issues.

TABLE A.2

The Distribution of Overseas Visits to Ireland by Reason for Journey

Year	Reason for Journey							
	Business		Holiday		VFR[1]		Other	
	(000)	%	(000)	%	(000)	%	(000)	%
1980	314	18.7	703	41.9	546	32.5	115	6.8
1981	313	18.8	650	39.0	571	34.2	134	8.0
1982	356	20.3	691	39.3	556	31.6	154	8.8
1983	357	20.1	720	40.5	566	31.8	135	7.6
1984	319	17.0	704	37.6	722	38.5	127	6.8
1985	290	15.2	792	41.4	712	37.2	117	6.1
1986	315	17.4	641	35.3	700	38.6	156	8.6
1987	354	17.4	710	34.8	836	41.0	139	6.8
1988	438	18.7	810	34.5	919	39.2	178	7.6
1989	471	17.2	106	138.8	1020	37.3	181	6.6
1990	507	16.5	132	743.2	1059	34.5	175	5.7
1991	445	14.8	146	648.9	909	30.3	177	5.9
1992	458	14.6	156	149.9	905	28.9	205	6.6

1 Visiting friends/relatives.

Source: CSO, Statistical Bulletin, various issues.

TABLE A.3

Foreign Tourism by Purpose of Visit

Country	Purpose of Visit							
	Business (%)		Holidays (%)		VFR (%)		Other (%)	
	1990	1991	1990	1991	1990	1991	1990	1991
Greece	9.1	9.4	82.8	81.0	3.9	4.0	4.1	5.6
Ireland	16.5	14.8	43.3	48.9	34.5	30.3	5.7	5.9
Portugal	2.4	N.A	92.0	N.A	0.9	N.A	4.7	N.A
Spain	7.9	13.0	83.2	56.0	4.0	12.0	4.9	19.0
UK[1]	-	-	56.9	55.4	26.7	27.9	16.3	16.7
Australia	11.9	11.2	55.7	59.7	20.6	20.0	11.8	9.2
New Zealand	11.3	1.1	50.2	57.0	24.1	27.1	14.5	14.8
Japan[2]	27.7	26.7	58.1	59.6	-	-	14.2	13.7

1 Business visits not categorised separately.

2 Visits by friends and relatives not categorised separately.

Source: OECD, 1993, *Tourism Policy and International Tourism.*

TABLE A.4

Distribution of Total Nights of Overseas Tourism by Area of Residence Plus Average Length of Stay

Year	Great Britain		Other Europe		USA + Canada		Other Areas	
	% of Nights	Av.	% of Nights	Av.	% of Nights	Av.	% of Nights	Av.
1987	50.3	8.0	22.7	11.4	21.9	11.0	5.1	14.8
1988	51.9	7.5	22.6	12.0	19.9	10.5	5.6	14.4
1989	49.0	7.6	26.6	12.8	17.9	11.1	6.4	15.2
1990	46.7	7.6	31.7	12.6	15.7	10.5	5.8	14.4
1991	45.2	7.9	36.3	13.3	12.9	11.4	5.5	16.3
1992	45.1	7.7	36.2	12.7	14.4	10.7	5.0	13.5

TABLE A.5

Distribution of Total Nights of Overseas Tourism by Reason for Travel Plus Average Length of Stay

Year	Business		Holiday		VFR		Other	
	% of Nights	Av.	% of Nights	Av.	% of Nights	Av.	% of Nights	Av.
1987	6.8	3.7	38.4	10.4	46.9	10.8	7.9	10.9
1988	7.8	3.8	39.6	10.4	44.9	10.4	7.7	9.2
1989	7.1	3.9	44.9	10.9	39.6	10.0	8.4	11.9
1990	7.2	4.1	49.4	10.8	36.1	9.9	7.3	12.1
1991	6.3	4.3	55.2	11.4	30.6	10.2	7.8	13.3
1992	6.9	4.5	56.1	10.8	29.2	9.7	7.9	11.5

Source: CSO, Statistical Bulletin; Secretariat Calculations

TABLE A.6

Distribution of Ireland's Overseas Tourism Revenue[1] by Area of Residence

Year	Total	Area of Residence							
	£m	Great Britain		Other Europe		US + Canada		Other	
		£m	%	£m	%	£m	%	£m	%
1983	328	141	43.0	682	0.7	103	31.4	16	4.9
1984	373	153	41.0	701	8.8	131	35.1	19	5.1
1985	443	162	36.6	841	9.0	170	38.4	27	6.1
1986	417	170	40.8	862	0.6	136	32.6	26	6.2
1987	483	199	41.2	104	21.5	155	32.1	25	5.2
1988	566	250	44.2	122	21.5	159	28.1	35	6.2
1989	661	285	43.1	158	23.9	175	26.5	44	6.6
1990	778	321	41.2	246	31.6	164	21.1	46	5.9
1991	835	332	39.8	305	36.5	150	18.0	48	5.7
1992	841	322	38.3	319	37.9	154	18.3	45	5.4

1 Excluding fare receipts of Irish carriers.

Source: CSO, Statistical Bulletin, various issues.

TABLE A.7

Average Expenditure of Overseas Visitors by Area of Residence

Year	Great Britain	Other Europe	USA + Canada
	£	£	£
1990	180	336	378
1991	192	370	439
1992	183	373	387

Source: Calculated from Tables A.1 and A.6.

TABLE A.8

Distribution of Ireland's Overseas Tourism Revenue[1] by Reason for Journey

Year	Total	Reason for Journey							
		Business		Holiday		VFR		Other	
	£m	£m	%	£m	%	£m	%	£m	%
1980	228	401	7.5	112	49.1	652	8.5	11	4.8
1981	250	451	8.0	116	46.4	753	0.0	15	6.0
1982	297	581	9.5	140	47.1	802	6.9	19	6.4
1983	328	591	8.0	164	50.0	902	7.4	16	4.9
1984	373	491	3.1	194	52.0	115	30.8	14	3.7
1985	443	531	2.0	238	53.7	131	29.6	21	4.7
1986	417	631	5.1	183	43.9	138	33.1	34	8.1
1987	483	761	5.7	196	40.6	177	36.6	34	7.0
1988	566	931	6.4	235	41.5	194	34.3	44	7.8
1989	661	101	15.3	292	44.2	216	32.7	52	7.9
1990	778	114	14.6	386	49.6	225	28.9	53	6.8
1991	835	106	12.7	455	54.5	213	25.5	61	7.3
1992	841	114	13.6	469	55.8	192	22.8	66	7.8

1 Excluding fare receipts by Irish carriers.

Source: CSO, Statistical Bulletin, various issues.

TABLE A.9

Average Expenditure by Reason for Journey

Year	Business	Holiday	VFR
	£	£	£
1990	225	291	212
1991	238	310	234
1992	249	300	211

Source: Tables A.2 and A.8.

TABLE A.10

Ratio of Out-of-State Tourism Receipts to GDP[1], and Exports of Goods and Services. (%)

1990

Country	% of GDP	% of Exports
Austria	8.5	18.4
Belgium-Lux.	1.9	1.8
Denmark	2.6	6.0
Finland	0.9	3.4
France	1.7	5.9
Germany	0.7	2.0
Greece	3.9	19.4
Ireland	3.8	5.0
Italy	1.8	8.0
Netherlands	1.3	2.0
Portugal	6.0	15.6
Spain	3.8	21.0
Sweden	1.3	3.6
Turkey	3.0	14.7
U.K.	1.4	3.7
Europe	1.9	5.4
Canada	1.2	4.3
U.S.	0.8	6.4
Australia	1.2	6.9
New Zealand	2.3	8.2

1 GNP in the case of Ireland as this allows for the existence of substantial net factor income outflows.

Source: OECD, 1993, Tourism Policy and International Tourism.

TABLE A.11

Structure of Employment in The Hotel Sector (1988)

Employment Type	As % of Hotel Employment	Women as % of Category
Full-time Permanent	52.1	59.2
Part-time Permanent	12.5	79.4
Full-time Seasonal	13.6	73.5
Part-time Seasonal	2.4	88.2
Casual	19.4	N.A

Source: Breathnach (1992), computed from CERT data (1988).

TABLE A.12

Structure of Employment in the Miscellaneous Tourism Sector[1]

Employment Category	As % of Total Employment	Women as % of Category
Full-time Permanent	49.9	48.0
Part-time Permanent	10.4	54.9
Full-time Seasonal	22.1	55.8
Part-time Seasonal	17.5	58.0
Total	100.0	52.3

1 Excluding accommodation, catering and access transport. The category consists mainly of employment in the leisure and recreation industries.

Source: Breathnach (1992).

CHAPTER 12

Financing the Development of Irish Business

FINANCING THE DEVELOPMENT OF IRISH BUSINESS [92]

1. INTRODUCTION

Businesses need finance to start-up and develop. While finance is only one of several constraints on the development of indigenous firms, and in many cases is not the dominant constraint, there are nonetheless specific aspects of the funding of business development in Ireland which give cause for concern. This chapter focuses on two broad areas of concern: the first relates to the "mismatch" between savings and investment in Ireland, whereby a high level of savings in the economy fails to translate into adequate investment in productive activity, particularly in the traded sectors. Of particular interest, from the point of view of policy, is the impact of Ireland's tax and regulatory environment on the distribution of savings and investment funds. Second, there are specific concerns about a number of gaps in the financial markets which are thought to constrain the development of indigenous businesses. The most notable of these relate to the inadequate provision of seed capital and venture capital; the limited availability and inappropriate form of much development capital; the poor availability of long-term credit, and deficiencies with respect to small company finance.

A consistent theme running throughout this report is the need to develop more successful indigenous businesses in Ireland, both in manufacturing and in other areas of the traded sector. If this is to happen, there will need to be an increase in the overall level of investment in such firms, as well as changes in the form and focus of that investment. The policy context within which future investment will take place is itself changing, with a reappraisal of the role of the State in financing business development and increased emphasis on the need for greater private sector participation.[93] Consideration of the adequacy and appropriateness of finance for business development is thus particularly opportune at this time.

Efforts to address the financial constraints on the development of Irish businesses must be complemented by a series of structural and developmental policies aimed at securing an improved competitive

92 This Chapter draws on background papers prepared for the Council by Danaher (1992) and Foley (1993).

93 See, for example, Culliton (1992) and Moriarty (1992).

performance by indigenous firms. The Council has consistently argued[94] that any sustained increase in the flow of finance to Irish businesses will require a significant improvement in the risk/reward profile of the sector. The measures required to secure such an improvement in performance are discussed elsewhere in this Report.[95] This chapter focuses more narrowly on specific aspects of the *financing* of business development in Ireland which may be impeding growth. Section 2 describes the current financing of Irish-owned industrial firms, highlighting a number of key gaps and deficiencies. Section 3 looks at the distribution of savings and investment in the economy, focusing on the "mismatch" between the high level of institutional saving which occurs and the low level of institutional investment in Irish business. Section 4 considers a number of specific financing gaps which impede the development of indigenous firms. The chapter concludes with a discussion of some of the factors which might be considered in framing future public policy in this area.

2. THE FINANCING OF IRISH INDUSTRY[96]

There are four main types of finance used to fund industrial development: internal funds, borrowings, state grants and equity participation. Previous work by the Council[97] showed that, in the early 1980s, the financing of Irish manufacturing firms was heavily dominated by state grants and bank borrowings. Private equity investment was weak and the level of internal funds available for re-investment was severely constrained by the low levels of profitability obtained in the sector. The report concluded that the overall financial health of Irish industry was poor, thereby adding a high degree of financial risk to already high levels of commercial risk. While no evidence was found of a *general* lack of finance for Irish industry, specific shortages were noted in the areas of equity finance and the provision of long-term debt. A central theme of the report was the need to increase the levels of equity investment and lengthen the time profile of borrowing in order to reduce the risk profile of Irish industry and provide a better base for future growth and development.

94 See, for example, NESC Report No. 76 (1984)

95 See, in particular, Chapters 4, 8, 9, 10 and 11.

96 While the focus here is on indigenous firms in the manufacturing sector, many of the issues raised in this section, and in succeeding sections, apply more generally to indigenous businesses as a whole.

97 NESC Report No. 76 *"The Role of the Financial System in Financing the Traded Sectors"*, (1984).

Ten years later, despite some progress in strengthening the capital structure of existing Irish industry, many of the same concerns remain.

TABLE 12.1

Capital Structure of Irish Industry
% Composition

	1978	1982	1989 Number of Employees		
			20-49	50-249	250+
Share Capital & Reserves	59	57	63	65	65
Borrowings of which:	32	33	29	26	24
— within one year	(16)	(15)	(9)	(13)	(10)
— over one year	(16)	(18)	(20)	(13)	(14)
Government Grants	5	5	7	7	6
Other	5	5	2	2	5
Total	100	100	100	100	100

Source: Data for 1978 and 1982 derived from NESC Report No. 76 (1984:55). 1989 data are from Review of Industrial Performance (1990:37). Note that the 1989 data exclude small firms employing less than 20 persons. The data for 1978 and 1982 would also exclude some (but possibly fewer) small firms in that they do not take account of companies with loans of less than £50,000.

Table 12.1 compares the capital structure of Irish industry in 1978 and 1982 with that which existed in 1989. Although the data are based on somewhat different sampling sets,[98] the results are sufficiently comparable to enable us to comment on some of the broad trends evident. By focusing on the results for 1978 and 1989, we can compare the capital structure of firms at similar stages in the business cycle.[99] The results for 1989 do not support the view that Irish industry, in general, is over-borrowed. Moreover, the broad thrust of change in Irish industry's capital structure over the period 1978-1989 was in the desired direction: share capital and reserves rose as a proportion of total capital from 59% in 1978 to about 65% in 1989; this rise was balanced

98 The 1978 and 1982 data are based on a sample of approximately 600 companies which had bank borrowings in excess of £50,000. The results are somewhat biased because the sample was restricted to those companies in existence in 1978 which were still operating at the end of 1982. The 1989 data are based on a statistically representative sample of all Irish manufacturing firms employing over 20 persons.

99 1982 was a recessionary year, whereas 1989 and, in particular, 1978 represented years towards the top of the business cycle.

by a fall in the proportion of borrowings, from 32% to about 25% over the same period. Finally, the term structure of borrowings has shifted slightly in favour of loans of over one year. In 1978, 50% of Irish industry debt was made up of loans of under one year; by 1989, this proportion, while still high, had moved down to about 40%.[100]

While Table 12.1 points to some improvement in the capital structure of existing Irish industry, a number of important concerns remain. Firstly, profitability in the sector remains very low and acts as a fundamental constraint on expansion. The average return on sales in Irish-owned manufacturing industry in the period 1982-1986 was only 1.8% (See Table 12.2). Although profitability increased in the second half of the 1980s, to an average of 3.7% in 1987-1991, the level of return remains low both in absolute terms and relative to the returns available on other forms of investment, many of which have a substantially lower risk profile. Increased profitability would lessen Irish industry's dependence on debt finance, while at the same time increasing its capacity to service existing debt. It would provide vital capital for investment and would improve the attractiveness of the sector for outside investors. The need to break out of the vicious circle whereby weak competitive performance leads to low profitability, which in turn exacerbates the financing problems of Irish industry and contributes to further weaknesses in commercial performance, points to the need for simultaneous action on a number of fronts. It reconfirms the Council's view that efforts to improve the level of investment in Irish industry must be seen as part of a wider agenda aimed at building successful Irish companies; simply tackling the financial constraints in isolation will not work.

TABLE 12.2

Profitability of Irish-owned Manufacturing Industry

Profit as % Sales										
1978	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**
5.4	1.6	0.6	2.3	1.8	2.7	3.3	4.1	3.9	3.7	3.6

Source: Data for 1978 and 1982 relate to net profit before tax and are taken from *NESC Report No. 76*, p. 56. Post-1983 data are from IDA's annual *Irish Economy Expenditure Survey*.

A second, major limitation of Table 12.1 is that it presents a *static* picture of the capital structure of existing Irish industry, based on present levels and forms of investment. It cannot answer the crucial question as to whether and to what extent that pattern of investment has itself been shaped or curtailed by the operation of Ireland's financial system. The difference between the financing requirements of the existing, generally under-performing, industrial base and the requirements which *would* arise in respect of a successful, rapidly-growing sector means that surveys of existing firms may be of limited value in helping to identify funding gaps and financial constraints on the development of indigenous companies. In many respects, it is the firms which did *not* get started and the investments which *never* happened which are of most interest in this regard, although these by definition are difficult to track and to evaluate. Concerns about a lack of investment finance in Ireland have typically focused on the shortage of *risk capital* to fund, for example, substantial investments in new product or market development or to support new start-ups. Even if the *overall* capital structure of Irish industry appears adequate, given existing levels and patterns of investment, gaps may exist with respect to the availability of specific forms of equity investment. Evidence of such gaps will be discussed in Section 4 below.

Some information on the adequacy of equity finance for the existing base of Irish industry is provided in a recent survey carried out by the Department of Enterprise and Employment.[101] It shows that, although the majority of Irish-owned industrial firms consider themselves to have enough equity, a substantial minority (32%) suffers from a shortage of equity finance. This result is broadly compatible with the findings of an earlier survey carried out in 1989.[102] Of the 32% of firms which reported a shortage of equity finance in the 1992 survey, more than half (54%) indicated that they had strong growth prospects. Companies suffering from a shortage of equity identified the main effects of that shortage as having slowed growth and delayed expansion (20% of total effects listed); prevented investment in R&D or plant (16%) and inhibited the development or expansion of export markets (12%).

One out of three companies surveyed in 1992 indicated that they would have an equity requirement over the following three years. The vast majority of these companies (78%) felt that raising this equity would be difficult. This response was consistent across all size categories of firm. There was no single reason given as to why raising equity would be difficult, with several firms listing more than one explanation. Table 12.3 ranks the reasons given in terms of the total number of mentions received by each category. The main factors identified by companies are the poor economic

100 Note, however, that in the important size category of 50 to 249 employees, short-term borrowings of less than one year still account for half of total company debt in existing Irish industry.

101 1992 Equity Capital Survey of Irish Indigenous Industry.

102 See 1989 Survey of Business Attitudes reported in the Review of Industrial Performance (1990).

climate/recession, the fact that manufacturing is not as attractive as other forms of investment and a shortage of funds (including bank, venture capital, BES and other funds).

TABLE 12.3

Reasons for the Difficulty in Raising Equity Finance — Perceptions of Indigenous Industrial Firms

	Total Reasons	
	Number	%
Current economic recession/climate for investment poor	30	14%
Manufacturing not as attractive as other forms of investment	28	13%
Banks reluctance/refusal to invest or lend	26	13%
Problems of small companies eg. insufficient assets and lack of security for lenders	19	9%
Lack of Venture Capital Facilities	18	9%
Inability of company to produce adequate after tax returns	16	8%
Security & personal guarantees required by the Bank	12	6%
BES restrictions	11	5%
Lack of funds	9	4%
Software industry has a bad reputation	7	3%
Other	33	16%
	209	100%

Source: 1992 Equity Capital Survey of Indigenous Irish Industry, Department of Enterprise and Employment, unpublished.

Firms were also asked what improvements they would recommend to improve the climate for raising equity. The responses reflected the range of problems identified in Table 12.3 above. The most important single recommendation, accounting for 22% of all items mentioned related to measures to redress the balance between investments in manufacturing industry and the attractive after-tax returns available on a number of lower-risk investments (special savings accounts and the post-tax return on property investment were cited as specific examples). The impact of the tax regime on the deployment of national savings and investment is discussed in Section 3 below.

Overall, there is evidence that a substantial section of the existing indigenous industrial base in Ireland suffers from a shortage of equity finance and that this acts as a constraint on development. It was also suggested above that equity shortages may exist in other areas not covered by the survey data, particularly in respect of new company start-ups. The substantial growth now required in the indigenous sector may exacerbate any existing shortfall. The sections which follow will consider some of the issues which need to be addressed, if financial constraints on the development of indigenous businesses are to be reduced.

3. THE MISMATCH BETWEEN INSTITUTIONAL SAVINGS AND INVESTMENT

Ireland does not suffer from a lack of savings. Kelleher (1992) has shown that the level of savings in Ireland is high relative to our income, and the amount we save has been growing rapidly in recent years. In 1992, gross national savings in Ireland amounted to £5.7 billion, equivalent to 22% of GNP. This ratio was higher than in many other OECD countries.[103] An inadequate level of investment in indigenous businesses is thus more likely to reflect the particular *deployment* of savings in Ireland, rather than any serious deficiency in the overall size of the national savings pool.

The deployment of national savings will reflect the returns generated by different forms of investment activity relative to the risks incurred, with funds moving towards areas with the best risk/reward profile. Given the low returns typically earned on investment in manufacturing activity, and the high risks associated with such investment, it is not surprising that the share of national savings committed to the sector is low. Several studies have shown however that the disadvantages of the traded sectors in attracting investment are *exacerbated* by aspects of the Irish tax regime, which encourage the movement of funds into areas of low-risk investment.[104] Most investments in the exposed traded sectors of the economy have to be made out of post-tax income and the return is taxed as it arises (notable exceptions occur in respect of investments qualifying for BES relief, the recently-introduced Special Investment Accounts and the Tax Refunds for New Enterprises introduced in the 1993 Finance Act). By contrast, several forms of investment in the sheltered sector can be made out of *pre-tax* incomes and/or the return can be

103 The average savings ratio (ie. gross national savings as a percentage of GDP) for the OECD in 1991 was 20.9%. Japan, Luxembourg and Switzerland stand out as having exceptionally high savings ratios, in excess of 30%. The US and UK, by contrast, had savings ratios of 15% or below in 1991.

104 See, in particular, Thom (1988). Also Andersen & Co (1992), Culliton (1992) and Moriarty (1992).

generated free, or partly free of tax. The principal investment categories which benefit from this form of fiscal privilege are pensions funds, insurance policies, certain forms of savings instruments (eg. Special Savings Accounts, Savings Certificates) and investment in property.[105]

Over the past 20 years, the structure of Ireland's saving market has changed substantially with a dramatic shift in market share away from the banks into life assurance, pension funds and other, non-building society accounts. This shift has been encouraged by the significant tax advantages which these afford compared to other forms of personal savings.[106] Between 1974 and 1988, the proportion of total savings going into the banks fell from 79% to 30%, while the share of life offices rose from 4% to 46% over the same period (see Table 12.4). More recent data suggest that the banks and building societies regained some market share in 1990 and 1991 (Jones, 1992; Duncan, 1992), but the broad picture of very rapid growth in the assets controlled by pension and insurance funds remains valid.

TABLE 12.4

Savings Market Shares

	1974 %	1988 %
Banks	79	30
Building Societies	8	7
Life Offices	4	46
Other	9	17
	100	100

Source: Duncan (1992:30).

The result of the shift in savings is that investment decisions are now heavily influenced by a small number of institutional investors, and the deployment of national savings is driven largely by their portfolio of investments. Irish fund managers, operating mainly within life companies or investment banks, currently have about £16 billion of funds under management with net cash flow of £1.3 billion per annum, although this can be volatile (Danaher, 1992). Despite the very substantial pool of assets under their control, institutional investment plays a very limited role in the financing of Irish industry and there are substantial structural impediments to securing a greater level of involvement as will be shown below.

105 The Council's views on the tax treatment of property are discussed in detail in Chapters 7 and 15.

106 In some instances (eg. pension funds), the monies invested are deductible for income tax purposes. In others, the advantage lies in the treatment of the income generated on the savings, with pension fund exemption and life assurance companies subject to only the standard rate tax. Further advantages arise in respect of tax exemption when savings are withdrawn in the form of life assurance policy proceeds or lump sum commutation of pension entitlements. Taken together, these benefits confer a considerable degree of "fiscal privilege" on the financial intermediaries involved.

TABLE 12.5

Asset Distribution of Irish Portfolios

Distribution of Average Fund at 31st December Sector	'80 %	'81 %	'82 %	'83 %	'84 %	'85 %	'86 %	'87 %	'88 %	'89 %	'90 %
Irish Equities	25	20	14	22	17	21	31	25	29	34	27
Irish Fixed Interest	23	24	27	40	38	41	34	41	37	23	25
Irish Index-Linked	-	-	-	-	4	4	3	3	2	2	2
Non-Irish Equities	26	24	17	19	19	18	21	16	18	25	25
Non-Irish Fixed Interest	4	8	13	3	2	2	1	2	2	3	4
Property	15	15	13	11	10	6	5	5	7	8	10
Cash	7	9	11	2	7	5	4	8	5	4	8
Other Assets	-	-	6	4	4	3	1	1	1	1	-
	100	100	100	100	100	100	100	100	100	100	100
Total Irish	70	68	64	75	73	77	77	79	78	70	70
Total Non-Irish	30	32	30	22	23	21	23	20	21	29	30

Source: Danaher (1992).

Table 12.5 shows the asset distribution of Irish portfolios. Roughly 30% of the average Irish fund is invested outside Ireland, mainly in overseas equities. This is not excessively high by the standards of the early 1980s. However, the proportion of funds invested overseas has risen substantially in recent years, from a low of 20% in 1987. Moreover, given the rapid growth in the total volume of funds held in institutional portfolios over the past decade, the level of funds placed overseas would appear to have risen substantially in absolute terms. Exchange controls for long-term savings institutions were effectively abolished in January 1989. The immediate impact of their abolition was to bring about a reorientation of portfolios away from domestic bonds into overseas equities. Part of this may have involved a once-off portfolio adjustment to reduce the gilt element of Irish portfolios which, at double the typical UK rating, was high by international standards (Jones, 1992). A more significant concern for the future is that, despite the relatively good value available in domestic equities, funds may continue to be invested overseas in order to provide a better portfolio spread than can be achieved from Ireland's small and concentrated equity market (Kelleher, 1992).

The proportion of Irish portfolios invested in domestic equities averaged 29% over the period 1986-90. This was higher than in the first half of the 1980s, but is still low by international standards. Pension funds in the UK, for example, invest an average of about 60% of their assets in UK equities (Kelleher, 1992). The relatively low rating of domestic equities in Irish portfolios reflects once again the very limited scale and intense concentration of the Irish stock market. Although more than 80 companies have a quotation on the Dublin exchange, it is heavily dominated by a small number of larger companies. The top four companies (Smurfit, AIB, Bank of Ireland, CRH) account for nearly 50% of the total market capitalisation and the top ten companies account for almost 75%. Smurfit, the largest company on the list, itself accounts for over 15% of the market. These problems of concentration in the equity market are compounded by a high degree of concentration in the fund management industry. The top three fund managers between them control more than 75% of all funds under management. As a result, if fund managers were to devote a high proportion of their funds to the Irish equity market, they would end up with portfolios with a high degree of stock-specific risk and a very skewed sectoral exposure.

For the vast majority of Irish industrial firms, the stock exchange is irrelevant as a means of raising finance. Even the Small Companies Market, which was established in the mid-1980s specifically to cater for the needs of growth-orientated smaller firms, has not proved successful. The number of companies listed on the SCM has halved, from 8 in 1989 to just 4 companies in 1992. With regard to companies seeking a full market listing, it is now widely accepted that companies with a capitalisation of less than 1% of the market (c. £100 million) will not, in future, merit the attention of institutional investors (Jones, 1992). This means that about two-thirds of the *existing* firms listed on the Irish stock exchange will find it increasingly difficult to raise funds on the market. For the ninety-nine per cent of Irish manufacturing firms which are too small to have made it to the market in the first place, there remains the long-standing problem that they have no effective means by which to gain access to institutional funds.

The recent report of the Task Force on the implementation of the Culliton Report (Moriarty, 1992) argued that government policies which have

encouraged the flow of savings into financial institutions should be balanced by a requirement for a proportion of those savings to be invested in productive enterprise in Ireland. This principle was accepted in the context of the new Special Investment Accounts which stipulate that, in order to obtain the benefits of a 10% tax rate for non-credit institutions, a proportion of investors funds (rising from 40% in Year 1 to 55% in Year 4) will have to go into Irish equities. Of this investment, a minimum percentage (6% in Year 1 rising to 15% in Year 4) must be invested in *smaller* Irish companies with a market capitalisation of less than £100m. Discussions are also underway with the Pension Funds Industry, with a view to identifying ways to secure a higher level of institutional involvement in the funding of business development in Ireland. While efforts along these lines must be vigorously pursued, the structural characteristics of much of Irish industry, with the very small average size of investments and the requirement for 'hands-on' participation is likely to place a continued limit on the scale of institutional investment for some time to come. This suggests that other possible routes to financing business development must also be considered.

4. FINANCE GAPS FOR IRISH BUSINESS

4.1 Inadequate Provision of Seed and Venture Capital[107]

In 1984, the Council pointed to serious inadequacies in the availability of seed capital and venture capital for Irish industry.[108] In the absence of private investors willing to provide such funds, the State at the time played the major role in this area, primarily through the IDA. Over the past decade, the situation has disimproved still further and despite the emergence of a number of new initiatives, the overall availability of funds remains inadequate and is widely accepted as acting as a constraint on the start-up and growth of Irish companies.[109]

Significantly, there is evidence that the level of new firm formation in the manufacturing sector fell considerably in Ireland during the 1980s relative to other countries. A recent study by Hart and Gudgin (1992) showed that, whereas Ireland had a relatively *high* rate of new firm formation compared

107 Seed capital represents the first point in the development chain of new businesses. It is used to finance the development and testing of new business ideas or concepts. Venture capital represents the second stage of development, in which finance is required to bring the concept into commercial production. Both terms relate specifically to start-up and very early-stage finance and distinct from the development capital which is required subsequently to fund growth and expansion.

108 NESC Report No. 76

109 See Culliton (1992), Moriarty (1992).

to the UK and other countries in the 1970s, its performance in 1980-1990 ranked it alongside those regions of the UK recording the *lowest* formation rates, namely Scotland and the North of England. The rate of formation of new manufacturing firms in Ireland during the 1980s, at 18.5 new firms per 1,000 employees, was considerably below that of Northern Ireland (22.2 per 1,000 employees) and the UK as a whole (28.82 per 1,000 employees).

Recent surveys have documented the sources of equity finance for those who succeed in starting-up in industry. (As noted earlier, they cannot capture the number of firms which *fail* to start-up due to a lack of finance). The surveys highlight the heavy reliance on private sources of funding: the 1992 Equity Capital Survey of Indigenous Industry showed that 49% of firms which had raised capital had done so from private sources. A further 27% raised equity through the BES, while venture capital and other sources (including rights issues, IDA preference shares, banks, etc.) each accounted for 12%. Similarly, Kinsella (1992) in his study of fast growing Irish firms found that personal savings accounted for 50% of the start-up finance for these companies, with grant-aid constituting the second most important source, at 20%. Venture capital was insignificant and it was pointed out that venture capital companies do not typically operate in the range - below £250,000 - required by fast growing firms at the start up stage. The second stage financing of Kinsella's group of firms was dominated by bank finance and retained earnings (at 40% each), with BES funding constituting an important third source of finance (20%) at this stage of development.

The shortage of finance for new company formation in Ireland reflects the fact that:

- The funds management industry which controls the bulk of Irish savings, is focused primarily on investments in large, developed companies and in liquid securities, both in Ireland and overseas;
- The banking system concentrates on shorter-term, secured lending and on less risky investments;
- The Irish venture capital industry has shifted decisively in recent years from the riskier end of the business (ie. seed/start-up finance) towards investments in more established companies (see Table 12.6). Danaher (1992) points out that, although Ireland is one of the best supplied markets in Europe from a venture capital perspective, only a tiny proportion (3%) of the industry's funds are available for fledgling companies or high risk investments.
- The reorientation of Ireland's venture capital industry has been accompanied by a decline in the number of companies operating in the market. Of the companies which existed in the early 1980s, 3i has pulled out of Ireland, NADCORP (the State's Venture Capital Agency) has been subsumed into the IDA and no longer participates in the venture capital industry, DCC is moving out of venture capital to become a holding company and ACT has shifted its focus to more mature companies. The role of ICC, the State development bank, is currently under review, but at present its emphasis is concentrated largely on established businesses rather than on start-ups.

TABLE 12.6

Changing Focus of Ireland's Venture Capital Industry

	1986 IR£M	1987 IR£M	1988 IR£M	1989 IR£M	1990 IR£M
Total Portfolio	43.6	69.2	101.0	125.0	134.0
New Investments	15.5	28.8	27.0	29.0	26.0
Of Which					
» Seed/Start-up	35.1%	29.1%	32.4%	1.6%	3.0%
» Development	42.4%	56.8%	40.5%	43.9%	94.9%
» Buy-Out	14.3%	12.3%	27.1%	54.5%	2.1%

Source: Danaher (1992).

The reorientation of Ireland's venture capital industry away from the high-risk areas of seed capital and early-stage finance towards more established businesses is in line with trends in the UK and other countries. Murray (1992) notes that, with the maturing of the UK venture capital industry over the past decade, the industry has moved decisively to concentrate its finances on a smaller number of larger firms. The share of total venture capital investment in the UK which was allocated to start-up and early-stage investments fell to 6% in 1991, down from 13% in 1987. This is very similar to the Irish experience. Murray notes that the majority of venture capitalists in the UK are generalists: their specialisation lies in the structuring of equity-based deals and not in the segmentation of companies, locations or sectors to which their funds are applied. This may help to explain why relatively little venture capital investment in the UK has been allocated to technology-related deals, in stark contrast to the position in the US. In Ireland, it has been suggested that technology-oriented firms have particular difficulties in attracting finance, because fund-managers do not have the expertise to understand their business (Dillon, 1993).

The current pattern of venture capital investment in the UK and Ireland seems set to continue. Murray suggests that, in the UK start-up and early-stage deals are unlikely to be seen as attractive core business for any more than a handful of the most intrepid or specialist venture capitalists. Despite high risk premiums, deals in this area have too high a perceived rate of failure compared with the more secure business of management buy-outs/buy-ins and development capital. Also, given the increasing concentration of funds in the industry, the small size of most new ventures is unattractive and would involve unacceptably high levels of administration, monitoring and control. Thus, risk and significant operational diseconomies will both operate against the financing of entrepreneurial activity by venture capitalists. These factors would appear to apply with at least as much force in Ireland.

The existing sources of seed and start-up capital in Ireland are diverse, with many of the private sector initiatives being small in scale. Despite a reduction in the level of grants available to Irish industry over the past decade, the State, through its industrial development agencies, continues to play a major role in the provision of early-stage finance. This support takes a variety of forms, including grants, subsidies and increasingly, equity. State support is often important in leveraging in other sources of private sector funding. The recently established County Enterprise Partnership Boards (which replace the former County Development Teams) will provide seed capital for small businesses in the manufacturing, tourism and agricultural sectors and in infrastructure. A fund of £12 million has been made available to support start-ups and small businesses, with the emphasis being on companies with less than 12 employees and a particular focus on the contribution of such firms to local community development. Grants of up to 50% of eligible investment expenditure will be provided, with a maximum grant limit of £50,000.

There are four Business Innovation Centres (BICs) operating in Ireland. These centres, which are partly funded by the EC, provide seed capital for small enterprises. The EC has established a Business Innovation Fund which is accessed through the BICs. The Fund is jointly financed by the EC, the State (through its industrial development agencies) and private institutional investors (including some of the main commercial and industrial banks). It provides seed capital of between £25,000 and £75,000 to start-ups and young businesses which can demonstrate future growth potential, in return for a minority share in the company. Support is restricted to companies with less than 10 employees and with an annual turnover of under £75,000.

In addition to the above sources, there are a number of smaller funds operating, many of them designed to meet the needs of particular

communities. Examples in this area would include the Smurfit Job C Enterprise Fund, the First Step initiative and Inner City Enterprise deals exclusively with start-up companies in Dublin's inner city a characteristic of many of these schemes is that they combine fundi the provision of hands-on' management expertise, and seek to provid package of support to the fledgling businesses.

Finally, the role of tax incentives in helping to secure early-stage fina Irish businesses is potentially important. The Business Expansion S (BES) has not proved a significant source of finance for firms at the s stage, although it has become an important secondary source of fund some more established companies, as was noted earlier. The 1993 F Act has widened the scope of the BES, to provide a refund of tax a paid by an individual who sets up and takes employment in a new qua business. The scheme is designed to provide a source of seed capital f entrepreneurs. The total amount of investment on which a tax refun be claimed is £75,000. Companies qualifying are restricted manufacturing and internationally-traded services sectors, including tourism operations.

Overall, it is clear that the availability of seed capital and early-stage fi for Irish businesses remains very restricted. Such funds as are availal generally provided by the State, by private individuals ("Business An or are provided on less than fully-commercial terms by community and organisations. The principal feature which inhibits private sector inves in seed/early-stage capital is the inherent riskiness of new company sta This is not something which policy can eliminate. Other inhibiting f may, however, be more amenable to policy influence. These include:

- The non-marketability of the investment and the absen mechanisms for buying in and out of small Irish companies;
- The time involved in evaluating risk relative to the size c investment;
- The "hands-on" nature of the investment, which typically re that the financial input be part of a much wider package of com support including, for example, assistance with manage marketing or financial controls; and
- Information gaps which restrict the level of private and institut investment.

4.2 Development Capital

Companies which have succeeded in getting past the initial hurdle of securing start-up finance must subsequently secure adequate injections of development capital if they are to grow and expand. In 1984, the Council noted the existence of a number of investors willing to provide development capital to companies with established track records and significant growth potential. The problem at that time was that the overall level of activity in the area of development capital was considered to be too low and was of little relevance to the vast majority of Irish businesses which had more modest prospects for growth.

The changing focus of Ireland's venture capital industry over the past decade has led to an increase in the overall level of development capital funds available (refer to Table 12.6 above). Despite this, the survey data reviewed in Section 2 above suggest that a substantial minority of indigenous firms in the manufacturing sector continue to have difficulty in securing adequate development finance. It was noted there that even firms which considered themselves to have strong growth prospects could have difficulty in raising equity, with 54% of firms which had suffered from an equity shortage over the preceding three years placing themselves in this category. The issues raised by the Council in 1984 are thus still relevant today. The pool of development capital available in Ireland appears to cater only for a limited group of indigenous companies. Companies outside this group are failing to attract adequate private equity, are forced to rely heavily on debt finance to fund their (limited) expansion and see themselves as suffering from lower growth as a result of these funding deficiencies.

4.3 Limited Availability of Long-Term Credit

Arrangements for long-term finance are not well developed in Ireland. In the past, State grant-aid was used as a way of bridging this gap, providing a form of quasi-equity for companies. With the emphasis in industrial policy moving away from cash grants, the need to develop new mechanisms for getting long-term funding into industry will become more acute.

Long-term finance is taken here to refer to loans repayable over periods of seven years or more. In Section 2 above, it was noted that roughly 40% of the borrowings of Irish industry is made up of loans of under one year (essentially overdrafts). The balance typically comprises variable interest loans of 1-3 years duration.

The dominance of short-term (and often very short-term) credit is not unique to Ireland. A 3i survey of debt structures in Europe found that three-quarters of the debt of small British firms was either in overdraft or other forms of short-term loan. In other European countries the proportion was about half.[110] Germany stands out as having an unusually small proportion of short-term debt, with only 14% of small business debt in the form of overdrafts.[111]

A shift to longer term credit would provide companies with a better base from which to plan their development. Firstly, it would reduce the pressure on companies to repay debt over shorter periods than would be justified by the payback on the project being financed. Second, it would reduce the level of uncertainty in company finances (overdrafts in particular can be recalled at any time), and facilitate a more strategic view of the company's development. Finally, if loans were made available at fixed interest rates, it would allow for greater certainty in the financing costs of a project.

Long-term fixed interest loans are available for small and medium sized businesses from the European Investment Bank (EIB) through global loans organised through intermediary banks in Ireland. A number of commercial banks (Bank of Ireland, Barclays, ABN and AIB) are now involved in lending on EIB funding. ICC which was the traditional conduit for such loans has not borrowed from EIB for some years. EIB loans are available for periods of 5-15 years to SMEs operating in industry, tourism or leisure activities and directly related services. The up-take of these loans by Irish businesses has been very limited at some £21.2 million since 1991. Several reasons may be put forward for this: these include the availability of competitive alternative sources of finance and EIB's strict financial and security conditions. EIB loans are provided on strictly commercial terms and are not subsidised in any way. In addition, the minimum loan available under the scheme is relatively high (£250,000) and the maximum funding available from the EIB is 50% of the project costs, so that total investment must be in excess of £½ million. Finally, the administrative difficulties in drawing-down EIB loans are not inconsiderable for small Irish businesses.

Proposals currently under consideration in the EC could help to overcome some of the above difficulties. The proposals would involve a special package of loan finance for small and medium-sized business, linked to employment creation. The scheme, which is part of Community efforts to

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110 *Economist*, 25 September 1993.

111 Foley and Griffith (1993).

speed up economic recovery and promote employment growth in the EC. could involve interest rate subsidies of up to 3 percentage points on certain EIB loans for SMEs. The proposal is one of several such proposals which are under consideration by the Task Force on Small Businesses. The Task Force was established earlier this year to bring forward recommendations in a range of areas, which would relax the constraints on the development of small firms in Ireland.

The limited development of long-term lending in Ireland in the past may be linked to the volatility of world economic growth over the past ten to fifteen years, with related swings in interest rates and inflation. The emergence of a more stable, low inflation macroeconomic environment in recent years may provide a setting more conducive to the development of fixed-rate and longer-term instruments. There are some signs that such a development may be beginning, with at least one industrial bank and one commercial bank currently offering a ten-year fixed-rate facility.

Finally, the Council notes that the current Government Programme envisages the establishment of a new Third Force in banking from within the State sector. Such a bank could offer an opportunity to develop the practice of long-term credit and equity participation which have been impediments to the establishment and development of indigenous industry and services. In this context, it might be relevant that any such bank have a link or participation with a foreign bank which has a culture of giving long-term credit and taking equity participation in companies.

4.4 Provision of Small Company Finance

Most companies in Ireland are small or very small by international standards. The adequacy and appropriateness of small company finance is not, therefore, a peripheral issue in Irish economic development, but is of central importance. The Council notes that the Task Force on Small Business, which was mentioned above, will be addressing in detail the question of small company finance and it awaits its conclusions with interest.

Small companies throughout the world have difficulty in raising capital and gaining credit because of their lack of track record, limited security and the high risk of business failure. This hampers their efforts to start-up or expand in business. For firms which *do* succeed in starting up, typical problems identified include an over-reliance on loans, particularly short-term loans, a lack of equity capital and higher interest rate costs than for larger

companies.[112] In Ireland, a 1989 survey by the Small Firms Association (SFA) identified the main finance related concerns of small manufacturing firms: the most important concern, cited by 30% of firms, was the amount of collateral required by banks. Other major concerns related to the high level of interest charges (cited by 21% of firms), the limited availability of credit (17% of firms) and high bank charges/fees (14% of firms).

A requirement for security against small business loans is normal in all countries and the use of personal security on bank loans seems, if anything, to be increasing in Europe[113]. A four country comparison of Ireland, the US, Canada and the UK[114] suggests that:

- The proportion of collateral free loans in Ireland (20%) is higher than in Canada (15%), but is lower than in the UK (29%) or the US (30%);
- The use of personal collateral is higher in Ireland and the UK than in the North American economies. Overall, some form of personal collateral was required in 24% of US cases compared with 43% in Ireland.

Standworth and Grey (1992) noted that smaller firms tended to be over-represented in the categories which are required to provide personal collateral. They also commented that 80% of the cases where no collateral was required was for small overdrafts.

With respect to interest charges, a major source of contention relates to the differential between rates charged to large businesses (typically AAA) and small firms (mainly AA). The 1990 Review of Industrial Performance noted that under one third of small Irish firms had their borrowings at AAA rates, compared with three quarters of the larger firms. The existence of an interest rate premium for small firms is a feature of most countries and reflects, among other things, the higher cost per firm to the banks of dealing with small firms and the greater risk of failure.

The difference between interest rates charged to different categories of borrower has varied over time: The differential between AAA and AA rates increased substantially in Ireland in the second half of the 1980s, from 1.4 percentage points in 1985 to 2.54 percentage points in 1988. It fell back subsequently to 2.17 percentage points in 1992, but has risen significantly since the beginning of 1993. In July 1993, the prime rate (AAA) stood at

112 European Commission, "An Enterprise Policy for the Community".

113 European Observatory for SMEs (1993).

114 Based on SFA survey 1989 and Bannock et al (1991), quoted in Foley (1993).

7.25% compared with an AA rate of 11.25 - 11.75 on overdrafts and loans of up to one year. This gap of 4 - 4.5 percentage points is exceptional by past standards.

The widening of the gap between the AA and prime interest rates since the beginning of 1993 reflects the fact that the substantial reduction in money-market rates in the first half of the year has not been reflected equally across all categories of borrower, as well as the fact that banks' cost of funds has not been falling as fast as have interbank rates. The reduction in the prime rate and to a somewhat lesser degree, mortgage rates, has followed closely the downwards trend in inter-bank rates. The AA rate, by contrast, has been much slower to fall, allowing a substantial gap to emerge.

It is not clear yet to what extent the recent rise in the interest rate premium charge to small business represents a temporary phenomenon, reflecting a slow settling-down period after the turmoil in currency and financial markets in late 1992/early 1993. A recent paper by Ryan (1993) suggests, however, that the trend may prove persistent. Ryan argues that the low nominal interest rate environment which currently prevails coupled with the growing competition in the financial sector, will increase the transparency of the economics of the different lines of business conducted by the banks. Banks have traditionally relied on cross-subsidisation between products and between different categories of customer. Ryan suggests that this approach is no longer sustainable and that future years will see the progressive elimination of much of the cross-subsidisation of disconnected lines of business. Viewed in this light, the widening of the gap between different categories of borrower may well prove to be less transient then was initially thought. Against this, the growing competition in the lending market will continue to put pressure on the banks to reduce their own internal costs, while at the same time offering increased opportunities for better quality AA customers to negotiate move favourable arrangements for themselves.

Loan guarantees for SMEs are provided by Governments in all member States of the EC except Denmark. Guarantees for commercial bank loans to SMEs also operate in Australia, Canada, Japan, Switzerland, the US and many other countries. In some countries, these schemes date back to the inter war period or even earlier, but in most cases they date from the 1970s (in the UK from the early 1980s) (Bannock et al., 1990).

In Ireland, guarantees are available for certain borrowings under the Business Development Programme operated by the IDA. The number of firms eligible to participate in this programme represents a very small proportion of the

total small business base, however, and the overall availability of loan guarantees in Ireland has been limited.

Guarantees are commitments given by Government or other private institutions against borrower default to a lending institution. Both funded and unfunded schemes are in existence. *Funded schemes*, usually in the form of guarantee associations, have a capital base supplied by all or some of Governments, trade associations, banks or insurance companies and supported by premiums that are paid by borrowers benefitting from the guarantee. The guarantee therefore, is not free. It costs the recipients. Funded schemes are to be found in Japan, West Germany and France. *Unfunded schemes* are found in the Netherlands, Canada, the US and the UK. In these schemes, Government compensation to lenders is made out of public revenue. The loss rates on the unfunded schemes are higher than on the funded schemes. Guarantees are normally only available for established businesses and they generally do not account for a very significant proportion of bank lending to SMEs. The funding body in both schemes usually guarantees 70-80 percent of the loan, so that the bank retains a proportion of the risk. However, banks in France, Japan, and the Netherlands bear zero risk. Banks assess the loan applications and credit worthiness themselves and lend accordingly in the unfunded schemes. For the funded schemes, the loan applications and creditworthiness of the applicant are subject to the guarantee association's approval.

There has been some improvement in the services available to new and emerging enterprises in Ireland in recent years. Specialist small business units are now operating in all of the main banks and the range of products available for small companies has widened to include newer areas such as treasury advice, interest and exchange rate management services, franchise funding, etc. In 1989, a Special Enterprise Loan Fund was established by four of the main commercial banks to provide monies for the creation and development of small firms. The main features of the Enterprise Loans are the absence of personal guarantees or family home guarantees, the availability of AA interest rates and, in some instances, the provision of hands-on' management and advisory support. The amounts loaned typically range from £10,000 to £150,000. Loans are made available for periods of up to ten years and moratoria are available. While the establishment of the Enterprise Loan Fund represents a welcome development, it remains very limited in scale: by early 1993, for example, Enterprise Loans by the Bank of Ireland amounted to just £8 million, compared with total small business loans by the bank of about £850 million per annum (Foley and Griffith, 1993). The total amount of loans committed by all four banks involved in the

Enterprise Loan Scheme amounted to £18 million at end-1992. These loans were distributed across 250 projects.

The problems encountered by small firms seeking to raise finance are not unique to Ireland. In most countries, recognition of the financing difficulties faced by small businesses has prompted the development of institutions or programmes specifically designed to cater for their needs. Foley and Griffith (1993) point out that, within the banking systems of most EC countries, organisations have evolved which concentrate solely on the provision of medium and long-term loans to SMEs.[115] It is notable that in virtually all cases, the State plays an important role in the funding or support of these organisations. This may take the form of direct State involvement as, for example, with the operation of State owned institutions such as the Caisse Nationale de Credit Professionel (CNCP) and the National Fund for Credit to Trade and Industry (NKBK/CNCP) in Belgium or the Credit National in France. Alternatively, and more commonly, State involvement may be in the form of indirect financial assistance, either through the provision of full or partial Government guarantees on loans made (eg. Luxembourg, Netherlands) or the provision of earmarked funds or incentives for financial institutions to invest in SMEs (eg. Greece, Italy).

In Ireland, the ICC Bank has similarities to some of the European SME credit institutions. The bank was established by the State in 1933 to specialise in meeting the financial needs of small and medium-sized businesses in all sectors of economic activity. The bank operates commercially and has been profitable since its establishment. Ironically, the commercial success of the bank has caused it to follow many of the same development paths as other, private sector financial institutions and has diluted its ability to meet some of the specific financing gaps for SMEs identified in this chapter. The current Programme for Government includes a commitment to develop a Third Force in banking from within the State sector by merging the ICC Bank and ACC Bank, with the possible involvement also of the Trustee Savings Bank and elements of An Post. The Programme envisages such a Third Force discharging both a commercial and a developmental role with small and medium-sized enterprises. The Council notes the proposal to reassess the needs of small business in this regard. While it is not clear at this stage what precise form any new State banking entity might take, the impact of any such Bank on the development of small businesses in Ireland is likely to depend

115 Note that the definition of "medium" and "long-term" varies considerably from country to country. In Spain, long-term is taken to mean loans of over three years. In most other countries, long-term refers to loans of at least five years and typically seven years or upwards.

in part on the manner in which, and degree to which, the commercial and developmental functions envisaged for it are ultimately combined. The Council is conscious that there are considerable difficulties in seeking to reconcile the varying objectives of supporting industry and jobs, trading profitably and paying adequate dividends implicit in these dual roles. The framework currently being developed must address specifically some of these issues.

5. IMPROVING THE FLOW OF FUNDS TO IRISH BUSINESSES

This Chapter has highlighted a number of specific financing problems which impede the development of Irish businesses. Two problems in particular stand out: Firstly, the analysis supports the view that there is a *shortage of risk capital* in Ireland. This shortage is perhaps most evident in the inadequate funding of new firm start-ups, but is also behind some of the deficiencies in equity funding of established businesses which were discussed above. While there is no indication of an overall shortage of finance in Ireland, the majority of the funds available are channelled towards a limited range of relatively low-risk projects. Second, the financing problems of Irish businesses are exacerbated by the *structural mismatch between the needs and characteristics of Ireland's financial system and the needs and characteristics of the indigenous business sector*. In many respects, the Irish financial system is over-developed by reference to the stage of development of indigenous companies. The very small size of most Irish businesses and the requirements which many firms have for "hands-on" management support create major diseconomies of scale which restrict investment.

In the past, the State has played a major role in filling the risk capital gap through the provision of grants and other aid to firms in the industrial sector. The role played by the State in financing industrial development is set to change substantially in the years ahead, with a fall in the level of "free money" available to companies and a desire to increase the level of private sector funding. This process will need to be managed carefully, if efforts to avoid excessive crowding out by the State are not to result in a simple withdrawal of State involvement, without any (or adequate) offsetting increase in the level of private sector involvement.

There are three broad categories of investors capable of providing funds for business development: institutional investors, private individuals and the State. While the balance between them must change, the need for a continued input from all three groups will remain. Turning first to *institutional investors*, there is clearly a mismatch between the dominance of the financial institutions in the savings markets and their very limited presence as investors in Irish business. There are, in principle, two ways in which this problem may be addressed - by reducing the level of inflows into the institutions (thereby leaving savings in the hands of individuals or intermediaries which are perhaps more likely to invest in Irish businesses), and/or by increasing the flows out of the financial institution into the indigenous business sector.

The Council believes that those aspects of the tax code which serve to distort the flow of savings towards low-risk and sheltered areas of the economy have a negative impact on the rate of development of the economy. The Council recognises the constraints on policy arising from the free movement of capital following the abolition of exchange controls and progress towards completion of the internal market. However, the weight of incentives designed to retain savings in the Irish economy is overwhelmingly towards investments which do little to promote the development of the economy. The Council has on a number of occasions highlighted the excessive subsidisation of investment in property. In the same context, the Council believes that those aspects of the tax code which actively promote the flow of savings into pension funds and life assurance companies should be urgently reviewed.

Even without fiscal preference however, the financial institutions would continue to absorb a major (though reduced) proportion of Ireland's savings. There are strong structural constraints militating against the investment of these funds in Irish businesses. This is because the investment requirements of the financial institutions (large scale, liquidity, low risk) are fundamentally at odds with the current financing profile of indigenous businesses (small scale, illiquid, high risk). In the absence of new policy initiatives, it is difficult to envisage any substantial increase in the level of institutional investment in the indigenous business sector. This is all the more so since the abolition of exchange controls and the opening up of new investment opportunities overseas.

In many ways, the characteristics of Irish business are more suited to a strong involvement by *private investors* than by large scale institutional investment. It is important therefore, that policies designed to stimulate an increased flow of funds to the sector take account of the needs of the individual, as well as the institutional investor. In this regard, the BES scheme, amended to focus on productive investment in the traded sector, can play a useful role and the Council welcomes changes in the scheme which have had that effect.

The third and final participant in the funding of Irish business is *the State*. Under the new guidelines for industrial policy, the State will have a continued, but different, role to play in the financing of industrial development. The Council supports the broad move away from the concept of the State as a provider of grant-aid towards the more comprehensive and complex view of the State's role set out in the Moriarty Report. In order to support this new role, policy action will be required in a number of areas. These include *structural policies* designed to make it easier for institutions and individuals to invest in Irish companies, and *financial/taxation policies* which make it more attractive for them to do so.

In the area of *structural policies* a number of issues arise: firstly, the absence of mechanisms for buying in and out of most Irish companies severely limits their attractiveness to outside investors, whether institutional or private. There is a need to develop an institutional framework which will allow a much broader base of Irish firms to gain access to private sector funds, while at the same time opening up the range of opportunities available to investors.[116] Second, the "information gap" on small companies and the high costs associated with researching and assessing a large number of small scale investments acts as a deterrent to Irish business investment. The State development agencies, which have detailed information bases and a tradition of 'hands-on' involvement with companies, could be used to help overcome these difficulties and offset some of the scale disadvantages of Irish business. Third, the role of the State development banks is currently under review in the context of Government proposals to establish a new Third Force in banking, through the merger of ICC and ACC, with the possible involvement of the Trustee Savings Bank and elements of An Post. The creation of a new State Bank could offer an opportunity to address some of the financing problems identified in this Chapter. A critical determinant of its success in doing this will be the extent to which it is, in fact, able to balance the commercial and developmental roles envisaged for it. This blend of roles has proved difficult to combine in the past but, if managed successfully, could contribute substantially to easing the financial constraints on indigenous business.

In addition to its direct role in providing risk capital for Irish businesses (eg. through the development banks and through the State development agencies), the State has a role to play in leveraging private risk capital into indigenous companies. Policies to stimulate increased levels of institutional investment in Irish businesses may take the form of positive inducements or penalties. The latter typically take one of two forms: a requirement to invest a given proportion of institutional funds in Irish-owned firms, or a levy on the financial institutions which would be used to provide a special fund for industrial development. Neither of these approaches is recommended by the Council. The use of arbitrary levies has been seen in the past to create as

116 This point is recognised in Moriarty (1992)

many anomalies as it has solved; while the introduction of a legal constraint on the deployment of investment funds would also represent an undesirable development. Moreover, unless such a constraint were accompanied by measures to expand greatly the access of institutional funds to small, unlisted companies, the policy would benefit only a tiny minority of predominantly large, established Irish firms.

A more effective way of inducing higher levels of private investment in industry is likely to be by establishing a series of positive incentives. In this context, the Council would favour specifically targeted use of financial incentives, (eg. through the provision of *partial* guarantees to lenders/investors or by using the existing industrial grant budget to leverage private investment into industry as suggested by the Moriarty Task Force).

A second incentive to investment by institutions (and individuals) in new and developing businesses is the type of structural change proposed above. If investment opportunities are identified in such a way that the information costs are not disproportionate to the amounts invested or the likely rate of return - through, for example, the provision of information and expertise associated with a development bank - a major obstacle to attracting investment for viable new projects will be overcome.

In conclusion, the Council believes that the fundamental requirement for increasing the rate of successful establishment of viable enterprises rests with the quality and expertise of the projects and their promoters. Finance is a secondary issue. However, it is a significant constraint on small business development everywhere and, for structural reasons, particularly so in Ireland. The Council proposes to continue its analysis of this issue and to publish further recommendations in due course. The conclusions presented here identify a number of priority issues to be considered in addressing the problem of financing new businesses.

CHAPTER 13

Social Policy in a Strategy for Employment

SOCIAL POLICY IN A STRATEGY FOR EMPLOYMENT

1. INTRODUCTION

The Council identifies unemployment, and particularly long-term unemployment, as the priority issue in the formulation of public policy in the period ahead. The tackling of this problem represents an urgent priority on both economic and social policy grounds. The Council has consistently argued that economic and social policy concerns are not necessarily contradictory and that, as in the case of unemployment, they represent complementary perspectives on policy issues. Thus, economic progress is one determinant of the depth and character of social need, while the capacity to provide adequately for social need depends in part on the level of national income. Nevertheless, trade-offs may arise in the shorter term between specific measures grounded in economic or social policy concerns. The Council believes that these trade-offs are best handled within a framework which includes both economic and social policy objectives.

It is the Council's view that such a framework should be based upon a set of values which reflect society's priorities and aspirations. The Council set out some years ago its statement of the values which it believes are widely shared in Irish society and which, accordingly, should underpin the development of public policy.[117] These include:

- The dignity and right to personal development of the individual;
- The value of bonds of mutual obligation between all members of the community;
- The importance of fair sharing of resources within the community;
- The securing of these rights within a democratic framework.

Arising from this set of values, the Council concluded that the principal objectives of social policy include: the elimination of inequalities of opportunity which arise from inherited social and economic differences; the provision of access for all, irrespective of income, to certain specific services; the development of services which make provision for particular disadvantaged groups in the community; and the expansion of sustainable employment to meet the needs of those seeking work. The Council

117 In NESC Report No. 61.

considered that these objectives should be pursued so as to have regard to inequalities of income and wealth and the development of responsible citizenship based on explicit recognition of the network of mutual obligations within the community.

These goals, which are broadly about fairness in society are pursued by a variety of policies which O'Connell and Rottman (1992) have categorised as:

(i) Policies directed at the level and structure of employment and unemployment;

(ii) Policies on equality of opportunity, especially education policy and policies concerning equality in the labour force;

(iii) Taxes and direct benefits, including social welfare, health care, education and housing.

The extent of unemployment in Ireland, together with the characteristics of unemployment outlined in Chapter 3, point to labour market policies, and general developmental strategies designed to boost sustainable employment, as meriting priority attention from a social policy perspective. This cannot be to the total exclusion of other dimensions of social policy. Indeed, the perceived fairness of public policy may well be a significant factor in securing the legitimacy of, and support for, strategies to accelerate employment development. In this regard, it is appropriate to continue the Council's analytical focus on the principal programmes of social expenditure, both with respect to their fairness and their implications for a strategy for employment.

Callan and Nolan (1992) have noted that "the Irish welfare effort is rather higher than might be expected on the basis of level of income per head". Such relatively greater effort is clearly related to the profile of needs, including demographic needs in Irish society, together with the impact of the standards of provision reflected in public policy. It is also influenced by European Community policies. The Council has drawn attention in the past to aspects of the performance of the principal social services, particularly with regard to their distributive effect. The record of recent performance in the principal areas of social welfare, housing, education and health care is set out in the following chapters.

As the Council has pointed out, social policies and objectives for the 1990s must be formulated in a different context. *Demographic changes* are gradually but cumulatively reshaping the composition of the population,

resulting in changes in the character and composition of households. Social policy must therefore find instruments and methods better able to deal with this changing social environment.

Associated with the evolving demographic scene is the well documented structural alteration to the *labour market*. The labour market is now characterised by a high incidence of long-term unemployment, a growth in female labour force participation and the emergence of 'atypical' forms of employment (job sharing, part-time employment, home-based work). Labour market and related aspects of Government policy must therefore adapt, and develop more flexible and more effective policies and frameworks for training, social security and income maintenance, and child care.

The innate, *complexity* of social problems has been increasing and will continue to increase, requiring more co-ordinated and multi-disciplinary definitions of problems and solutions to problems. For example, the problem of homelessness in the housing system has its origins in the complex, social, demographic and economic changes which affect the framework in which housing is sought and the types of housing needs to be met. Appropriate responses to this issue go beyond the direct production of sufficient quantities of 'standard' public sector housing, and entail co-ordinated elements of social services, health care, and housing interventions in a number of housing tenures. Likewise, the growth of a significant component of very elderly persons in the population requires a multi-disciplinary approach to services for the elderly, one which crosses traditional, professional and organisational boundaries and facilitates flexible policies and service delivery.

It is the Council's view that economic and social policy objectives are not mutually antagonistic, despite possible trade-offs in the short-term. Unemployment, resulting in poverty or involuntary emigration, is the single most important contributor to inequality. The expansion of sustainable employment to meet the needs of those currently out of work and those seeking work in the future would, accordingly, make a major contribution to securing a more equitable distribution of income and opportunities. It is sometimes suggested that narrowing social inequalities might not be consistent with sustaining the current economic expansion and that there may be trade-offs between equity and efficiency. It is not surprising that trade-offs arise in particular instances.

The nature of the trade-offs will be different in each particular case and may differ between the short-term and the long-term; no generalisations are possible. Efficiency/ equity trade-offs occur most frequently in the areas of public expenditure, taxation and the labour market. In considering interventions in these areas, the Council has attempted to strike the appropriate balance between narrowing social inequalities and enhancing the efficiency of the economy, with all the decisions being informed by the Council's over-riding objective of increasing employment. The Council sees social inequalities being narrowed through a restructuring of policies, services and subsidies rather than through increased public expenditure. In general, if real increases are required in some programme areas they will have to be counter-balanced by reductions in other areas.

Widespread and long-term unemployment has trapped some individuals and families into long-term dependence on social security. This dependence is associated with both a 'hysteresis' type *economic* obstacle to unemployment reduction and with a set of *social* and institutional obstacles to labour market participation. Policies which enhance the growth rate of the economy and increase the overall demand for labour need to be supplemented by very *specific* policies to increase the re-employment rates of those on the fringes of the labour market. Groups affected by such policies would include the long-term unemployed, lone parents, and early school leavers. A number of such measures have been suggested in Chapter 3.

A number of specific social policy initiatives may improve the long-term employment performance of the economy. Firstly, if the 'poverty trap' situation affecting some segments of the unemployed is improved then the increase in employment may be more rapid. Secondly, there is a growing dependence on the social welfare system among lone parents and women. Active policies in the areas of child care and training will facilitate re-employment by removing constraints on labour market participation. Thirdly, the high unemployment rates among early school leavers suggest that significant initiatives in the education and training areas may be necessary. Policies which increase the participation of second level pupils from low income families in the school system, and which improve their skill level may have a significant contribution to make to the reduction of long-term unemployment. Social policies which improve the employment and labour market outcomes of the high levels of economic growth have, therefore, two distinct but reinforcing rationale: the *economic* benefits of higher employment, and consequently reduced state transfers, and the *social* benefit of reduced poverty and deprivation.

Secondly, the principle of *protecting* the *disadvantaged* from the burdens of fiscal adjustment has continued and, indeed, renewed relevance in the 1990s. Those aspects of public policy which contribute to, and reinforce, social inequalities must be addressed. This principle of policy is not an implicit plea for increased public expenditure or for a generally less restrictive fiscal

stance. The Council's analysis of social policies in health, housing, education and social security suggests that *reform* - by which is meant a restructuring of policies, services and subsidies within existing resources - can make a significant contribution to enhancing social equity.

Thirdly, the need for *targeting* and *priorities* in social policy is no less important now, in the Council's view, than in the period of intensive fiscal retrenchment in the late 1980s. The approach being advocated here is not one of increased selectivity through greater means testing but rather of careful identification of problems and the design of very specific programmes to confront these problems. In the housing system, for instance, it is clear that some chronic problems require small scale and particular responses. However, the fiscal constraints should not obscure the intrinsic *social policy rationale* for identifying priorities and target groups.

Fourthly, the potential role of *area-based strategies* in social policy should be developed. The concentrated incidence of unemployment, low incomes and deprivation in certain communities and regions gives *a prima facie* case for deepening area-based social programmes. Currently, social policies and services operate on a 'functional' or 'departmental' basis (Health, Social Welfare and others) without any coherent attempt to integrate services at local levels. Clearly, many low income communities are affected by the services, and receive resources from a range of state agencies - local government, Health Boards, the Department of Social Welfare, FÁS, for example. The scope for area 'renewal' and community based co-ordination is therefore considerable.

Fifthly, it will be necessary to have particular regard to the impact of the EC on social policy developments. In keeping with the legislative basis for social policy actions, the Community's influence to date has been primarily felt in terms of the harmonisation of social protection for workers, especially those migrating between member States, the promotion of gender equality, support for vocational education and training measures and intervention in support of disadvantaged minorities. Many aspects of the Community's programmes in respect of agriculture and rural development would also have a particular social policy orientation. As the Council has previously pointed out, the development of harmonised social provision may result in very uneven burdens arising as between the different member States. This points towards the need for cost sharing across the Community as a whole, particularly when migration flows mean that member States may benefit from the social expenditure incurred in another country. The EC Commission will shortly publish a Green Paper on Social Policy in the light of the Maastricht Treaty. The debate and action prompted by that publication will represent an important stage in the evolution of European social policy. The Council has previously argued that "Ireland must contribute positively to formulating the agenda for the Community's social policy discussions. This is necessary because Ireland and other peripheral economies may have different social policy preoccupations to the wealthier central economies" (NESC, 1989, p.554).

2. AREA-BASED STRATEGIES FOR SOCIAL DEVELOPMENT

In *A Strategy for the Nineties*, the Council advocated that local area-based initiatives to tackle marginalisation and social exclusion should be developed as a potentially effective strategy in promoting greater effectiveness and integration of social policies and labour market measures. The Council noted evidence suggesting that concerted intensive programmes in small areas, containing elements of housing and environmental improvement as well as retraining and employment schemes and "outreach" health and educational projects, can have an impact over and above the separate effects of individual programmes. Furthermore, the Council argued that the more closely involved are local communities in the planning and delivery of area-based projects, the more they will reflect local needs and priorities. Subsequently, under the PESP 12 pilot area-based partnership companies were established between May and November 1991 to focus on the needs of the long-term unemployed. The structures were designed to ensure greater co-ordination of existing services for the unemployed and to encourage enterprise at local level. Each partnership company prepared an Action Plan for its area and initial evaluation suggests that this plan and participation in the local structure has proved relatively effective in enhancing provision for the Long-Term Unemployed and in improving co-ordination of education and training activities. Generally speaking, progress was less marked in the areas of enterprise development and job creation. Up to the end of 1992 over 5,000 people were placed in educational courses and a further 6,000 on mainstream training courses as a result of the work of the partnership companies and the agencies and community bodies working with them. In addition, about 400 unemployed people were placed in jobs in the 12 pilot areas and about 200 supported to establish their own businesses by the end of 1992. The evaluation to date suggests that there is a need for better and more refined information to assist in the monitoring of impact, a better re-direction of resources in line with the distribution of long-term unemployment and a clearer mechanism for ensuring participation by statutory agencies and refocusing of their resources committed locally in order to maximise the potential of the initiative (Craig and McKeown, 1993).

The National Development Plan envisages an expanded programme of area-based local development targeted at disadvantaged areas. It is envisaged that this programme will operate in designated areas chosen by reference to objective criteria, such as indicators of disadvantage, feasible operational boundaries and viability in terms of size and economic base. Structures similar to those operating at present in the 12 pilot areas would be established with the object of facilitating employment and enterprise development on the part of the long-term unemployed but with a broader focus extending to educational initiatives in respect of those at risk of early school leaving or educational under-achievement, as well as to increasing the capacity of local community organisations and the improvement of the physical environment of the areas concerned. The proposals envisage that the specific resources allocated under the programme will be designed to increase the effectiveness of mainstream programme spending, which each public agency will be required to identify in respect of each designated area.

The Council welcomes this enhanced commitment to a local development strategy. In particular, it welcomes the more comprehensive approach to area-based intervention. This broader focus is particularly welcome since it addresses the nature of the cumulative disadvantage which generates and sustains social exclusion. It is this localised process of interaction between labour market, education, housing and environmental factors which is most likely to be addressed effectively by an area-based strategy. It is unlikely that the majority of the unemployed or those experiencing poverty will be concentrated in discrete areas. The Council's analysis of labour market and occupational structures suggest that this is not the case. However, area-based strategies can complement national policies designed to stimulate employment growth and thus address mechanisms which exclude particular communities or populations from benefiting from generalised improvements in economic and employment conditions.

For example, there is considerable evidence to suggest that a decentralised approach to the management of local authority housing, with opportunities for residents to participate in decision-making and to carry out aspects of estate maintenance and environmental improvement, has a substantial positive impact on living conditions and on tenants' satisfaction (Pinto, 1993). The Council develops its support for this approach in Chapter 15 on housing policy. The development of innovative measures to tackle educational disadvantage at all levels of the education system, and to strengthen parental involvement in this process represent key features of the Council's approach to the development of education policy, as set out in Chapter 16. A local, area-based approach is likely to prove particularly appropriate to such a strategy. Similarly, the development of skills development programmes which will prove effective in meeting the needs of the long-term unemployed and facilitate their reintegration into the labour force is likely to be most effective at a local level, where local knowledge and acceptability are more likely to encourage participation. Furthermore, the structuring of work opportunities in meeting local needs provides a basis for direct action to structure work opportunities for the long-term unemployed with little prospect of open employment. The Council's views on this strategy were set out in Chapter 3.

The Council recognises that a central concern in any area-based strategy will continue to be the tackling of long-term unemployment. This will require complementary measures to link residents of designated areas more effectively to the wider labour market and, secondly, to increase the local employment base. An area-based approach in rural areas is likely to be more focused on the latter approach. For example, rural development measures designed to promote diversification of farm enterprises and off-farm activity, such as agri-tourism, have the explicit objective of increasing local employment opportunities. In urban areas, especially those characterised by high concentrations of long-term unemployment, the focus is likely to be more on increasing local linkages to the wider labour market, in particular through training and placement activities. This is not to discount the importance of enterprise development but rather to recognise that the prospects for establishing viable enterprises requires considerable support for those whose employment prospects are already very poor.

The Council recognises that the local development programme for disadvantaged areas will be complemented by the work of the County Enterprise Partnership Boards. These will have a more general remit, operating throughout the country to support the establishment of small enterprises in all sectors. Furthermore, the Leader Programme will be due for renewal in 1994 and is a Community initiative focused on the needs of rural areas. The Council is concerned that the variety of agencies involved in the local development process, which may be justified in terms of differing needs and priorities, should give rise to confusion, or duplication of resources, or wasteful competition for resources. Accordingly, the Council recommends that these initiatives should be co-ordinated within a national framework for local development so that their relative impact can be monitored and national policy adapted in the light of the experience of implementation of the local development approach.

CHAPTER 14

Social Welfare Policy

SOCIAL WELFARE POLICY

In this chapter we focus on the system of cash transfers to the less w
as it currently operates in Ireland and assess the extent to wh
development in recent times has been consistent with the prii
formulated by the Council in its two previous strategy reports.

Social Welfare policy entails consideration of two, often conflicting,
issues. On the one hand, there is a need to channel resources towa
provision of adequate incomes for those members of society who are
to compete effectively in the economic process, such as the sick, elc
long-term unemployed. On the other hand, concern is often express
the level and duration of benefits, operating in conjunction with the
tax system, may impair economic incentives and distort the e
functioning of the labour market. Reconciling the aims of equ
economic efficiency therefore involves devising policies tailored
intricacies of the benefit/tax system.

The structure of this paper is as follows:

Section 1 describes the evolution of social welfare payments in recei
from the standpoint of criteria such as adequacy and consistency. **Se**
charts the growth in overall welfare expenditure over the years 198(
both in absolute terms and as a percentage of GNP/government expei
The main programme areas contributing to recent growth in real
spending are identified. The remainder of the paper concentrates or
issues. **Section 3** summarises the Council's overall conclusic
recommendations in this area as documented in *A Strategy for the N*
while **Section 4** examines the degree of progress made in implementii
suggested reforms, particularly those dealing with issues such a
income support and unemployment/poverty traps. Some evidence
presented on the relative extent and severity of unemployment/povei
in 1990 and 1993.

1. GENERAL TRENDS

(i) Structure of Social Security Payments.

Table 14.1 provides a comparison, in nominal terms, of the personal
social security payments applying to different categories of recipient
and 1993. Although significant increases, averaging 12.5%, were r
in the case of all the main payment categories, the improven

unemployment/disability benefit and long-term unemployment assistance are particularly notable. Moreover, the table shows that the per capita equivalent entitlement of two-children families relying on unemployment benefit or assistance increased by almost 15% over the three-year period.

In *A Strategy for Development 1986-1990* the Council expressed concern at the wide and seemingly illogical disparities then existing in payment rates differentiated by status of recipient, and accordingly advocated relatively greater rates of increase for those on the lowest income scales, particularly the unemployed. *A Strategy for the Nineties* documented the considerable progress that was made between 1986 and 1990 in evolving a more coherent rate structure. This coherence has been maintained since 1990. Table 14.1 points to a relatively high degree of uniformity in rates of payment. more evident in the case of social assistance. Structural distinctions remain. however, with personal rates of unemployment/disability benefit substantially below contributory old age pension rates. at just under 81% in 1993.

One apparent anomaly in relation to the personal rates of unemployment benefit/assistance remains in the system and, if anything, has increased in significance since 1990. The Council previously observed that between 1986 and 1990 the long-term rate of unemployment assistance had grown to a level where it exceeded the entitlement of individuals on unemployment benefit. Thus, in 1990 the personal rates of payment for unemployment benefit and assistance, short and long-term, were £48. £45 and £52 respectively. Post-budget 1993, the rates stand at £55.60 for both unemployment benefit and short-term assistance and at £59.20 for long-term assistance. Furthermore, Table 14.1 indicates that, in per capita equivalent terms, the amount received by a long-term unemployed married man with 2 children is slightly greater than that received by his counterpart on benefit (excluding any pay-related element). While the differential may be justified by the higher costs associated with long-term unemployment, especially of a quasi-capital nature, it may be thought anomalous given the insurance-type nature of unemployment benefit.

TABLE 14.1

The Structure of Social Security Payments 1990 and 1993

Insurance		**1990**	**1993**	**% Change**
		£ Weekly		
Contributory Old Age	-80	61.50	68.90	12.0
Contributory Old Age	80+	65.50	73.50	12.2
Contributory Widow	-80	56.00	62.60	11.8
Contributory Widow	80+	60.00	67.20	12.0
Invalidity Pension	-66	54.10	60.80	12.4
Unemployment/Disability		48.00	55.60	15.8
Unemployment as % of Old Age Pension	-80	78.0	80.70	
Assistance		**1990**	**1993**	**% Change**
		£ Weekly		
Old Age	-80	53.00	59.20	11.7
Old Age	80+	57.00	63.80	11.9
Widows/Deserted Wives	-80	53.00	59.20	11.7
Widows/Deserted Wives	80+	57.00	63.80	11.9
Unemployment Long Term		52.00	59.20	13.8
Disabled Persons Maintenance Allowance		52.00	59.20	13.8
Lone Parent's Allowance		66.50	74.10	11.4
Unemployment as % of Old Age Pension	-80	98.11	100.0	
Families on Unemployment Payments: Man, Wife and 2 Children Per Capita Equivalent				
Unemployment Benefit[1]		43.88	50.30	14.6
P.C.E. Unemployment Assistance		45.26	51.85	14.6

1 Using equivalence scales of 1.0.66. and 0.33 for an adult. adult dependant and child. respectively.

Notes: Personal rates of social insurance and assistance applying in July (October for child benefit) are shown. Unemployment/disability benefit does not include pay-related element.

Source: Budget Booklets.

(ii) Trends in Payment Rates.

Table 14.2 shows the pattern of real social welfare payments during the period 1980-1994. As can readily be seen, each of the five payment categories registered a significant long-run increase in purchasing power. However, there has been substantial variation in growth rates within sub-periods. Much of the early increase occurred in 1982, followed by a decline in 1983 and a subsequent period of stagnation or very low growth up to around 1990. Unemployment Assistance and Child Benefit were exceptions to this general pattern, with long-term rates of assistance increasing sharply from 1988 onwards and child benefit displaying considerable fluctuation in its real value.

With the exception of child benefit payments, the years since 1990 have witnessed continuous real increases in payment rates for the categories shown. This is particularly the case for long-term unemployment assistance, the real value of which is 13% greater in 1993 than in 1990. Child Benefit (which is shown in the table for the case of one child), was increased substantially in the 1993 Budget. Combined with the predicted low level of inflation for the next twelve months, this is likely to result in the 1994 real value of child benefit (for one child) being almost 25% above its 1993 level. However, previous jumps in the real value of child benefit were not maintained in subsequent years, a fact that makes it difficult to ascertain the long-run significance of the 1993 Budget changes in this area.

Of course, assessing the purchasing power of welfare payments tells us nothing about changes in the relative standard of living of social welfare recipients compared with those in work or the population in general. In many respects the latter measures may be of far greater significance, both from the point of view of tackling poverty and maintaining work incentives. Unfortunately, comprehensive data on incomes in general are not available. Table 14.3, however, indicates how the social welfare incomes of certain types of recipient have fared in comparison with the disposable incomes of male employees in manufacturing industry.

In the case of *single people* on social welfare, it can be seen that the ratio of a contributory pension or unemployment benefit to disposable income earned in industry has declined slightly over the 7-year period to 1993. However. an increase of over 4 percentage points may be observed in the ratio for a single person's long-term unemployment entitlement. Taking the sub-period 1990-1993, very little change is evident in the relative position of single social welfare recipients. These data as a whole would suggest that, since the publication of the Council's first Strategy report in 1986, there has been

a small improvement in the relative position of the long-term unemployed single person, but little noticeable change for those on benefit or receiving contributory pensions.

TABLE 14.2

Social Welfare Payment Rates, 1980-1994, at Constant (1985) Prices
£

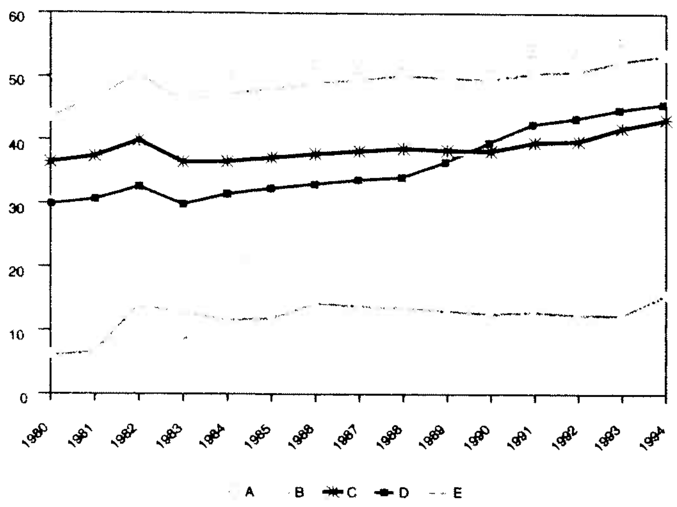
Year	Unmarried Mother's Allow.	Old Age Contributory Pension	Unemp./Disability Benefit	Unemp. Assist.	Child Benefit
1980	49.82	43.75	36.52	30.36	6.25
1981	51.48	46.75	37.45	31.12	6.86
1982	53.70	50.74	39.90	33.09	14.18
1983	49.15	46.44	36.52	30.29	12.98
1984	50.17	47.44	36.61	31.92	11.83
1985	51.05	48.25	37.25	32.80	12.05
1986	52.09	49.21	37.82	33.46	14.41
1987	52.28	49.76	38.26	34.17	14.01
1988	52.84	50.37	38.67	34.56	13.76
1989	52.91	50.01	38.39	36.98	13.25
1990	52.67	49.77	38.29	39.99	12.80
1991	54.89	50.76	39.62	42.92	13.04
1992	54.97	50.99	39.84	43.82	12.59
1993	56.69	52.58	41.84	45.16	12.47
1994	57.63	53.59	43.25	46.05	15.56

Note: Personal rates applying in April of each year; Unmarried Mother's Allowance/Lone Parent's Allowance is for one child; Old Age Contributory Pension is for person aged 66-80; Unemployment Assistance is the urban long-term rate; Child benefit is for one child; C.P.I. is for May annually (estimated for May 1994 on the basis of a forecast inflation rate of 1.5%).

Source: Budget Booklets.

FIGURE 14.1

Social Welfare Payment Rates at Constant (1985) Prices



A = Unmarried Mother's Allowance/Lone Parent's Allowance (with one child) (p.w.)

B = Old Age Contributory Pension (p.w.)

C = Unemployment/Disability Benefit (p.w.)

D = Long-term Unemployment Assistance (p.w.)

E = Child Benefit (per month)

The case of a ***married person with two children*** reveals broadly similar trends. As a percentage of disposable income of workers in industry, unemployment benefit fell slightly in the period up to 1990, but by 1993 had recovered to just below its 1986 level. An increase occurred, however, in the relative incomes of married persons on the long-term rate of unemployment assistance.

More detailed information on replacement ratios and the likely extent of their importance will be presented in Section 4.

TABLE 14.3

Disposable Incomes of Certain Social Welfare Recipients in Relation to Disposable Income of Average Male Worker 1986-1993

	Single Person				Married Person + 2 Children		
	Net Earn.of Average Male Workers	Cont. Pen. as % of N.E.	Unemp. Ben. as % of N.E.	Long-Term Unemp. Assist as % of N.E.	Net Earn.	Unemp. Ben. as % of N.E.	L.T.U.A. as % of N.E.
Year	£ p.a.						
1986	7034	39.5	30.4	27.1	8675	56.7	53.2
1987	7192	39.8	30.6	27.3	8958	56.4	52.9
1988	7641	38.6	29.7	28.6	9329	55.7	54.3
1989	8172	37.2	28.6	29.9	9838	54.3	54.9
1990	8619	37.1	28.9	31.4	10334	54.7	56.3
1991	8993	37.0	28.9	31.8	10735	55.4	57.8
1992	9514	36.4	29.0	31.2	11265	55.2	57.1
1993	9681	37.0	29.9	31.8	11509	56.0	57.6

Notes: The Table refers to average male earnings in manufacturing industry for 1986/87, 1987/88 and so forth. In the case of the married person with 2 children example, the calculations include annual child benefit payments. Social Welfare payments are the July rates annualised. Net earnings are estimated for 1992 and 1993.

(iii) Changes in Entitlement

Although, as the previous discussion has indicated, the real value of social welfare payments has generally risen over the last number of years, there have been some significant changes in the provisions governing entitlement to some forms of social insurance and assistance payments. The Social Welfare Act 1992 tightened the eligibility criteria for welfare payments in a number of respects. The Act provided for the introduction of a disqualification period of nine weeks (previously zero) in the case of applications for unemployment benefit from redundant workers receiving redundancy packages over a prescribed limit. The rationale for such a change was that immediate entitlement to unemployment benefit was commonly being included in reckoning the value of redundancy packages by employers, thus transferring part of the costs to the State. In addition, the disqualification period for unemployment benefit was raised from six to nine weeks in respect of those leaving employment voluntarily, and pay-related benefit discontinued in the case of week on/week off workers. The pay-related element in disability benefit was also to be removed for new applicants.

Finally, the Act provided for the imposition of an earnings limit on entitlement to deserted wife's benefit.

Also of importance has been the decision to make unemployment benefits taxable and the introduction, from April 1993, of income tax on injury and disability benefit. This is in accordance with the Council's previous call for the taxation of short-term benefits as part of a comprehensive approach to the definition of income and it should remove a source of horizontal inequity from the tax/benefit system.

In considering the structure and evolution of transfer payments for the unemployed, it is useful to note the growth in participation in and expenditure on the Social Employment Scheme. The Scheme represents an active labour market policy response to unemployment and its function is primarily in the area of training and preparation for employment. Therefore, expenditure on the SES is not included in the social welfare expenditure totals given in Section 2. Nevertheless, it is providing an income for a significant number of the unemployed.

TABLE 14.4

Throughput[1] and Expenditure on Social Employment Scheme

	No.	Exp.(£m)
1988	13,623	48.88
1989	11,226	43.81
1990	12,279	63.43
1991	16,276	68.94
1992	17,001	73.9

1 Defined as those fully completing a course on the scheme.

Source: Department of Enterprise and Employment.

The *coverage* of the social insurance system was extended in 1991 to encompass a much higher number of part-time workers. Department of Social Welfare estimates indicate that the effect of this extension was to reduce from 30,000 to 4,000 the number of part-time workers excluded from social insurance coverage (figures quoted in Cousins, 1992). As Cousins points out, however, these figures do not include other atypical workers falling outside the scope of social insurance, such as persons engaged on social employment schemes, many workers assisting spouses and relatives, and low-income self-employed workers.

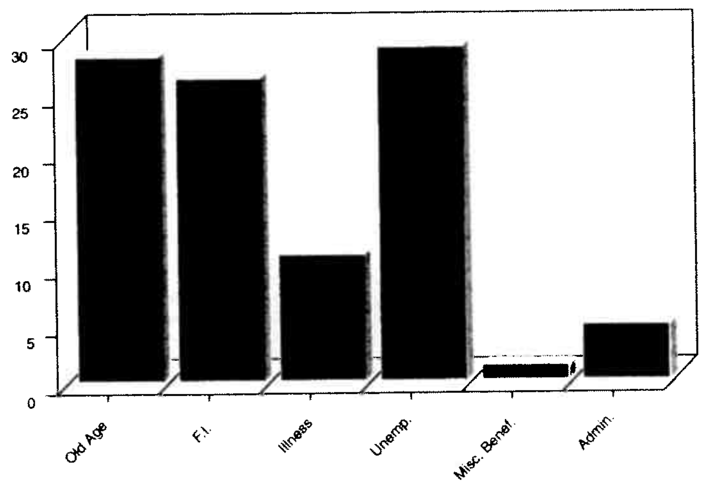
2. SOCIAL WELFARE EXPENDITURE

In 1992 the total cost in current prices of the social welfare system of cash transfers was approximately £3,431 million. This total does not include the cost of some schemes targeted at low-income groups in, for example, the health, education or training areas. Figure 14.2 illustrates the breakdown of 1992 expenditure by broad programme area.

The overwhelming bulk of expenditure, 83%, is incurred within three programme areas - Unemployment (29%), Old Age (28%) and Family Income Support (26%). The latter programme comprises a host of schemes ranging from widows' pensions and lone parents' allowances to child benefit and family income supplement. Not surprisingly, the unemployment programme has absorbed an increasing proportion of the welfare budget in recent years (25% in 1990 and 27% in 1991) and in 1992 marginally displaced Old Age as the single largest programme area. It might also be noted that the proportion of resources accounted for by the various illness schemes administered by the Department of Social Welfare has fallen steadily from over 14% in 1986 to just under 11% by 1992.

FIGURE 14.2

Social Welfare Expenditure by Programme, 1992 (%)



Note: F.I. = Family Income Support (including Family Income Supplement)
Misc. Benef. = Miscellaneous Benefits (includes equal treatment payments category)

Source: Department of Social Welfare, Statistical Information on Social Welfare Services 1992.

(i) Trends in Overall Expenditure

The growth in social welfare spending in current and constant prices is detailed in Table 14.5. Expressed in constant (1985) prices, welfare expenditure rose continuously up to 1987, registering a total increase of over £800 million. Although the late eighties were marked by a levelling off and stabilisation of the welfare budget, there was a resumption of the previous upward trend in 1990, with a particularly sharp acceleration of growth rates in 1991 and 1992. Social welfare expenditure of approximately £3,700 million has been budgeted for in 1993, which, given the expected low rate of inflation, points to a further substantial increase in real terms.

TABLE 14.5

Social Welfare Expenditure at Current and Constant (1985) Prices

Year	Exp. at Current Prices (£m)	Exp. at Constant (1985) Prices (£m)
1980	899	1604
1981	1192	1766
1982	1630	1989
1983	1900	2174
1984	2093	2205
1985	2298	2298
1986	2480	2388
1987	2593	2420
1988	2614	2389
1989	2663	2339
1990	2809	2386
1991	3092	2547
1992	3431	2739

Note: These figures refer only to expenditure by the Department of Social Welfare. Certain income maintenance payments by Health Boards are therefore *excluded* while they are included in Table 5.2.

Source: Department of Social Welfare, Statistical Information on Social Welfare Services; Statistical Bulletin.

Instead of focusing on absolute levels of spending, it may be more worthwhile to examine social security outlays in relation to GNP, as the latter provides some indication of the likely range and magnitude of welfare programmes that the economy can support. Figure 14.3 depicts the rapid upward movement in welfare spending as a proportion of GNP during the early to mid-1980s. Between 1980 and 1986, this ratio moved from just under 10% to 14.7%. In the ensuing years to 1990, however, the social welfare budget fell steadily in relation to GNP, reflecting the combined impact of restrictions on public expenditure and strong output growth in the general economy. By the same token, strongly rising welfare spending and slower output growth have combined to produce a reversal of this trend in 1991 and 1992.

Figure 14.4 shows that social welfare has been accounting for a rising proportion of current government expenditure in recent years. Most of this growth occurred in the early and late 1980s.

FIGURE 14.3

Social Welfare Expenditure as % of GNP

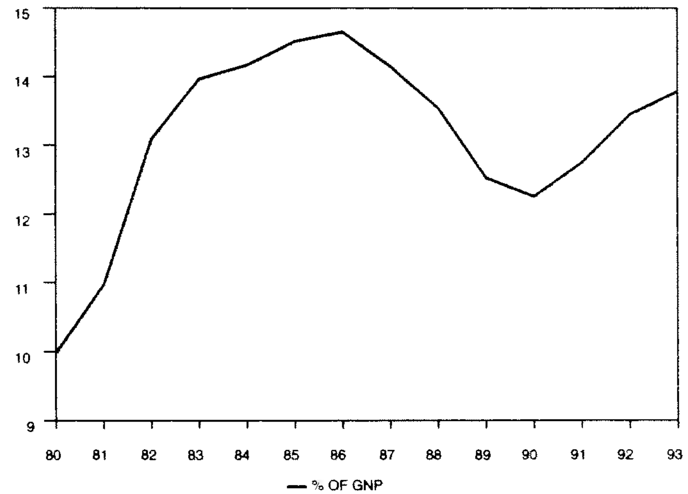
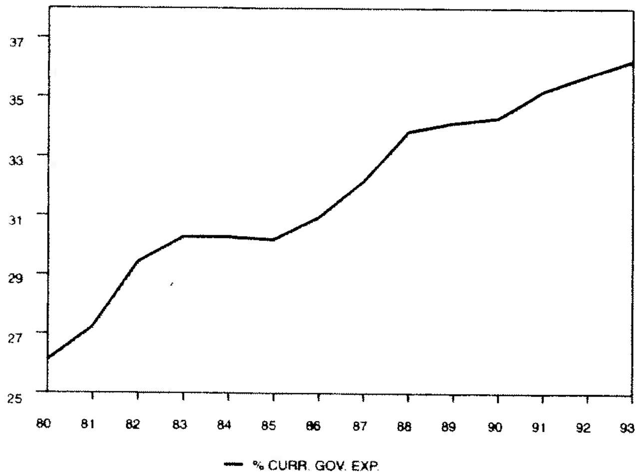


FIGURE 14.4

Social Welfare Expenditure as % of Current Government Expenditure



1 Actual audited expenditure except for 1992 and 1993, where post-budget estimates are used. The figure for social welfare spending used in this diagram is that reported in the budget booklets.

Source: Department of Social Welfare, Statistical Information on Social Welfare Services, various issues; CSO, National Income and Expenditure, various issues; Central Bank Reports; Budget Booklets.

(ii) Main Areas of Expenditure Growth 1985-1992

In *A Strategy for the Nineties* the differential impact of the various welfare programmes on overall expenditure growth between 1985 and 1989 was noted and decomposed to show the separate effects of growth in numbers of beneficiaries[118] and payment rates. Tables 14.6 and 11.7 present similarly disaggregated data for the years 1989-1992, retaining the 1985-89 figures for purposes of comparison.

118 The term 'beneficiary' denotes not only the immediate recipient of a social welfare payment but also adult and child dependants. The use of such a definition is necessitated by the existence of the allowances paid to individual social welfare recipients in respect of adult and child dependants.

Turning first to Table 14.6, we can see that expenditure on unemployment payments increased by £182 million in real terms between 1989 and 1992, a figure that contrasts sharply with the £27 million reduction recorded during the previous four years. Spending on lone parent schemes, old age and widows' pensions also increased significantly in absolute terms. Two programmes, Sickness and Child Benefit, yielded small reductions in real terms. This is consistent with the declining importance of illness schemes in the total social welfare budget, as noted above.

TABLE 14.6

Expenditure Growth On Main Social Welfare Expenditure Schemes 1985-1992 (Constant 1985 Prices)

	1985	1989	Real Change		1992	Real Change	
	£m	£m	%	£m	£m	%	£m
Old Age Pensions	680	700	2.9	20	736	5.1	36
Widows Pensions	234	254	8.5	20	275	8.3	21
Unemployment	629	602	-4.3	-27	784	30.2	182
Sickness	304	264	-13.1	-40	258	-2.3	-6
Lone Parents	64	99	54.6	35	147	48.5	48
Child Benefit	172	182	5.8	10	175	3.8	-7
Total	2083	2101	0.9	18	2375	13.0	274

Source: Department of Social Welfare, Statistical Information on Social Welfare Services.

Table 14.7 provides a more detailed perspective on changes in expenditure, indicating the relative amounts attributable to growth in numbers and payment rates respectively. Several features are worth noting. To begin with, higher spending in the period 1989-1992 on old age pensions was associated almost entirely with higher payment rates. This is almost a complete reversal of the situation experienced in the previous period. Second, the decline in expenditure on sickness and child benefit was principally caused by falling beneficiary numbers, with higher payment rates having only a minor influence on these categories of expenditure. Third, higher expenditure on lone parents' schemes and unemployment payments is attributable mainly to growth in the number of beneficiaries. Of the real increase in expenditure on unemployment payments between 1989 and 1992, 80.7% reflects the growth of beneficiary numbers. By contrast, in the period

1985-1989 growth in unemployment payment rates was substantially offset by fewer beneficiary numbers. Finally, real growth in expenditure on widows' pensions was attributable to both higher beneficiary numbers and payment rates, though the latter exerted a considerably stronger influence, accounting for almost two-thirds of the recorded increase in real expenditure.

TABLE 14.7

Analysis of Social Welfare Expenditure Growth 1985-1992 (Constant 1985 Prices)

	1985-1989 Change due to:			1989-1992 Change due to:		
	Numbers £m	Payment Rates £m	Residual £m	Numbers £m	Payment Rates £m	Residual £m
Old Age Pensions	15.0	4.0	0.2	0.3	35.7	0.0
Widows Pensions	9.7	9.9	0.4	7.1	13.5	0.4
Unemp.	-60.0	37.1	-3.5	146.9	28.2	6.9
Sickness	-58.2	22.6	-4.3	-11.0	5.3	-0.2
Child Benefit	-6.4	16.6	-0.6	-7.1	0.1	-0.0
Lone Parents	35.9	0.6	0.3	41.0	4.9	2.0
Total	-64.0	91.6	-7.5	53.9	214.6	5.5

Notes: Old Age Pensions figures refer to contributory, retirement and non-contributory pensions, and include expenditure on 'free schemes'. Pay-related benefit is included in sickness and in unemployment expenditure. Child Benefit recipients are counted as individual adult beneficiaries. Expenditure on Lone Parents does not include Prisoners Wives or Single Womens Allowance, and is estimated for 1991. The decomposition of expenditure is obtained by using per capita equivalence scales of (1, 0.66, 0.33) for an adult, adult dependant and child respectively. Figures may not add exactly to total changes because of rounding. A number of minor schemes are excluded from the above tables.

3. SUMMARY OF COUNCIL'S 1990 RECOMMENDATIONS

The recommendations made by the Council in the social welfare field in 1990 can be broadly summarised as follows:

(i) The Council recommended that, in the event of real increases in social welfare payments, the real value of the basic personal and PAYE allowances should increase apace. The rationale for this was to prevent a narrowing of the social welfare - net earnings gap. Accordingly, the Council reiterated its view that these basic

allowances be indexed. However, with the exception of the increases announced in the last budget, these have not been kept in line with inflation since 1990.

(ii) The Council restated the need for a comprehensive definition of income for tax purposes, including social welfare income. As indicated previously, some progress has since been made in the taxation of short-term social welfare benefits.

(iii) In the area of child income support, the Council considered that, in order to improve work incentives and ease the poverty trap, Child Dependant Additions should be merged into a higher, taxable rate of child benefit. The Council envisaged a gradual lessening of the role played by CDAs in child income support and an enhancement of child benefit as the best means of achieving this. It was also observed that the system of CDAs created inequities between those families on social welfare and those supported by low-paid employment.

(iv) The Council favoured a restructuring of employee's PRSI, with a single lower rate and no exemption or ceiling. This was seen as particularly desirable from the viewpoint of improving incentives and helping those on below-average incomes.

4. POLICY ISSUES

This section reviews recent evidence and progress in respect of the main social welfare policy themes identified by the Council in 1990. These issues include (i) the relative severity and practical significance of unemployment and poverty traps as well as possible solutions to them (ii) the restructuring of PRSI (iii) reform of the system of child income support.

(i) The Unemployment Trap

This term refers to a phenomenon whereby due to the combined impact of the tax and benefit system, an unemployed person may find that accepting paid employment produces little or no increase in net disposable income. As a result, it is argued that certain sections of the unemployed, particularly those whose only employment option is likely to be in relatively low-paid jobs, have little pecuniary incentive to move out of unemployment, thus making the unemployment problem partially a supply-side one. Some economists have also argued that the problem created by benefit levels is not simply one of reluctance to accept job vacancies as a result of the unemployment trap, but rather the effect of the benefit system overall in raising reservation wages and thereby reducing the aggregate demand for labour.

The relative severity, though not the actual extent, of unemployment traps is measured by means of replacement ratios. These show, for given levels of gross earnings, the disposable income of an unemployed person on benefit or assistance in relation to the disposable income gained from employment. Replacement ratios vary according to the earnings benchmark used, marital status and number of children, since taxes and benefits are also related to these variables. Ideally, they should incorporate cash and non-cash benefits and costs associated with medical cards, rent reductions, and travel-to-work.

Table 14.8 presents hypothetical income replacement ratios for the case of a married man with four children. The data refer to the long-term rate of unemployment assistance, although it is equally possible to calculate short-term ratios for those on unemployment benefit. As may be observed, replacement ratios are high at gross incomes below average earnings. Compared with the tax year 1989/90, however, some reduction is evident for 1993/94 in the ratios at low gross earnings levels.

It is difficult to determine *a priori* how much significance, from the point of view of work incentives, should be assigned in general to replacement ratios. The conventional view is that high benefit levels in relation to earnings will, when combined with the utility derived from leisure, produce disincentives to take up low-paid employment. An alternative view, however, is that replacement ratios measure only the monetary cost of remaining unemployed and exclude non-tangible psychic costs associated with social pressure to work, loss of social status, lack of a daily time structure etc. (McLaughlin et al, 1989). Against this, Jenkins and Millar (1989) have argued that, for risk-averse individuals who are unemployed, even large benefit-earnings gaps could cause disincentive effects. Their argument is that the transition from unemployment to low-paid work may involve a *perceived* high degree of income risk, primarily because it involves a reassessment for means-tested earnings supplements and rent reductions. What is involved, therefore, is a move from a low but relatively assured income when unemployed to a perhaps significantly greater but more uncertain expected income in employment. One implication of this is the need for provision of adequate information to the unemployed on the earnings-related supplements and other types of support that may be available to them upon entry into the paid workforce.

Nevertheless, even if high replacement ratios for some sections of the unemployed do alter incentives to take up low-paying work, the primary effect, in the context of a large labour surplus and significant heterogeneity in individual motivations and family circumstances, may be to change the composition of unemployment rather than its actual level. In other words, vacancies for low-paid jobs may be filled principally by those who would otherwise face low replacement ratios, such as single people or married people without children. To the extent that a significant proportion of those at present unemployed could be characterised as having low replacement ratios, it would be logical to conclude that unfilled vacancies are probably due to other factors.

Some of the econometric evidence on the role played by replacement ratios and the benefit system overall in contributing to unemployment is reviewed below. Overall, the results of research on this issue appear inconclusive. It is also likely that many of the econometric models are mis-specified or reflect the influence of incorrectly measured variables. For example, by definition it is difficult to measure any income derived by unemployed persons from the black economy. Thus, models of unemployment that focus on replacement ratios may misrepresent the actual incentives faced by some sections of the unemployed to enter low-paying jobs and overstate the relative influence of social security payments (McLaughlin et al, 1989).

Atkinson and Nickelright (1991) carried out a detailed review of the empirical literature on the effects of benefits on labour market transitions. Their findings may be summarised as follows:

> "Our review of the evidence leads us to conclude that there may be adverse effects on the incentive for the unemployed to leave unemployment but that these are typically found to be small and that there is little ground for believing that much voluntary quitting is induced by the unemployment insurance systems (although there may be a significant impact on employer behaviour in countries where temporary layoffs are common)."

They also identified positive effects of the benefit system on the labour market:

> "Unemployment insurance may have positive effects in encouraging labour force participation - the effect identified by Friedman in his Nobel lecture - and in favouring regular rather than marginal employment."

As regards the effect of the level of benefit on wages, Minford (1983) reports very large effects, although this probably reflects the effect of omitted variables (Nickell, 1984). Other researchers found little evidence of effects of benefit levels on wages (Layard, Nickell and Jackman, 1991). Although Layard, Nickell and Jackman find little evidence of the benefit system directly affecting wages, they still argue that the benefit system is important in understanding unemployment: "The important mechanism is not, however, the direct effect of benefit levels on wages, but more via the impact of the benefit system as a whole on the effectiveness of the unemployed in reducing wages, and on the duration structure of unemployment." They find that large variations in the unemployment effects of wages are strongly inversely related to the duration of benefits. The provision of indefinite income support reduces the impact of unemployment on achieving labour market adjustment.

Irish research on the role of benefits and replacement ratios has been very limited. In the Irish context Newell and Symons (1990) found that 11% of the increase in the unemployment rates between 1979 and 1986 could be attributed to increases in the replacement ratio. However, the methodological problems of estimating such effects are substantial. It is reasonable to concur with McCarthy (1993) that "there exists a disincentive effect due to the level of unemployment compensation but the size of the effect is not large". The Council concludes therefore that the benefit system is not a major cause of Irish unemployment but that, on the basis of the work of Layard, Nickell and Jackman, it may play a role in influencing unemployment through wage behaviour.

In principle there are two broad approaches to reducing any unemployment traps that may potentially exist in the system: restricting the level of, or access to, unemployment payments, or manipulating the tax and benefit system to boost the net incomes of those on low pay. Internationally, a combination of approaches has been tried. In some countries unemployment/social security provisions stipulate entry onto a training course or community work programme after an initial period of job search has been exhausted. Elsewhere, notably in the UK, benefit entitlements have been reduced in real terms. However, the fact that Irish unemployment payments have been increased considerably in real terms over the course of the last number of years, as well as the Council's previously-stated concern to protect the living standards of one of the most seriously disadvantaged groups in society - the long-term unemployed, point to solutions centred on increasing the disposable income of those in employment.

Decisions taken on taxation and PRSI impact directly on the social welfare - earnings gap. Family Income Supplement, besides serving a redistributive function, also improves work incentives. However, it is also one of the

principal components of the poverty trap discussed in the next section. In 1990 the Council noted that one of the primary causes of high replacement ratios in an Irish context was the system of Child Dependant Additions (CDAs) paid to unemployed people with children but not to those in employment. Accordingly, the Council favoured a gradual integration of these CDAs into the child benefit payment and argued, furthermore, that this should form part of a comprehensive overhaul of the entire programme of child income support. Such an integration, while safeguarding the position of those unemployed with families, would widen the social welfare - net earnings differential considerably. Although higher child benefit payments could be either means-tested or taxed as a means of recouping the higher outlays involved, the possible low take-up of a means-tested entitlement, as well as the reservations noted earlier in respect of income risk, would both suggest the tax option. Taxation was in fact the method favoured by the Council in 1990. The degree of progress in implementing the Council's 1990 proposals on child income support is discussed later.

TABLE 14.8

Replacement Ratios[1], Married Person (with Non-Earning Spouse) + Four Children

% of Average Earnings[2]	1989/90	1993/94
40%	95.5	88.2
50%	85.2	83.7
60%	86.4	80.6
70%	96.1	88.1
80%	91.0	90.3
90%	83.0	86.0
100%	76.3	78.8

1 Including value (at cost) of medical card, FIS and travel-to-work costs.

2 Average male earnings in manufacturing industry.

(ii) The Poverty Trap

A concept closely related to the unemployment trap, this problem invites much popular discussion in the media and elsewhere. However, whereas the unemployment trap is of a discrete nature, referring to decisions about *whether or not* to enter the paid workforce, the poverty trap refers to a situation potentially faced by a small subset of the employed for whom an increase in gross income, such as results from a decision to supply more labour, yields a decrease in net disposable income. The term also applies in a more general sense to situations where disposable income increases very slowly in response to a change in gross income.

In the case of a married person with four children, an increase in gross pay from £8,000 p.a. to £15,000 *might* result in a fall in net disposable income. Starting from an income of £10,000 p.a., for example, an extra £1 gained in income would attract 48p in tax (at the marginal relief rate), 5.5p in PRSI. 3.25p in the various levies, and a loss of Family Income Supplement of 60p, combining to produce a marginal tax rate of almost 117%. Moreover, the poverty trap is exacerbated by increases in means-tested local authority rents and loss of eligibility for medical cards.

FIGURE 14.5

Impact on Net Income of a £1,000 increase (10%) in Gross Pay from £10,000 to £11,000 for a 4 Child Family

Date	1/10/92	1/1/93	6/4/93	1/10/93
Gross Pay	£10,000	£11,000	£11,000	£11,000
Tax	672	1152	960	960
PRSI	550	605	605	605
Levies	225	247	357	357
Net Pay	£8,553	£8,996	£9,078	£9,078
FIS	708	708	708	732
Net Income	£9,261	£9,704	£9786	£9,810

Notes:
1. The hypothetical person/family above were awarded FIS on the 1/10/92 on the basis of a family income of £10,000. Entitlement to the payment was based on the income limits that applied at that date ie. those introduced in Budget 1992. Once awarded it does not fall to be reviewed until 1/10/93.
2. A £1,000 (10%) increase in pay on 1/1/93 attracts tax/PRSI at source but **no** withdrawal of FIS, therefore, the MTBR is the same as the marginal tax/PRSI position.
3. The Budget 1993 tax/levy changes have effect from 6/4/93 but again **no** change in FIS.
4. FIS is reviewed with regard to the increase in income and the changes in the FIS income limits (+£20) introduced in Budget 1993 and which had effect from July the same year.

Source: Department of Finance.

It should be noted that Family Income Supplement is renewable on a yearly basis and is therefore not withdrawn or reduced within the current year in response to gross pay increases. Thus the operation of the trap is not so immediate as is sometimes suggested. This is demonstrated by Figure 14.5

which reflects the dynamic impact of increases in pay, taxation, the Budgetary process and the rules governing FIS. Nevertheless, there is still the possibility of workers, say, refusing promotion lest their FIS entitlement be reduced/withdrawn in the subsequent means reassessment.

In theory, the poverty trap creates problems of equity and efficiency. It is inequitable in the sense that people on below-average incomes can potentially face extremely high marginal tax rates. It is also inefficient insofar as it inhibits increased labour supply.

How much of a policy priority the existence of such a trap should be considered to represent is less clear. It is argued, for example, that not all families liable to be caught in the trap may actually avail themselves of FIS or other forms of support available to them. For these families, there may be no adverse effects on labour supply. Nevertheless, low take-up of benefits through lack of information or other factors creates horizontal inequities and still leaves unresolved the basic structural weaknesses in the tax/social security system. It is estimated that the number of people both paying tax and benefiting from FIS (ie. those most likely to fall into the trap) is between 1,500 to 2,000. The OECD estimates that those potentially affected constitute only 0.75% of the workforce, or at most 5,000-6,000 persons (Department of Finance). Nevertheless, as Dilnot and Stark (1989) observe, the trap may affect the welfare of families not directly caught in the trap if they work more or less hard than they would otherwise do to avoid the high marginal rates associated with it.

There exist various solutions to the poverty trap, though most are either too costly to implement or conflict with other social or economic objectives. A complete integration of the tax and benefit system, as implicit in a social dividend or negative income tax scheme for example, could eliminate the trap entirely. However, a major supposed advantage of a social dividend scheme, a reduction of administrative costs, would be substantially offset by the costs of making the dividend a totally comprehensive payment. If the dividend were not to be totally comprehensive and additional benefit programmes were required for particulary needy groups in the population, the administrative savings would be correspondingly reduced. Moreover, the very high marginal tax rates implied by such schemes, applied to all income earners, would produce far more pernicious disincentive effects than any emanating from the poverty trap as it currently exists.

The Council has previously ruled out a complete integration of income taxes and benefits but has pointed to the need to co-ordinate the development of specific aspects of both systems. Attempts to mitigate or remove the effects of the poverty trap therefore involve identifying its individual components and effecting an appropriate restructuring. In general, however, appropriate solutions to the poverty trap are elusive because of the need to consider factors such as cost, the need to maintain the standard of benefits available to the low-paid, and the need to avoid adverse impacts on replacement ratios. On balance, the best solution remains that suggested by the Council in 1990 viz. the gradual phasing-out of Family Income Supplement and its replacement by a significantly higher child benefit rate, which would then be incorporated into the definition of taxable income. The main drawback to this scheme is cost. In 1992 there were only 7,735 families receiving FIS, in respect of 26,764 children and at a total cost of £12.6 million. By contrast, in the same year child benefit was paid to 476,100 families in respect of 1.1 million children. The direct expenditure costs of a wholesale transition to child benefit could, however, be minimised by use of a refundable tax credit, with the forgone revenue component being met from the proceeds of base-widening measures undertaken in the general tax area.

The above form of restructuring may now be more difficult to implement because of increases in the real value of CDAs in recent years, although, as indicated earlier, child benefit rates recorded big increases in the 1993 Budget. If removal of the extreme form of the poverty trap were viewed as a priority, then one possible solution would be to make FIS a payment based on some proportion of net earnings (as in the UK). Given appropriate adjustments to other benefit entitlements (such as subsidised local authority rents) and provided that the withdrawal rate was not more than 100%, it would become impossible for any taxpayer to face marginal rates of 100% or more. Depending on the FIS rate applied, however, those on very low incomes would suffer a reduction in net income while those on higher incomes would gain somewhat. The precise effect on replacement ratios and work incentives for the unemployed would depend upon the specific values chosen.

The Council considers that large increases in public expenditure to solve the poverty trap are not justified because of its limited quantitative significance and because significant disincentive effects have yet to be conclusively demonstrated. This points to the need for better data on aggregate incomes and detailed empirical analysis of the effects of taxes and benefits on work incentives as a prelude to policy changes in the area.[119]

119 The Council notes the establishment of a working group on the integration of the tax/benefit systems by the Minister of State of the Department of Social Welfare.

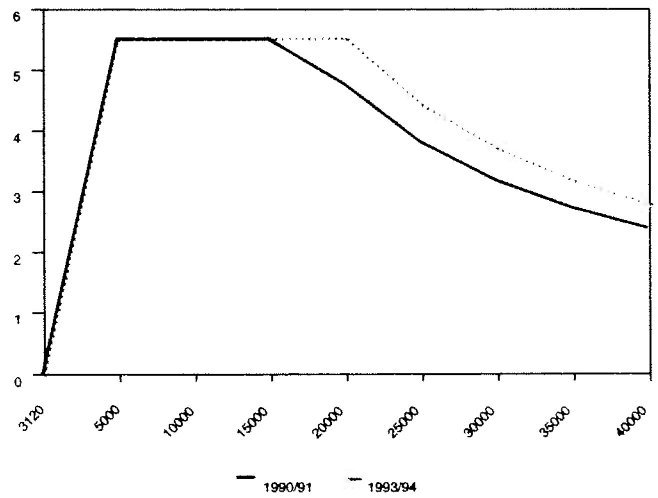
(iii) PRSI

In *A Strategy for the Nineties* the Council recommended a single lower rate of PRSI, to be applied to all income, with no exemption and no ceiling. The rationale for such a restructuring was that it would aid workers on low pay, ease the severity of unemployment and poverty traps, and produce a smoother marginal tax rate schedule.

Figure 14.6 compares effective PRSI rates operating in 1990/91 and 1993/94.

FIGURE 14.6

Average PRSI Rates 1990/91 and 1993/94



Taking PRSI and the various ear-marked taxes together, very little progress is evident in the implementation of any of the Council's 1990 proposals in this area. The one exception to this was the abolition, in 1991, of the income ceiling on the 1¼% health contribution. This has resulted in a slight smoothening of the marginal tax rate schedule. Nevertheless, the schedule remains highly discontinuous because of the continued existence of the PRSI exemption in respect of gross wages below £60 in any week, as well as the £20,000 income ceiling on contributions. The £60 p.w. exemption has remained unchanged since 1990. In the absence of any restructuring of the PRSI *rate*, this has resulted in those on low real pay gradually moving back into the PRSI net.

The introduction of the 1% income levy in 1993 created a further jump in the marginal tax rate schedule and in effect constitutes another element in the poverty trap. If it is not to prove a temporary levy it should be merged into a single restructured rate for PRSI/levies.

Within the context of an overall programme of tax reform discussed in Chapter 7, the Council reiterates its view of the need for a broad restructuring of the employee's PRSI contribution rate: exemptions and ceilings should be abolished and there should be one rate lower than at present. The impact of rate reduction on the cost of unskilled labour would be greater if the reductions were concentrated at low levels. There are a number of ways that this could be achieved. One possibility would be to introduce a progressive rate structure. Another possibility would be to provide an exemption for employer's PRSI for low-wage employees which would be phased out in a linear manner. In the longer run there is the possibility of replacing PRSI with a comprehensive social security tax. The Council considers that these options merit serious consideration.

(iv) Child Income Support

There are four types of income support currently targeted at families. These are child benefit, child additions to the tax exemption limits, Family Income Supplement, and Child Dependant Additions paid to welfare recipients. As indicated previously, the Council argued in 1990 that there was a case for the amalgamation of these various forms of support into a higher taxable rate of child benefit. As a first step, however, it proposed the phasing-out of CDAs and an enhancement of the role played by child benefit.

Child benefit fell slightly in real terms in 1991 and 1992 (in the case of 2 children families). Although the 1993 Budget increased the payment rates significantly, it is difficult to ascertain whether this represents a concerted attempt to intensify the role played by child benefit in child income support or whether it is simply a repetition of the fluctuation in real values observed throughout the 1980s (see section 1 (ii)). Table 14.9 shows CDA payments in constant (1985) prices in the case of two and four children respectively. As can be determined from the table, all categories of CDAs shown have displayed small but continuous real increases since 1990. Thus, in summary, little progress has been made in implementing the Council's 1990 proposals in this area.

TABLE 14.9

Child Dependant Additions, in Constant (1985) Prices

	Two Children			Four Children		
	Un. Ben.	Un. Asst.	L. Parents	Un. Ben.	Un. Asst.	L. Parents
1985	18.75	17.45	22.15	35.15	31.95	45.35
1986	19.05	17.81	22.60	35.71	32.55	46.25
1987	18.53	17.32	21.97	34.73	31.66	44.97
1988	18.74	17.55	22.22	35.20	31.20	45.44
1989	18.66	17.96	22.01	35.04	32.75	45.08
1990	18.55	17.87	21.95	35.56	34.88	44.92
1991	18.82	18.16	22.29	36.98	36.32	44.57
1992	19.15	19.15	22.34	38.29	38.29	44.68
1993	19.77	19.76	23.09	39.53	39.53	46.18

Source: Budget Booklets; CPI.

5. CONCLUSION

The years since the publication of *A Strategy for the Nineties* have seen social welfare payment rates generally increased in real terms, as well as an acceleration in real welfare expenditure growth, both in absolute terms and as a proportion of GNP. In particular, substantial growth was recorded in the rate of long-term unemployment assistance, which increased by almost 14% between 1990 and 1993.

The Council remains of the view that its 1990 recommendations in the social welfare field are still appropriate. Then it considered that the combination of declining numbers of beneficiaries in some areas and continuing real growth in national income would at least enable real payment rates to be maintained and would allow some scope for social welfare recipients to share in the growth in national income. The Council recommends that such scope as exists for real increases in benefit levels in the period ahead should be applied to the progressive implementation of the priority recommendations of the Commission on Social Welfare. The restructuring of PRSI advocated in 1990 has not taken place, with the PRSI schedule remaining highly discontinuous.

The system of child income support should be integrated in a way that would reduce the potential for unemployment and poverty traps. This, allied to maintenance of the real value of social welfare benefits in general, would represent a socially responsible attempt to combine the over-riding concern to promote employment growth with an effective strategy to secure the income position of the disadvantaged.

CHAPTER 15

Housing Policy

HOUSING POLICY[120]

1. INTRODUCTION

Irish housing policy has been successful in enabling most Irish people to live in reasonable accommodation and to achieve the widely held goal of house ownership. However, the policy instruments which have supported these considerable achievements have an impact on the general functioning of the economy and must be examined in present conditions, particularly when looking for an effective strategy for employment. It was these considerations which led the Council in *A Strategy for the Nineties* to call for a more balanced housing policy framework, incorporating all tenures, including the non-profit voluntary and co-operative housing sectors, in their complementary roles. In this framework, the Council recommended that priority be given to the creation of an equitable and efficient tax subsidy regime for owner-occupied housing, coupled with an explicit policy for the private rented sector; a more equitable and efficient local authority rent system; and a greater commitment to the voluntary/social housing movement. The Council's recommendations focus on the need to redistribute resources and expenditure both within and between housing sectors in the interest of equity and efficiency.

The Council notes that significant progress has been achieved in some of these directions, notably in the field of social and voluntary housing and in the private rented sector. However, notwithstanding these favourable developments, significant problems remain, including the marginalisation of local authority tenants, the position of those at the bottom end of the private rented sector and the problem of homelessness. While it could be argued that some of the present housing difficulties spring from the lack of co-ordination between local authorities, health boards and the social welfare system, it is the view of the Council that it is the policies specifically directed at the housing system which continue to be the major cause of the inequities visible in that system.

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120 The CIF have substantial reservations with regard to the analysis of taxation on owner occupied housing contained in this chapter - this analysis is based on the Council's published report, a Review of Housing Policy (NESC, 1989a). The CIF opposes the Council's proposal for the introduction of a comprehensive residential property involving a further shift in the tax burden towards property which is already subject to higher tax than the EC average. It is also against the introduction of capital gains tax on the sale of principal private residences. This proposal would have major negative implications for the efficient operation of the housing market, especially if it applied without full relief when the proceeds are reinvested in the purchase of another principle private residence (as proposed by the Commission on Taxation). Furthermore, the CIF opposes the introduction of a comprehensive property tax and of capital gains tax on the sale of principal private residence's without a prior, thorough assessment of their impact on the housing market.

This chapter reviews developments in each of the spheres of Irish housing policy, public, private and voluntary, along with changes in the areas of housing requirements and completions, homelessness and urban renewal. Each section will review (i) the targets and proposals for housing policy set out by the Council in *A Strategy for the Nineties*, (ii) the trends in housing policy since 1990 and the extent to which policy developments have been consistent with the recommendations of the Council, and finally, (iii) the extent to which these recommendations remain valid in the light of these and other changes.

2. HOUSING REQUIREMENTS AND NEED

Housing needs reflect a wide variety of factors, including the rate of household formation, changes in the composition of households, the state of the housing stock and trends in geographical mobility. Most households and individuals have the capacity to meet their own housing needs within the framework of existing policies. However, the Council believes that a priority for policy must be the situation of those who require special assistance to meet the accommodation standards which our society considers to be the minimum. Housing needs in this case are experienced by homeless people, people living in hostels, those living in physically substandard accommodation, and those living in overcrowded accommodation. In March 1991 following a comprehensive assessment of housing need, over 4,300 households in the Dublin Corporation area were judged to be in need of new or improved accommodation, of which almost 1,150 were assessed to be in acute need. Results for the country as a whole in 1991, presented in Table 15.1, reveal a wide diversity of housing need with households living in overcrowded, unfit or unsuitable accommodation comprising over 45% of households in need.

TABLE 15.1

Local Authority Needs by Category Of Need
1991

Category	No. of Households	Percent
Living in overcrowded accommodation	5,896	25.4%
Living in unfit or materially unsuitable accommodation	4,590	19.7%
Unable to afford existing accommodation	4,075	17.5%
Involuntarily sharing accommodation	2,432	10.5%
Elderly	2,379	10.2%
Homeless	1,507	6.5%
In need of accommodation for medical/compassionate reasons	1,331	5.7%
Travellers	748	3.2%
Disabled/handicapped	180	0.8%
Young persons leaving institutional care or without family accommodation	104	0.5%
Total (1991)	23,242	100.0%
Total (1993) [provisional]	28,620	100.0%

Note: Disaggregated figures for 1993 are not yet available.

Source: Department of the Environment, January 1992.

An indication of the significance of changing household composition, and therefore of the need for flexibility in housing policy, is the estimate that one-bedroomed units would be sufficient to meet the immediate housing requirements of 40% of the households assessed as being in need.

More recently, March 1993 saw the completion of nationwide local authority statutory assessments of housing needs. Results reveal a sharp increase of 23% in the number of households seeking accommodation. In short, the data reveal increasing numbers in 'housing need' and indicate a continuing trend towards a widening diversity of needs.

Implicit in the discussion of this category of housing needs is a consideration of the volume of public and private house completions, as displayed in Table 15.2.

TABLE 15.2

Housing Completions, 1979-1992

Year	Local Authority	Private[1]	Total
1979	6,214	20,330	26,544
1981	5,681	23,236	28,917
1983	6,190	19,948	26,138
1985	6,523	17,425	23,948
1987	3,074	15,376	18,450
1989	768	17,300	18,068
1990	1,003	18,536	19,539
1991	1,180	18,472	19,652
1992	1,482	20,982	22,464

1 This includes completions by the non-profit voluntary and co-operative sector using mainly public funds, averaging about 500 over the past 4 years.

Source: Department of the Environment, Housing Statistics Bulletin.

As Table 15.2 illustrates, the rapid decline in local authority house completions witnessed during the late-1980s was reversed during the 1990s. The downturn in the number of completions during these years was broadly in line with a general policy trend across Europe to reduce expenditure on public housing and also, in Ireland's case, reflected a downturn in the economy, an increase in emigration and a reduction in local authority housing lists. While local authority house completions have been rising since 1989, the figure remains far below the levels which applied up to 1985, averaging in excess of 6,000. However, the number of dwellings sanctioned for capital grants under the funding schemes for approved voluntary housing bodies has risen to about 1,000 in 1993. Nevertheless, the supply of local authority houses has proved inadequate to meet demand, as manifested in growing waiting lists. The increasing demand for local authority housing does not necessarily imply a need for the resumption of large scale local authority house building. It does, however, require a coherent housing strategy, within which the local authority sector has an important role to play. As outlined below, the Council believes that continued support for the voluntary sector, more equitable and efficient support for low income households in the private rented sector, better maintenance and management of local authority housing and more restrictive policies towards the sale of public housing are all required in response to lengthening local authority waiting lists.

3. OWNER OCCUPIED HOUSING

The vigorous pursuit of home ownership has resulted, over time, in the gradual elimination of tenure options for entrants to the housing market (O'Connell, 1993). Individuals and households entering the housing system face strong fiscal bias towards the owner occupation sector. While this accords with the wishes of many people, the extent of the fiscal bias could be seen as a form of housing constraint rather than housing choice. From the wider perspective of economic and employment development, the degree of fiscal support for owner occupation has arguably distorted investment patterns to the detriment of economic development, while having significantly regressive effects. The evolution of policy for owner occupation over recent years is set out below.

The Council's first concern is with the tax treatment of owner occupation. Detailed consideration of the underlying taxation and housing policy arguments led the Council, in 1990, to argue for the imposition of a property tax on all residential property (as part of a comprehensive property tax) and the retention of full tax relief on mortgage interest at the standard rate of tax. Further, and in keeping with its fundamental principle of broadening the tax base to facilitate lower rates of tax, the Council also proposed the inclusion of real capital gains on the sale of principal private residences in the tax base.

The extended arguments put forward by the Council in support of these proposals can be summarised in two key points. First, from the perspective of the housing system the proposals represent more neutral tax treatment: equity between owners and renters, and between investors in housing and in other assets, would be achieved. Furthermore, the existence of significant tax relief, combined with the absence of a property tax, acts as a strong stimulus to the demand for owner occupation, supports upward pressure on house prices, and can result in the effective capitalisation of the subsidies in house values.

Secondly, from the standpoint of tax reform, the absence of property taxation and capital gains tax, combined with the continuation of significant levels of mortgage interest relief, represents an inequitable and inefficient limitation of the overall tax base. Inequity arises because of the regressive impact of mortgage interest tax relief at the marginal tax rate and because of the disproportionate benefit to higher income households and owners of larger dwellings from the absence of capital gains tax and a general and property tax. Inefficiency arises to the extent that the present tax treatment of owner occupation displaces investment into a non-traded sector of the economy, and contributes to an overall imbalance in the tax system in favour of property and against income.

The Council's proposals in relation to the tax treatment of housing must be seen as part of its more general concern with tax reform. *In particular, the Council stresses that implementation of its proposals must be accompanied by reductions in income taxation.* Reforming the tax treatment of housing should not result in a net increase in the overall tax burden, but rather a restructuring of the tax burden away from income and towards property. The Council remains of the view that there will be a need for careful design and implementation of its proposals to avoid undue disruption of the housing market.

The Council's analysis of the tax regime for housing focused on the inter-relationship between the taxation of housing property and mortgage interest tax relief. Specifically, the Council adopted the view that, in the absence of a property tax, mortgage interest relief should be restricted:

> If a property tax is introduced, as the Council has recommended, it would be logical and equitable to have full mortgage interest relief at the standard rate of tax; if the present non-taxation of property continues then a very restrictive approach to interest relief should be initiated (NESC, 1989a).

Prior to 1974 all mortgage interest was allowable against income tax, but in successive Finance Acts the relief has been restricted. In 1989 the Council[121] recommended the initiation of a very restrictive approach to interest relief in the absence of a property tax. The relief then stood at 90% of interest up to a maximum of £4,000 for a married couple, and in the subsequent tax year, 1989/90, the interest relief was further restricted to a maximum of 80% of the qualifying amount of £4,000. This restriction in interest relief, to 80%, combined with reductions in tax rates, was a reflection of the Council's broad taxation strategy of rate reduction and base widening. Moreover, as interest relief at varying marginal tax rates renders the relief regressive, the restriction on the relief increased the progressivity of the income tax system. However, in the wake of exceptionally high interest rates experienced during late 1992/early 1993, the 1993 Budget introduced, as an exceptional temporary measure, an increase in the percentage of interest qualifying for relief, to 90% up to a maximum of £5,000 for a couple. For first time buyers in 1993/94, the relief has been increased to 100% of mortgage interest paid, for the first three tax years in which mortgage interest relief is claimed. An exclusion disallowing the first £100 single/£200 married of previously allowable interest was also introduced to fund in part these changes. Hence the 1993

121 In Report No. 87, *A Review of Housing Policy*

Budget served to reverse to some degree the restrictions on relief which had occurred during early 1990s.

The Council expressed the view that *general* cash subsidies for owner-occupiers are an inefficient and inequitable instrument and considered that such grants can only be appropriate if selective, and targeted to meet specific housing needs. The recommendation was not adopted. In fact, the grant for first time owner occupiers of new houses was increased (from 1st March 1993) from £2,000 to £3,000 to offset the effect of the increase in VAT on building services on the cost of new homes.

As part of the overall tax reform strategy put forward in 1990, including capital gains tax on the proceeds of the sale of a principal private residence, the Council proposed the phased abolition of stamp duty. The 1993 Budget reduced stamp duty for larger new houses (with duty now levied on the site value only for houses with a floor area in excess of 125 square metres). This was designed to readdress an anomaly in the treatment of large new estate houses vis-a-vis large individually constructed houses.

A number of points should be noted about the Council's proposal on the phased abolition of stamp duties. Firstly, in the context of a tax system which levied capital gains tax on house sales, stamp duties would comprise double taxation. Second, insofar as stamp duties are levied to meet the administrative cost of retaining registers, records and so on, then they can be replaced by economic charges for these administrative services. Thirdly, the Council emphasises that the process of phasing out stamp duties on property etc. can *only* begin when the wider reforms it has proposed are in place - property tax and capital gains tax. Fourth, the Council recognises the revenue significance of stamp duties (almost £50m in the current tax year for stamp duty on houses) and suggests that they can be phased out over a period of time as resources permit, and *only* when the preconditions of property taxes and capital gains tax are met. The Council attaches much greater priority in tax reform to the reduction in taxes on earned income and the reform of indirect taxes. Following the Commission on Taxation, the Council does not see reform in this area as a priority.

Residential property tax, having a high income exemption limit as well as a property value threshold (£91,000), generates annual revenue of only just over £7.5 million. Furthermore, the cost of collecting this tax is relatively high, largely due to the need to identify a small number of taxpayers to whom the tax is applicable. In essence, owner occupied residential property continues to represent a major source of effectively untaxed income (albeit not in cash form). As a result, an owner occupier is, generally speaking, better off than an individual with an identical cash income who is renting similar accommodation because (s)he does not have to pay rent. The situation of those purchasing a house with a mortgage is more complicated. but a similar inequity arises.

In this context, the Council reiterates that the combination of capital gains tax on sales, the retention of full mortgage interest relief at the standard rate and a comprehensive property tax would be the most equitable and efficient policy for the tax treatment of housing.[122] The Council further recommends that in the absence of a property tax a very restrictive stance of interest relief is justified. However, the Council emphasises that in its view the appropriate policy is one which combines property taxation with retention of full interest relief at the standard rate, for a number of reasons. First, from a housing point of view it may be more difficult to facilitate first time buyers in a situation where interest relief is restricted relative to prevailing mortgages and interest repayments. This could make the attainment of the goal of public policy (endorsed by the Council) in relation to the encouragement of owner occupation, more difficult. In short, the alternative position of full mortgage interest relief at the standard rate, combined with a comprehensive property tax, is more consistent with the objective of encouraging owner occupation. Second, the broadening of the tax base entailed in the property tax is a considerably more comprehensive extension of the base than restriction of interest relief. Property taxation, for example, would apply not just to properties with mortgages but also to those owned outright. Restricting interest relief extends the *income* tax base, while property taxation would be a *structural* improvement in the overall tax base, away from income and towards property. Third, the absence of a property tax and of capital gains tax combined with the availability of a substantial level of mortgage interest relief has specific inequitable results; the first two benefit most those who own expensive dwellings and those who own outright.

(i) Tenant Purchase Schemes

A contentious issue affecting both owner occupied and local authority. sectors concerns the operation of generous 'sales schemes', allowing local authority tenants to become owner occupiers at very reduced or even nominal cost. Little systematic research has been carried out in Ireland into the effects on the performance of public housing policy of these measures aimed at extending owner occupation. However, the impact appears to have been that

122 The recommendations on the introduction of a property tax and the taxation of capital gains on housing are subject to reservation by the CIF.

local authority renting is characterised by the predominance of old, poor, unskilled, disadvantaged and often unemployed people who are unable to afford anything else. Vacancies are filled in turn by more marginalised groups, thereby further narrowing the social mix of tenants. Furthermore, the sale of such dwellings reduces the pool of dwellings available for renting to people who cannot afford to buy their own homes (manifested in the growing local authority waiting lists) and, in the longer run, this creates a requirement for expensive new construction work or the purchase of further dwellings by the local authorities or voluntary housing bodies at market prices far higher than those received from the sale of existing dwellings to tenants. It is clear that the savings on maintenance costs arising from such sales do not remotely balance the capital losses incurred by the local authorities.

A new long-term tenant purchase scheme has recently been announced, offering a discount of 3% of the market value of the house for each year of tenancy, subject to a maximum of 30%, along with exemption from stamp duty and with legal/transaction costs being borne by the local authority. The Council notes that these terms represent a significant reduction in the discount and that private sector financing is required for 50% of the purchase price.

However, the Council is of the view that privatisation of a significant element of local authority housing stock at a large discount on its market value has reduced, and will continue to reduce the capacity of local authorities to meet severe housing need, as well as having adverse income redistribution effects. For instance, the capital subsidy to the 2,400 tenant purchasers in 1992 in the Dublin Corporation area alone was of the order of £50 million (Lord Mayor's Commission on Housing). The Council, while recognising that tenant purchase arrangements can result in stability in housing estates relative to a policy of encouraging families to leave in order to purchase, reaffirms its support for a radical revision of the existing sales schemes, incorporating provision for variations in the terms of sales and a greater focus on the sale of dwellings with unusually high maintenance costs. Consideration should also be given to introducing a sliding scale claw-back for tenant-purchased dwellings and a provision to exclude from local authority housing, for a period of years, former tenants who purchased their dwellings at discount prices and subsequently resold them at market prices.

The Council welcomes the fact that surrender grants are no longer payable to tenants vacating local authority dwellings. A limited mortgage allowance for tenants was introduced under the 1991 Plan for Social Housing, providing a mortgage subsidy of £3,300 spread over 5 years to tenants who surrender their dwellings to the local authority and purchase a private dwelling. Up to the end of 1992, 310 applications had been approved under this scheme.

Finally, in this discussion of owner occupation, the Council draws attention to Shared Ownership as an innovative measure introduced under the Plan for Social Housing which enables marginal households who aspire to home ownership to do so in a number of stages. It enables households to avoid a choice between the two extremes of renting and owner occupation by allowing consumers to choose differing mixes of housing consumption and investment. The legislation for this scheme was enacted in 1992 and to date take-up has been encouraging, with about 3,000 applications approved in principle, of which about 1,300 households are actually in occupation of their new houses. The scheme offers a number of advantages to low income purchasers among which include: a deposit of just £1,000 is required to enter the owner-occupier market; it can provide a much longer term of financing than is available under a conventional mortgage from a commercial lending agency; a generous rent subsidy is payable to purchasers with an income below £10,001; and purchasers have a far greater choice of dwelling and location. While these advantages may well enhance the accessibility of the scheme to low income purchasers, tenants on the lowest levels of income are still, by and large, incapable of benefitting from the scheme, which underlines the marginalisation of local authority tenants. This scheme, as a means of supporting home ownership, has undoubtedly considerable advantages over the discount sales schemes, since it entails greatly reduced management and maintenance costs; no exchequer subsidy is paid in respect of the cost of house purchase; and, whereas local authority house purchase schemes involve substantial subsidies, the rent charged under this scheme appears to approximate to an economic rent.

For these reasons, the Council recommends the continuation of this scheme, although not without some important amendments. In cases where there are difficulties with repayments, the Council recommends that households should have access to appropriate support systems, instead of being required to default and thus losing the home. In addition, the Council believes that it is not necessary to require of participants a commitment to eventual purchase of all of the equity in the property. Given that an economic rent is being charged on the unpurchased element of the equity and on the basis that maintenance clearly remains the responsibility of the occupier, it should be a matter of indifference to the local authority whether the remaining equity is purchased or not. There is also a case for assisting approved housing bodies, particularly housing co-operatives, to develop shared equity ownership arrangements, leading to a form of social housing with an

ownership stake and tenant participation. Finally, the financial parameters of the shared ownership scheme should take account of the fact that house prices are higher in Dublin than in the country as a whole, as Table 15.3 illustrates.

TABLE 15.3

Average House Prices

	1990	1991	1992	1993 Q1
New:				
All Areas	£51,618	£52,699	£54,550	£53,535
Dublin	£63,595	£61,993	£64,375	£56,659
Secondhand:				
All Areas	£49,134	£50,500	£51,452	£51,847
Dublin	£58,936	£59,917	£61,028	£60,406

Source: Annual Bulletin of Housing Statistics, Department of the Environment.

4. PRIVATE RENTED HOUSING

While many private sector tenants are capable of meeting their requirements unaided, the Council's principal concern is with those at the bottom end of the private letting tenure are faced with a relatively poor quality of housing services and a considerable degree of insecurity.

The Council in *A Strategy for the Nineties* was particularly concerned about the regulation of this tenure. While recognising that rent regulation is inappropriate, the Council concluded that there are grounds for increasing regulation to ensure basic standards and to develop good practice. The Council therefore welcomes the measures which have been taken by the Department of the Environment to address such issues, including the requirements for minimum written notice to quit, for the issue of rent books to tenants, and for compliance with specified physical standards. The Council emphasises the importance of effective enforcement of regulations. The Council notes that a substantial sum, in excess of £28 million in 1993, is being applied to rent supplements under the Supplementary Welfare Allowance system. The Council reaffirms its belief that there is a need for a means-tested, nationally uniform, statutory housing benefit for private tenants.

A further concern articulated by the Council was the need for measures to enhance the supply of rented accommodation to address the current demand for affordable housing. There is, for example, at present a significant volume of vacant residential accommodation located over retail and commercial premises. The 1986 Census data indicated that 591 flats attached to shops and 4,589 houses and flats elsewhere were vacant, undoubtedly a vacancy rate greater than the level of vacancy which may arise from normal market friction. It is desirable that these vacancies be used to increase the supply of accommodation in the private rented sector. The advantages accruing to landlords of such a development would include the additional income and increased security of the premises.

Another policy measure which sought to increase supply in this sector was the provision of tax relief to landlords upon the acquisition or construction of new property. While this has undoubtedly enhanced the supply of better quality rental accommodation, along with facilitating the move from traditional housing to purpose-built housing for rental, it was targeted at the landlords rather than the tenants. In like manner, a tax deduction was available for expenditure incurred (from January 1988 to March 1992) on the conversion of a non-residential building into a single residential unit for letting. The Council is of the view that these measures may have stimulated supply without benefitting the tenants most in need of support on policy grounds. For this reason, the Council recommends that policy to support private sector tenants should aim to target support to tenants whose housing needs and income levels indicate priority claim on public resources, rather than to landlords.

5. SOCIAL HOUSING PROVISION

Despite the increasing number of households on local authority housing lists, the funding allocated to meet these needs had declined until 1993, when there was a significant expansion of the local authority programme to 3,500 units. However, just 500 new local authority houses are incorporated into the 1993 Dublin Corporation housing programme despite the fact that the number of families and single people currently awaiting housing stands at almost 5,152, with just 1% of Dublin Corporation houses vacant at the present. As Table 15.4 indicates, the volume of applicants on Dublin Corporation's Waiting List, having reduced significantly during the late 1980s, has been expanding steadily since 1989.

In addition to the proposed local authority house-building programme the number of dwellings to be provided by the voluntary and co-operative

housing sector is set to increase in the Dublin area - these dwellings are specifically targeted for local authority waiting list applicants under the terms for the disposal of sites and the Rental Subsidy Scheme. Some 300 dwellings have already received approval for funding in 1993 in the Dublin area for provision by the voluntary and co-operative sector with more projects planned. This indicates that simply relying on local authority building programme data does not give an accurate picture of social rented housing provision any longer.

TABLE 15.4

Dublin Corporation's Waiting List: 1981 to 1992

Year	Applicants on Waiting List
1981	6,732
1982	6,228
1983	6,714
1984	5,023
1985	4,484
1986	3,522
1987	3,548
1988	2,819
1989	3,970
1991	4,377
1993	5,152

Source: The Housing Department, Dublin Corporation.

While local authority building is only one element of an overall housing strategy to meet housing needs with maximum efficiency and equity, it is the Council's view that while the increase in the provision of social housing is welcome, it is too early to say if this is likely to be sufficient to prevent further growth in waiting lists and a deterioration in housing conditions. As the Council has previously recommended, the purchase, rather than the building of properties for rent to tenants may be a quicker, more flexible and less costly means of meeting housing needs. The Council notes that there has been an increase in this method of housing provision by local authorities.

The shortfall in public housing provision may be exacerbated as a result of the fact that once individuals/households obtain for local authority housing. their eligibility is never reassessed, irrespective of changes in their income situation. This permits a situation where high income households with high standard accommodation may receive significant housing subsidies, while simultaneously less well-off households may remain effectively homeless. For this reason, reassessment, on a regular basis, of the economic situation of local authority housing occupants, would be desirable, both with regard to rent levels, as discussed below, and with a view to encouraging transfer to different tenures as the family cycle evolves and housing needs change.

Under the local authority Differential Rent System, maximum rents continue to be calculated on the historical cost of the dwelling, a situation resulting in maximum rents being significantly higher on new, rather than older dwellings. Consequently rents may be lowest in the high demand areas and highest in the low demand areas, since houses in the older, more settled estates are generally in greater demand than those in newer estates. The Council believes that maximum rents should be calculated on the replacement cost of a dwelling to create greater equity and progressivity. The Council is also concerned that the rent structure continues to contribute to the poverty trap caused by high implicit marginal tax rates on those with low incomes. The Council reiterates the recommendation that the Differential Rent Schemes be revised with a view to improving its progressivity, and reducing its impact on the poverty trap. The Council also believes that there are grounds for applying the system nationally on a more uniform basis.

It has been suggested that the present system of local authority rent collection is highly inflexible with, in some cases, people required to pay their rent on the day before they receive their social welfare payment - a feature which may well encourage tenants to fall into arrears. It is the view of the Council that the recent introduction of a scheme whereby social welfare recipients will have the choice of having deductions of agreed amounts from their weekly social welfare payments, for direct payment in respect of ESB bills, rent and so on, is to be welcomed. Acceleration in the implementation and availability of this new scheme on a nationwide basis, should be regarded as a priority.

(i) Management and Maintenance

Discussion of the local authority sector would be incomplete without a consideration of management and maintenance issues. As Brennan (1993) calculates, over £700 million was spent on local authority management and

maintenance during the 1980s, suggesting, at a minimum, that it is capable of being carried out on a significantly more cost effective basis. In general terms, maintenance practice can be criticised on the grounds of being (a) response dominated, with an emphasis on ad hoc repair operations and (b) inefficient in its use of labour and materials, including a significant unproductive time content. Despite the very substantial investment in the upkeep of local authority housing, much of the public housing stock is run down, many tenants are dissatisfied and alienated and some housing schemes are viewed as 'problem estates'. Demands for Remedial Works Scheme Capital funding are also growing. In the light of this negative assessment, the Council feels that there is an urgent need to move away from the current 'fire brigade' approach, towards planned maintenance, with a greater concentration of resources on preventive programmes and a curtailing of the response programme to emergency repairs only. The Council recommends that the Department of the Environment should conduct a detailed analysis of the costs of maintenance and of the requirements to ensure that the condition of the housing stock is not permitted to deteriorate further. In this analysis special attention should be paid to the situation of those on low incomes. The Council welcomes the initiatives taken by the Department of the Environment to encourage a more planned approach to maintenance, including the preparation by local authorities of statements of policy towards housing management and maintenance. This process is likely to focus greater attention on the significant issues involved in this area, while facilitating the identification and extension of best practice. The Council also welcomes the arrangements to encourage localised management and tenant participation, on a structured basis, in the management of their own estates. Estate management units developed by local residents can not only contribute to the effective management of estates but they can also strengthen local communities. This could be an extremely effective contribution to the reduction of maintenance problems, as well as improving other important aspects of estate management.

(ii) Social Segregation in Housing

The fact that local authority dwellings in urban areas have generally been, and continue to be built in large blocks or estates, rather than in smaller numbers, has had the undesirable effect of creating a social segregation of local authority tenants. While there are arguments for grouping together public authority dwellings for older people, and others whose accommodation has to be designed specifically for their needs, the case against otherwise adding to existing public authority estates is a strong one.

The Council noted in 1990 that past policies had resulted in

> "an increasingly stratified and polarised public sector".

This view has been echoed by Threshold, who analysed local authority letting policies in the light of the £5,000 surrender grant. Commenting on the trends Threshold have pointed to the tendency towards residualisation: "By grouping people who are already disadvantaged in some way there is a considerable risk of ghettoisation of communities where there is already high unemployment".

In this context, the Council welcomes the provisions of the Housing Act 1992, which require all local authorities to draw up, within a year, written policies setting out how they intend to counteract segregation in housing and the policy commitment that future expansion of the public housing stock be carried out in a manner to avoid creating large areas of single class housing, adding to the degree of social polarisation which is already evident. This might best be achieved through the acquisition, rather than the construction of additional standard sized dwellings, either singly or (in the interests of cost-effective maintenance) in relatively compact estates or blocks. Public sector construction would then concentrate on the provision of smaller, or special needs dwellings such as for the elderly, or single persons. The Council is concerned that, despite a policy decision taken almost a decade ago to switch from construction towards the purchase of individual private dwellings for local authorities, there has been extremely limited progress in this direction. This suggests a degree of inflexibility in the local authority sector which is not in the interest of efficient and flexible housing provision. An important requirement for the expansion of voluntary housing and the development of a reliable, effective, well co-ordinated and properly managed voluntary housing movement is the availability of accurate information, advice, guidance and training, particularly for management board members and officers. New housing associations need reliable guidance about legal formation, project planning, financial accounts, housing management and maintenance as well as landlord and tenant responsibilities. Experience from other countries clearly indicates that this is best achieved through adequate Governmental support for national federations of social housing associations to enable them to promote high management standards and a co-ordinated approach to organisation and representation etc. The Council considers that the resources made available for this essential work should be commensurate with the current expansion and public capital commitments.

(iii) House Improvement Grants

While primary responsibility for the maintenance and upgrading of the housing stock rests with owners and occupiers, the Council recognises that there are equity and efficiency grounds for state intervention. The Council is of the view that house improvement, relative to new building, should be accorded greater priority in the future. In considering specific public policies to support house improvement, the following principles should be followed:

- The central objective of any scheme of grants should be the attainment of minimal standards in all of the housing stock, rather than high quality improvement to a limited part of the stock;
- Grants are more likely to yield high levels of return in terms of improvement if they are narrowly focused on particular and acute problems;
- In urban areas in particular, economies of scale and high social returns can be achieved if area-based improvement policies are pursued for specific periods of time;
- There is a strong case for a degree of selectivity in relation to income when eligibility for grants is determined;
- The case in principle for loans rather than grants should be considered, and the role of private financial institutions in funding house improvement could arguably be extended.

6. NON-PROFIT VOLUNTARY AND CO-OPERATIVE HOUSING

In many respects, this sector of the Irish housing system has been the focus of the most significant changes in recent years. As the Council has previously pointed out, until recently Ireland has failed to share to any significant degree in the development of the voluntary housing sector which has successfully emerged in several European countries over the past 20 years or so. The Council therefore welcomes the shift in policy expressed in the 1991 document, *A Plan for Social Housing*. The fundamental objectives underlying the Plan are to improve access to housing, to widen housing options, to encourage self-help and to enhance the role of the voluntary sector in meeting housing needs. A variety of new schemes were introduced under the Plan, with full responsibility for implementation being given to local authorities and approved voluntary housing bodies. The Council welcomes the emphasis on devolution and the recognition that the various measures are best integrated at a local level to maximise their impact on waiting lists.

Between 1984 and 1991 the Voluntary Housing Capital Assistance Scheme enabled voluntary organisations to meet special housing needs such as those of elderly persons and the homeless, with some 3,000 units provided to date under this scheme. In an attempt to harness voluntary housing effort to meet more general needs, a new capital loan and rental subsidy scheme was introduced under the 1991 Plan, to encourage the voluntary sector to provide for a more comprehensive range of households. The level of activity under this scheme is again encouraging, with many rental subsidy schemes (in excess of 500 dwellings) now being successfully provided in co-operation with local authorities throughout the country. Under these programmes, variable and flexible types of accommodation are provided in response to an increasing array of housing needs.

Despite the significant increase and diversification in voluntary sector housing provision since the publication of the Plan, it has been outpaced by the rapid increase in demand for social housing. This increase in needs, as has been discussed earlier, arises from economic, demographic and social trends, especially rising unemployment, a reduction in emigration and increasing incidence of family dissolution and single parenthood. The Council notes that demographic trends imply a sharply rising demand for sheltered housing for the elderly, especially in the Eastern Health Board area. In this context, the level of funding available to support social housing initiatives is falling short of what is required to meet the objectives of the Plan. Given that many of the schemes involve substantial savings to the state compared with the alternative of constructing and allocating local authority dwellings for low income households, an increase in resources for these measures is desirable. In particular, it would be desirable for the financial parameters of the capital loan assistance under the schemes of funding for approved housing bodies to be modified to take account of the higher costs of construction in Dublin and other centre-city areas.

7. URBAN RENEWAL

The objective of urban renewal has been pursued through a set of incentives introduced in 1986, aiming to attract business from existing locations to designated areas characterised by extensive levels of urban decay and high levels of dereliction. A total of £567 million (up to May 1993) has been invested or committed in urban renewal projects in 23 cities and towns throughout Ireland, since the scheme came into effect (this figure does not include the Custom House Docks scheme where an additional £400 million has been invested). The tax breaks which constitute the relief equate to an average 20% subsidy on the cost of building, excluding site costs. Of this

20%, it is arguable that perhaps 10% goes on enhanced site value. However, in examining the incentives, Pierse (1993) notes that the incentives are weighted against housing development in designated areas in favour of commercial development in the same areas. The combination of tax relief and remission of rates is more than five times higher for commercial development than for residential development. Activities classified as industrial also tend to be less favourably treated. It must be noted, however, that rates do not apply to residential property in any case. The overall impact is likely to favour commercial rather than residential uses and also new development rather than refurbishment. The Council recognises that commercial development in designated areas is an integral part of the regeneration of the urban areas, but considers that it should be controlled balanced and must not take place to the detriment of housing provision. It is also appropriate to make provision for some light industrial activity.

There can be little doubt that building on derelict sites has occurred in certain parts of the designated areas throughout the country which would not have happened without economic incentives. However, many of the areas which most needed revitalisation when the incentives were first introduced are still suffering dereliction, such as parts of Dublin's north inner city. This may be linked with an unduly dispersed range of incentives - even at the outset there may have been simply too many areas designated for renewal, thus spreading the benefits thinly and producing a haphazard pattern of development. The Council believes that policies involving infrastructural development, environmental upgrading and so on, must be strengthened and more concentrated on small areas to produce more immediate and cost effective results than can be obtained from spreading resources widely, as is currently the case. Similarly, the availability of Section 23 benefits (until March 1992) on a nationwide basis substantially diluted the attractiveness of such benefits to investors in the designated areas. The Council has strong reservations about the operation of such incentives, and it welcomes the fact that their continuation has been confined to the designated areas, to the Temple Bar area and to the Custom House Docks area for a limited period.

In terms of loss to the Exchequer and competitive effects on non-designated areas, it is questionable whether all areas currently designated actually require designation in order to allow development to occur (Corrigan, 1991). The Council believes that incentives should only be introduced, or extended to areas where it is clearly established that an additional incentive is necessary in order to achieve normal property investment criteria. Policy to counteract dereliction might place greater emphasis on penalties for leaving land derelict, such as those applying under the Derelict Sites Act introduced in

1990, reflecting the fact that some land owners are in effect 'blighting' the prospects of quality renewal by their neighbours, due to the negative spill-over effects associated with dereliction. More generally, however, the extent of dereliction and the perceived need for tax incentives to counteract it may be related to the disincentive effects of the rating system used to part-finance local authorities. Local authorities themselves contribute to this blight as do uncertainties concerning ownership of property. When redevelopment of commercial premises occurs the rateable valuation is reviewed and increased, with a consequent sharp rise in liability for rates. The Council believes that a more comprehensive property tax would reduce the disincentive effects of commercial rates and the need for specific incentives to combat dereliction.

The Council recommends that incentives for urban renewal should pay particular attention to the desirability of increasing, both from the private and social housing sectors, housing investment and should not inhibit improvement and refurbishment rather than new construction. Accordingly, tax relief and other benefits should promote a balanced approach to urban development. The level of incentive required, even in areas of severe dereliction, could be reduced by adoption of the Council's recommendations on housing benefit for private sector tenants.

8. HOMELESSNESS

Deteriorating social conditions such as high unemployment, poverty, marital breakdown and other family problems are clear contributors to the worrying problem of homelessness. The Council is concerned that the policy and administrative responses to the growing problem of homelessness should be adequate to the challenge posed by this extreme form of housing need, especially in the major urban areas.

The Council is aware that organisations concerned with the homeless have expressed concern at the approach taken by local authorities to the measurement of the problem. The Council believes that the local authorities and voluntary organisations active in this area should establish more satisfactory arrangements to define and monitor the scale of homelessness, with independent research assistance as necessary. The adequacy of the policy response can only be assessed against reliable indicators of the scale of the problem.

The 1988 Housing Act permits local authorities to house homeless people, and to make arrangements with approved voluntary organisations to house

them, or to provide money to enable the homeless to pay for private accommodation. The Council welcomes the steps which have been taken to improve provision for the homeless, including increased capital and operating grants to voluntary bodies in this field and the establishment of a Housing Forum and after-hours emergency service in the Dublin area. Despite this progress, the Council repeats its call for a comprehensive strategy to deal with homelessness, which would co-ordinate elements of housing, health and social services and link them to local structures with responsibility for implementation of the strategy. The Council notes the continuing concern about the adequacy of provision, including on-site care staff for psychiatric patients and other socially vulnerable persons. A strategy to alleviate homelessness can only be achieved with the aid of a comprehensive assessment based on an appropriate methodology, incorporating estimates and forecasts of age groups, categories of need and groups at risk. There is a particular need for health boards, local authorities and voluntary organisations to develop new forms of sheltered housing, group homes and hostel accommodation, including the re-design and upgrading of existing accommodation. The Council welcomes the progress made in this regard in recent years.

The Council recommends that this activity should be supported by advisory and inspection services; the provision of the option of more appropriate accommodation for those who currently make up the long stay population of hostels; and the development of a variety of daytime activities, including support for counselling, health care and training services for homeless people during the daytime hours when most hostels close, and as a means of addressing the factors which make for long-term homelessness.

9. CONCLUSION

The central thrust of policies proposed by the Council continues to reflect a concern to make the use of public resources in support of housing policy more selective and more efficient. The Council's recommendations focus on the need to redistribute resources and expenditure both within and between housing sectors in the interests of equity and efficiency. A shift from a reactive approach to public housing maintenance towards more planned and preventive programmes; from the construction of new local authority dwellings in favour of the purchase of new and secondhand dwellings; from incentives to private landlords towards targeted subsidies for low-income private sector tenants and from commercial development in the designated areas towards residential development would all be examples of redistribution within sectors. The Council's recommendation for a reallocation of resources towards voluntary and co-operative housing away from private ownership exemplifies inter-sectoral redistribution. The Council's appraisal emphasises not only the essential complementarity between the various housing sectors, but also the fundamental links between housing policy and wider issues of economic and social policy. As an example, the Council stresses that its proposals regarding the tax treatment of housing must be viewed as part of its general concern with tax reform, and specifically, its concern for a shift in the tax burden from employment towards property, with a view to enhancing employment.

Finally, while the development of housing policy has been supported by systematic research, including the Council's own previous work in this area, there is a need for comprehensive research into the effects of a number of aspects of policy on the housing market, (such as the impact of measures aimed at extending owner occupation), together with more comprehensive assessment of homelessness based on effective co-operation between statutory agencies and voluntary bodies and an appropriate methodology.

CHAPTER 16

Education and Training Policy

EDUCATION AND TRAINING POLICY[123]

1. INTRODUCTION

Modern educational systems have complex and potentially competing objectives. Among the most important is the socialisation of people into the highly complicated cultural, and ever evolving economic, social and political arrangements of their communities. But individual and personal development, preparation for work and adult life are equally important and classification and certification of individuals' attainment are also needed (Hannan and Shortall, 1991). The education system also has an important role to play in enhancing the productivity level on potential output of the economy.

The educational system absorbs approximately 6% of Irish GNP. Here, as in many other countries, public expenditure on education has risen rapidly since the mid-1960s, a growth which was associated with demographic changes, increases in the participation rate in education and real increases in the volume of educational services (teachers, schools, equipment etc.).

In this Report, the Council is particularly concerned with the role which education and training policies can play in promoting employment growth and in reducing the extent of unemployment, especially long-term unemployment. In Chapter 3, the Council discussed the role which education and training can play in addressing specific skill strategies. In Chapter 4 the importance of the quality of the labour force at all levels was emphasised as a key component of long-run competitiveness, especially as a foundation for a more innovative society and economy. The Council's views on these issues, and on more specific issues arising from the Green Paper on Education have been set out in a recent Report.[124] This Chapter reviews these issues and sets out the priorities for education and training policies within its overall strategy for employment.

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123 This Chapter draws heavily on a paper which was prepared for the Council by Dr Philip O'Connell of the ESRI. Copies of the paper are available from the Council Secretariat.

124 NESC Report No. 95, *Education and Training Policies for Economic and Social Development*.

2. EDUCATIONAL QUALIFICATIONS OF THE LABOUR FORCE

Table 16.1 provides data on the educational qualifications of those at work, by economic sector, based on a special analysis of the 1991 Labour Force Survey undertaken by the Central Statistics Office. Over 22% of those at work had no educational qualifications whatsoever in 1991, over 25% had attained an Intermediate or Group Certificate, almost 31% had a Leaving Certificate, and almost 21% had a third-level qualification. Generally, the distribution of educational qualifications is more favourable among female than male workers: almost 70% of females had a Leaving Certificate or third level qualification, whereas this was true of only 43% of males.

Educational attainment in agriculture is particularly low, with over half the agricultural labour force possessing no qualifications, and less than 20% in possession of a Leaving Certificate or higher qualification. Attainments in construction were also low, with over a third possessing no qualifications, and a further 38.5% possessing a Group or Intermediate Certificate. In the transport sector, almost half of the workforce does not possess a Leaving Certificate. The highest educational attainments are in the professional services sector, in which over 85% of workers have the Leaving Certificate, and almost 63% have third-level qualifications; males in this sector have significantly higher qualifications than females. Over half of workers in public administration have the Leaving Certificate, although the public administration aggregates conceal interesting sex differences. Among males, over 40% do not have the Leaving Certificate, 45% have the Leaving Certificate only, and 20% have third-level qualifications. Among females in public administration, on the other hand, just over 14% do not have a Leaving Certificate, almost 70% have only the Leaving Certificate, and 16% have third-level qualifications. These differences appear to represent occupational differences between the sexes in public administration; males are polarised between manual and lower non-manual occupations, on the one hand, and higher executive, technical and professional occupations, on the other, whereas females tend to be concentrated in clerical areas.

TABLE 16.1

Educational Qualifications of Those at Work by Economic Sector 1991

	Total at Work	Total at Work	No Qualifications	Inter/ Group Cert	Leaving Cert	Third Level	Total[1]
	(000s)	%	%	%	%	%	%
MALES							
Agriculture	153.7	20.4	54.6	26.9	13.7	4.7	99.9
Construction	73.5	9.7	35.5	39.0	19.3	6.0	99.9
Manufacturing	177.3	23.5	22.4	35.9	26.2	15.3	99.9
Commerce	138.7	18.4	16.7	29.1	37.7	16.4	99.9
Transport	54.7	7.2	28.9	31.4	31.3	8.2	99.8
Professional Services	72.0	9.5	7.9	7.6	11.1	73.3	100.0
Public Admin.	45.6	6.0	14.5	20.0	45.4	20.2	100.0
Other	39.3	5.2	23.4	29.3	28.8	16.3	97.7
Total	**754.7**	**100.0**	**27.8**	**28.8**	**25.3**	**17.8**	**99.8**
FEMALES							
Agriculture	13.7	3.7	41.6	26.3	24.1	8.0	100.0
Construction	2.6	0.7	15.4	23.1	46.2	15.4	100.0
Manufacturing	67.0	18.0	16.6	29.9	42.4	10.9	99.7
Commerce	86.0	23.1	8.5	23.1	55.1	13.3	100.0
Transport	13.1	3.5	7.6	13.0	64.9	13.0	98.5
Professional Services	120.3	32.4	5.7	7.9	30.1	56.1	99.8
Public Admin.	18.4	5.0	3.3	10.9	69.6	16.3	100.0
Other	50.6	13.6	19.0	27.9	37.7	14.4	99.0
Total	**371.5**	**100.0**	**11.4**	**19.2**	**42.2**	**26.9**	**99.8**
TOTAL							
Agriculture	167.4	14.9	53.5	26.9	14.5	5.0	99.9
Construction	76.1	6.8	34.8	38.5	20.2	6.3	99.9
Manufacturing	244.3	21.7	20.8	34.3	30.7	14.1	99.8
Commerce	224.7	20.0	13.5	26.8	44.4	15.2	99.9
Transport	67.8	6.0	24.8	27.9	37.8	9.1	99.6
Professional Services	192.3	17.1	6.6	7.8	23.0	62.6	99.9
Public Admin.	64.0	5.7	11.2	17.3	52.3	19.1	100.0
Other	89.9	8.0	20.9	28.5	33.8	15.2	98.4
Total	**1126.2**	**100.0**	**22.4**	**25.6**	**30.9**	**20.8**	**99.8**

1 The residual represents those whose education was not stated.

Source: Special tabulations from the *Labour Force Survey, 1991.*

TABLE 16.2

Persons at Work Classified by Economic Sector and Participation in Education or Training in 4 Weeks Prior to Labour Force Survey 1991

	Total at Work		Received Training	
	(000s)	%	(000s)	%
MALES				
Agriculture	153.7	20.4	1.8	1.2
Construction	73.5	9.7	5.5	7.5
Manufacturing	177.3	23.5	13.9	7.8
Commerce	138.7	18.4	9.1	6.6
Transport	54.7	7.2	2.7	4.9
Professional Services	72.0	9.5	7.2	10.0
Public Admin.	45.6	6.0	4.4	9.6
Other	39.3	5.2	3.0	7.6
Total	**754.7**	**100.0**	**47.6**	**6.3**
FEMALES				
Agriculture	13.7	3.7	0.2	1.5
Construction	2.6	0.7	0.2	7.7
Manufacturing	67.0	18.0	4.4	6.6
Commerce	86.0	23.1	4.9	5.7
Transport	13.1	3.5	1.0	7.6
Professional Services	120.3	32.4	15.4	12.8
Public Admin.	18.4	5.0	1.5	8.2
Other	50.6	13.6	5.2	10.3
Total	**371.5**	**100.0**	**32.8**	**8.8**
TOTAL				
Agriculture	167.4	14.9	2.0	1.2
Construction	76.1	6.8	5.7	7.5
Manufacturing	244.3	21.7	18.3	7.5
Commerce	224.7	20.0	14.0	6.2
Transport	67.8	6.0	3.7	5.5
Professional Services	192.3	17.1	22.6	11.8
Public Admin.	64.0	5.7	5.9	9.2
Other	89.9	8.0	8.2	9.1
Total	**1126.2**	**100.0**	**80.4**	**7.1**

Source: Special tabulations from the *Labour Force Survey, 1991*.

Tables 16.2 and 16.3 present information on participation in education and training in the four weeks prior to the Labour Force Surveys of 1988 and 1991, from a special analysis of that data by the Central Statistics Office. Such data do not provide an accurate account of the absolute *levels* of education and training in any year, because they relate to a four week period and there is no indication of the duration of training. The data do, however, provide a basis to compare levels of education and training activity across sectors and to examine trends in the incidence of training over time.

Table 16.2 presents data on participation in education and training in the 4 weeks prior to the Labour Force Survey by economic sector in 1991. Overall, 80,000 people, or 7% of those at work, received some form of education or training during the preceding month. The incidence of training was highest in professional services (11.8%) and in public administration (9.2%). The lowest incidence of training was in agriculture, where only 1.2% of the workforce received education or training. In both manufacturing and construction, 7.5% of the workforce received some education or training. The incidence of education and training for those at work thus roughly parallels educational attainments by sector. Those sectors characterised by high educational attainments are those in which the incidence of continued education or training is highest. This would suggest that deficiencies in initial educational attainments are unlikely to be rectified by continued education and training at work. The construction and manufacturing sectors, where the incidence of training of those at work is fairly high, although initial educational attainments are relatively low, seem to be something of an exception. Analysis of the Labour Force Surveys of 1988 and 1991 shows that the total number of persons aged over 15 years receiving some education or training in the four weeks prior to the surveys increased by 11%, from 354,000 to 393,200 between 1988 and 1991. Over the same period, the over-15 age population increased by 1.5%. A substantial proportion of that participation, almost 75% in both years, was in initial education, and was heavily concentrated in the younger age groups.

The total population in the 15-19 year age group increased by 2.7% between 1988 and 1991 while the 20-24 year age group fell marginally. Participation in second-level education increased by 4% over the three years, from 203,400 to 211,100. This meant that the age-specific participation rate in post-compulsory second-level education increased from 60 to 61%. Within secondary education, participation in vocational education increased only slightly.

As Table 16.3 shows, the most marked expansion was in third-level education. Participation increased from 65,600 in 1988 to 83,800 in 1991, an increase of 27%. Most of that increase was in the younger age groups. In 1988, 8.7% (29,200) of all 15-19 year olds had participated in third-level education in the month prior to the survey; this increased to 11.4% (39,300) in 1991. 11.5% (31,500) of those aged 20-24 had participated at third level in 1988, 14.3% (39,200) did so in 1991.

TABLE 16.3

Participation in Education and Training in 4 Weeks Prior to the Labour Force Survey 1988 and 1991

	Year	15-19	20-24	25-39	40+	Total
	(000s)					
Primary Education	1988 1991	1.5 1.2	0.1 0.1	0.0 0.1	0.0 0.0	1.6 1.4
Secondary Education	1988 1991	203.4 211.1	2.2 3.4	0.8 1.2	0.2 0.4	206.6 216.1
Third-Level Education	1988 1991	29.2 39.3	31.5 39.2	4.3 4.3	0.6 1.0	65.6 83.8
Adult Education	1988 1991	1.5 1.5	1.7 1.9	2.4 3.5	2.0 3.2	7.6 10.1
Training at Place of Work	1988 1991	11.2 11.1	13.7 12.7	9.3 12.8	3.3 5.9	37.5 42.5
Training at School or College	1988 1991	2.6 2.4	4.7 5.0	7.0 7.8	2.2 2.9	16.5 18.1
Apprentice Training	1988 1991	3.2 3.5	2.5 2.6	0.2 0.3	0.0 0.0	5.9 6.4
Other Job-Related Training	1988 1991	2.8 2.1	3.2 3.7	4.2 5.2	2.1 2.7	12.3 13.7
Total	**1988** **1991**	**255.4** **272.7**	**59.6** **68.8**	**28.4** **35.3**	**10.6** **16.4**	**354.0** **393.2**
Population	1988 1991	336.6 345.9	273.7 273.2	730.2 704.9	1199.8 1256.5	2540.3 2580.5

These "snapshots" of education and training activity in the LFS data are, perhaps, most useful in relation to assessing changes in continuing training of those at work, given the scarcity of comprehensive data from administrative sources. The number receiving training at their place of work increased from 37,500 to 42,500; this represented an increase of 13% in the

incidence of such training between 1988 and 1991. The number receiving apprenticeship training increased by 8% from 5,900 to 6,400, and those participating in other job-related training increased by 11% from 12,300 to 13,700. Combining these types of training, the numbers receiving some form of work-related training increased from 55,700, representing about 4.3% of the labour force in 1988 to 62,600, or about 4.8% of the labour force in 1991. This represents an increase of about 12% in the total level of work-related training. It does not, of course, give us any information on the quality of the training involved.

3. EDUCATION AND UNEMPLOYMENT

It has been established that education is strongly related to labour market success, not only because income derived from employment is positively related to educational qualifications, but also because *access* to employment is related to education. Table 16.4 compares the educational levels of those at work with those unemployed, and, within the unemployed, between the short-term and long-term unemployed.

TABLE 16.4

Educational Qualifications of Those at Work and Unemployed 1991

Educational Level	At Work	Unemployed	Short-Term Unemployed	Long-Term Unemployed	
				Total	Of which ≥35 years
	%				
No Qualifications	22.4	40.1	24.3	47.2	65.1
Intermediate/ Group Cert	25.6	34.5	37.7	33.2	22.4
Leaving Cert.	30.9	18.6	26.9	14.9	8.3
3rd Level	20.8	6.7	11.1	4.8	4.1
Total	100.0	100.0	100.0	100.0	100.0

Source: *Labour Force Survey, 1991* (Special tabulation).

About 22% of those at work had no qualifications while this was true of over 40% of the unemployed. Three-quarters of those unemployed had either no qualification or an Intermediate or Group Certificate, whereas this was true of less than half of those at work. At the other end of the educational scale, almost 21% of those at work had a third-level qualification while less than 7% of the unemployed had such a qualification.

The unemployed are not, however, a homogenous group, and there are significant differences in educational qualifications by duration of unemployment. The distribution of qualifications among the "short-term" unemployed (those unemployed for less than one year) is significantly better than the average for all those unemployed. On the other hand, however, the long-term unemployed tend to have a particularly poor educational profile. About 47% of long-term unemployed persons were without formal educational qualifications, compared with 24% of persons out of work for less than one year. Some 20% of the long-term unemployed held qualifications at Leaving Certificate or higher levels, compared with nearly 40% for other unemployed persons. Those with the greatest educational disadvantages are the older long-term unemployed: almost two-thirds of the long duration unemployed who were aged 35 years or more were without any qualifications and only 12% of this group had attained Leaving Certificate or higher qualifications.

The analysis of educational qualifications of the unemployed helps to explain why long-term unemployment has increased to the alarming levels in Ireland discussed in Chapter 3. Table 16.5 shows the distribution of education by employment status for young labour force participants (aged 15-24 years) in 1990. Of the 294,200 young people participating in the labour force in 1990, 57,600, nearly 20% were unemployed. A total of 29,300, fully 10%, had no qualifications whatsoever, and 46% of them were unemployed. An additional almost 100,000 (34%) young people had attained only the Intermediate or Group Certificate, and almost 27% of them were unemployed. The table suggests that the relationship between education and labour market success is particularly strong for young workers; as educational attainments increase, unemployment rates fall sharply; less than 8% of those with third-level qualifications were unemployed.

Table 16.5 indicates the presence of a very substantial number of educationally disadvantaged young people who are ill-equipped to compete in the labour market; almost 130,000 or 44% of young labour force participants either had no qualifications or the minimal Group or Intermediate Certificate. The most seriously disadvantaged are those who are both unemployed and unqualified; 13,500 in 1990. The next most disadvantaged group is probably the 26,600 people who were unemployed and had attained only the Intermediate or Group Certificate. Given the high

risk of unemployment in both of these educational categories and the unstable nature of employment in this sector of the labour market, however, we should also include a substantial proportion of those who had low educational qualifications, but who were currently employed in 1990, in our assessment of the extent of disadvantage in the youth labour market.

TABLE 16.5

Employment Status by Level of Education of those in the Labour Force, Aged 15-24 Years
1990

Level of Education	At Work	Unemployed	Total	Percentage Unemployed
	Number			%
No Qualifications	15,800	13,500	29,300	46.1
Inter/Group Cert.	73,100	26,600	99,700	26.7
Leaving Cert.	111,100	14,300	125,400	11.4
Third-Level	36,200	3,000	39,200	7.7
Not Stated	500	200	700	28.6
Total	236,600	57,600	294,200	19.6

Source: 1990 Labour Force Survey.

4. INITIAL EDUCATION AND LABOUR MARKET ENTRANTS

We turn now from the analysis of the *stock* of labour market participants to that of *inflows* to the labour market. Table 16.6 shows the levels of education completed by second-level school leavers from 1980 to 1991. The data are based on the annual Survey of School Leavers conducted on behalf of the, now, Department of Enterprise and Employment. The survey is based on a sample of over 2,200 school leavers and is conducted in May-June of the year following exit from school, so one full year is allowed to elapse before post-school experience are recorded. In 1991, of the 66,900 young people who left second-level education, 5,200 (8%) had no qualifications, and a further 11,700 (17%) had a Group or Intermediate Certificate. This represents an improvement over the situation in the early 1980s, when up to 40% of each cohort left school with no qualifications or with poor qualifications. Such progress notwithstanding, the problem of early school leaving must remain a priority issue for education and labour market policies since it is from among young labour market entrants who are poorly qualified that the future ranks of the long-term unemployed will be recruited. The increase in the proportion of the 1991 school leavers who left without any qualifications whatsoever should serve to highlight the importance of addressing this problem as a matter of urgency.

TABLE 16.6

Second-Level School Leavers Classified by Education Level Completed 1979-1990

Year (of leaving)	No Qualifications	Inter/Group Certificate	Leaving Certificate	Total
	(000s)			
1980	6,800	18,900	39,000	64,700
1981	4,600	16,700	39,600	61,000
1982	5,500	16,600	39,900	62,000
1983	4,800	15,900	41,900	62,600
1984	5,100	15,200	40,700	60,900
1985	4,400	14,300	45,000	63,700
1986	4,800	15,000	46,000	65,800
1987	4,900	15,700	46,000	66,600
1988	4,200	15,300	48,500	67,900
1989	4.600	12,800	49,900	67,300
1990	3,600	11,500	51,900	67,000
1991	5,200	11,700	50,000	66,900

Source: Department of Labour, *Annual Surveys of Second-Level School Leavers.*

Most of those who leave school with poor qualifications do so to enter the labour market, notwithstanding the poor employment prospects. Almost 88% of those who left with either the Group or Intermediate Certificate or less in 1991 were either at work or unemployed one year later. In contrast, about 45% of those who left with the Leaving Certificate were in full-time education the following year. Of those who left school without any qualifications in 1989 over 42% were unemployed one year later in 1990, and over 53% of the 1991 cohort were unemployed in 1992 - this group was hit hardest by the fall in the demand for labour. 30% of those who left without qualification in 1989 were still seeking a first job one year later, and this proportion increased to over 37% of the 1991 cohort. Those with the Group or Intermediate Certificate fared rather better: over 60% of the 1989 cohort

and although only 47.5% of the 1991 cohort were at work one year later. Unemployment increased from almost 24% of the earlier cohort to almost 42% of the 1991 school leavers.

Given the differences in participation in further education by educational attainment, it is best to compare unemployment across the educational categories on the basis of unemployment *rates* - expressed as a percentage of the labour force, rather than the cohort. On this basis, unemployment among those who left school with the Leaving Certificate in 1991 was 29% of those who entered the labour force, compared to a rate of over 63% of those with no qualifications and 47% of those with a Group or Intermediate Certificate.

Currently, about 45% of second-level school leavers continue to further education or study. About 58% of students in higher education are enroled in universities and other degree awarding institutions administered by the Higher Education Authority, while more than 40% attend the Regional Technical Colleges and Colleges of Technology. The pattern of destinations provides additional support for the general contention that labour market success is strongly related to educational attainment: graduates from third-level are more likely to be at work, and less likely to be unemployed, than are those with second-level qualifications or less. However, graduates have also suffered from the deterioration in labour market conditions, both at home and abroad, in recent years.

This examination of new entrants to the labour force from the educational system suggests the following conclusions. First, there is a strong relationship between educational attainment and labour market success; those with the highest qualifications are most likely to find employment when they enter the labour market, have greatest access to further education, and are least likely to be unemployed. Second, up to one-quarter of those leaving second-level education are poorly qualified and are ill-equipped to compete either for jobs on the labour market or for access to further education. Third, at the higher end of the credentials scale, there is some evidence of an oversupply of highly trained graduates relative to current demand, as evidenced by the emigration of graduates, such as engineers. In the late 1980s emigration among recipients of both diplomas and degrees from institutions of higher education ranged between one-fifth and one-quarter of all graduates. When external labour market conditions deteriorated, emigration rates of such graduates fell, but unemployment increased. In 1991, the percentage of such graduates finding work in the Irish labour market was about 40% in the case of diploma and primary degree recipients and about 62% in the case of recipients of higher degrees.

education and training is a matter for some concern, since most participants in these programmes suffer severe educational and occupational disadvantages and are likely to experience continued difficulties in the labour market without further education or training. This point is discussed below.

(b) *Skills Training*

A substantial element of training for unemployed persons consists of training in specific skills to meet skill demands in local labour markets. The largest such programme is the Specific Skills Training Programme administered by FÁS, which involves the training of over 10,000 persons annually. The measure is targeted on the unemployed (90%) and those at risk of unemployment (10%), and its objective is to raise the skills of the unemployed workforce and thus contribute to economic growth. The average course lasts about 18 weeks.

Courses are linked directly to the local labour market through instructors, who continually monitor skill needs. Instructors conduct placement surveys on completion of each course, and if placement in employment falls below 70% the course is reviewed to determine whether it is consistent with labour market needs and whether adjustment or substitution is in order.

The "Follow up of FÁS Programme Participants" survey conducted by FÁS in 1990 found that 43% of SST trainees were at work, and 4% were engaged in further education or training immediately upon completion of training, and that the proportion at work increased to 66%, 14-17 months after completion of the programme. The aggregate placement rate is only marginally above the "quality control" threshold of 65% then in place, but it should be recognised that SST programmes cater for participants with a very wide range of abilities, educational attainments, and labour market experiences. O'Connell and Sexton (1993), found that there were significant variations in the impact of SST by personal and background characteristics, and that, generally, better qualified individuals with greater previous experience in the labour market tended to benefit more, in placement terms, from participation in SST than other less qualified participants. However, while some trainees may be difficult to place because of poor education or labour experience, a report by the Programme Evaluation Unit of the Department of Labour showed that there are a large number of SST courses which fall below the "quality control" threshold. In about 28% of SST

courses in 1991 the placement rate was below 50%.[126] Many of the courses concerned are in medium and high level skills, suggesting that the problem probably lies not with the characteristics of the participants but with either the relevance or quality of the course itself.

SST cannot be expected to create jobs, at least in the short-term, but, by upgrading the skills of the unemployed it improves their labour market opportunities and has the potential to reduce the incidence of long-term unemployment. Second, given the relatively low commitment to training attributed to employers in Ireland, and given that 50 to 60% of those who are unemployed at any given point in time are likely to have found work six months later, then SST-type training of the unemployed can have the direct effect of gradually upgrading and/or updating the skills of the labour force - yielding longer term increases in productivity and, therefore, competitiveness and economic growth. The impact of SST depends on demand in the labour market: if unemployment were to be significantly reduced, thus increasing the outflow from Specific Skills Training into employment, then the impact of the measure would be greatest.

(c) *The Long-Term Unemployed*

Currently there are two major training programmes targeted on the adult long-term unemployed: Alternance Training and the Vocational Training Opportunity Scheme. In addition, about 1,500 participate annually in Specific Skills Training courses.

Alternance Training, provided by FÁS, allows trainees to alternate between employment experience and formal vocational training. The programme is designed to reintegrate long-term unemployed people over 25 years of age into the workforce and facilitate the re-entry of women who have been out of the labour force for a number of years and provides basic vocational and job searching skills. The course lasts 6 months and there are about 1,500 participants per year. Women, mainly seeking to return to the labour force after a prolonged absence, account for about 75% of participants in Alternance. If the Alternance programme is to function effectively, then linkages to the mainstream training and education systems may need to be strengthened. This would require

126 Programme Evaluation Unit, 1992, *Evaluation Report: Specific Skills Training*. Dublin: Department of Labour, Programme Evaluation Unit

certification of those who successfully complete the programme, provision of appropriate "follow-on" courses, and the inclusion within the curriculum of guidance and counselling on opportunities for further education and training.

The Vocational Training Opportunity Scheme (VTOS) provides vocational education and training, including opportunities to enter mainstream senior cycle secondary education to long-term unemployed people. It is the responsibility of the Department of Education, and is implemented by the 38 regional Vocational Education Committees. In most centres the measure has developed, in part, into an opportunity for long-term unemployed adults to re-enter the mainstream second-level education system; many participants take a mix of Leaving Certificate and vocational courses. The measure is targeted at those over 21 years of age who have low educational attainments and who have been unemployed for at least 12 months and currently, there are about 3,000 participants on the programme. The National Development Programme does not provide for any increase in this level of participation.

(ii) Training of Those at Work

Roche and Tansey (1992) note that the incidence of formal training of employees in Ireland is significantly lower than in the more advanced countries of Europe and that the duration of training actually conducted is of substantially shorter duration.[127] Table 16.3 showed that there has been some increase - of the order of about 12% - in the incidence of training of employees between 1988 and 1991. Much of this increase can be attributed to the impact of the Community Support Framework, which now provides for a significant share of such training. The CSF has also had an impact on training of those at work - a substantial amount of training of employees is now funded by the ESF.

Under the CSF, the most important programmes directed at training of employees in the Industry and Services Programme are: (1) The Training Grants, administered by the industrial development agencies, which mainly provide training grants for the induction training of new employees; (2) The Industrial Restructuring Programme, which provides grant aid for companies

127 Frank Roche and Paul Tansey, 1992, *Industrial Training in Ireland: Report to the Industrial Policy Review Group*. Dublin: Stationery Office.

to purchase training for their employees on the market (about 50% management and 50% operatives); (3) The Management Development Programme, which provides training for only about 400 managers annually. The Middle Level Retraining Programme, also supports part-time and short-cycle training for employees in the regional technical colleges and colleges of technology.

Most of the public financial support for training of those at work in industry and services takes the form of grant aid. This raises the issue of potentially high rates of deadweight. Much of the activity supported under the Training Grants schemes relates to induction courses for new employees which some firms would undertake at their own expense in the absence of grant aid. In some instances, training grants are a part of the package of incentives to attract inward investment. There is also cause for concern with the level of training of those at work. Most of the training that currently takes place is at a relatively low level. Currently, about 70% of training supported by the CFS in industry and services is in basic or medium level skills.

Information on the training of employees organised and funded by their employers is limited, largely because it takes place outside of the State arena, and the State has, therefore, had no administrative reason, or opportunity, to collect such information. What information we have on this sector of training is based on survey data.

In 1989, FÁS commissioned a survey of training activities in industry and services. The survey was administered to 474 firms in industry (including manufacturing, construction, and the retail motor trade) and services (excluding the public service, and hotel catering industries). Total employment in the sectors covered was 961,800. During the previous 12 months, 404,000 (42%) persons had received some training. Of these, almost 207,000 (21% of total employment covered) received off-the-job training. Overall levels of training were higher in industry than in services. Apart from apprentices in industry, among whom there was a high incidence of training, the occupations with the highest levels of training were professional and technical occupations. Training activity was much greater among larger firms; in 65% of small firms no training had been conducted, this was the case for only 10% of large firms. Most training was of short duration; 73,000 workers (7.6%) received four or more days off-the-job training. The survey was unable to estimate the incidence or quality of on-the-job training.

Fox (1990/91) estimates that total expenditure on formal training in the non-agricultural economy (including the public sector), including trainee wage costs, at about IR£95 million per annum, representing about .9% of labour costs. He adds, moreover, that on-the-job training could double this estimate - to IR£215 million, or almost 2% of wage costs annually.[128]

(iii) Skill Shortages and the Quality of Skills

The review of labour market trends in Chapter 3 indicated the dimensions of Ireland's very substantial unemployment problem. While unemployment is disproportionately concentrated among those poorly educated with low skills, the overall level of unemployment is such that unemployment occurs also among those with higher level educational qualifications and skills. The expansion of the education and training system over the past two decades has substantially increased the supply of persons with high levels of education and skill. Given the structure of the economy and the profile of firms, this supply has outstripped current demand. The surplus of educated and skilled labour is augmented by the additional pool of labour currently abroad, who can be attracted home when skill shortages occur.

Given the extent of unemployment, it is hardly surprising that survey data reveal little evidence of shortages of skilled labour; the proportion of Irish firms reporting skill shortages fell from about 20% in the late 1970s to almost none in the late 1980s (Sheehan, 1992).[129] Such evidence must be interpreted with caution, however, since what it indicates is that there is no shortage of people to fill particular jobs; it does not ensure, however, that people have the right skills, or that skills in Ireland are on a par with best international practice - the crucial issue in an economy which depends heavily on export led growth.

When skill levels in Irish firms are compared with those in similar competing firms in other countries, a wide skills gap is evident. Roche and Tansey (1992) argue that there is a high degree of complacency about the adequacy of skills in Ireland. They note "the top level professional skills in Ireland such as Accounting, Legal, Finance, Personnel etc. appear to be on a par with best practice competitor countries. The major gaps are in the areas of production skills, general management, and entrepreneurial skills."

128 Roger Fox, "Total Training Expenditure in Ireland: Initial Estimates", *Labour Market Review* Volume 1, No. 2, Winter 1990/91, FÁS.

129 J. Sheehan, 1992, "Education, Training and the Culliton Report". Policy Paper No. PP92/5 Department of Economics, University College Dublin.

In a recent study for the Council,[130] Hitchens and Birnie reviewed the evidence regarding skill levels, productivity and economic performance in Ireland compared to Denmark and the Netherlands, successful economies which share significant structural characteristics with Ireland. Skill differences are noticeable at all levels; shop floor worker, supervisor and manager. The findings from the matched plant studies are in line with the conclusions of the Industrial Policy Review Group: *there is a skills gap between Ireland and best practice firms in competitor countries.* Our shop floor workers tend to have far less formal training than their counterparts, who are usually apprenticeship trained. Dutch/Danish supervisors are also more formally trained and carry out a range of tasks which are usually undertaken by management personnel in Ireland. Irish management tends to focus heavily on the financial side of business, while their Dutch/Danish equivalents focus more on technological matters and developments in product and process. The important question is whether or not the different skill levels arising from different training practices affect performance. The matched plant studies suggest that they do; poorer quality skills, less attention to detail, inadequate supervision and quality control procedures, lower skilled management with poorer marketing and financial skills have all affected the quality and marketability of the Irish product. In particular, supervisor and management training needs to be improved. This led the Industrial Policy Review Group to recommend the linking of the provision of some publicly-funded services and aids to the willingness of firms to undertake management training.

Recent Irish education and training debates have identified flexibility and adaptability as key skills. Flexibility and adaptability emerge as key competencies which have been acquired by our competitors to a greater extent. Flexibility has various positive and practical implications; for example, it (1) allows for greater innovation in product type and product process; (2) promotes the addition of other skills throughout a person's working life; (3) shows benefits in a practical way as it results in fewer machinery breakdowns, because operators understand the basic mechanics of their machines, how to maintain them and how to carry out basic repairs. By contrast, the comparisons suggest that Irish indigenous industry is caught with a mismatch of skills. It can function, however, as long as relatively low costs, including low labour costs in line with low productivity, are maintained. Greater competition from newly-industrialising countries suggests that this is not likely to prove viable for much longer. At present the simple, low quality, standardised product range in many indigenous firms

130 Report in NESC Report No. 95.

in Ireland does not demand higher skill levels. However, this type of product does not guarantee long-run survival, expanded employment or higher living standards.

The study suggests that technical and vocational education and training are quantitatively and qualitatively different in Ireland. The qualitative difference has led to comparability problems as, for example, the fact that the proportion of workers qualified to technician level is reported to be equivalent to overseas competitors. Closer analysis reveals significant differences in the level of skills actually available. The recent changes in the Irish apprenticeship training system, from time served to standard based training, moves us closer to practice in Denmark and the Netherlands.

It is striking that the availability of skilled personnel has not constituted a barrier to the development of the largely foreign-owned high-tech sector in Ireland. On the contrary, the availability of such skills is one of the main attractions of Ireland as a base for such activities. This suggests that it is not enough to provide the skills necessary for efficient production. Skill shortages and emigration of skilled workers (in particular, engineering graduates) occur simultaneously. The pattern of demand for and use of skills reflects market and product characteristics. It also depends on the capacity of management to use a skilled workforce. It follows that product ranges and corporate and management strategies are key both to a firm's long-run success and to its demand for skills. The available evidence, confirmed by the study for the Council, suggests that **management development is the strategic priority in the development of education and training policies for economic development**. Unless senior managers are capable of taking the right strategic decisions on products and markets, they are unlikely to create the demand for, or use effectively the skills which the education and training system is capable of providing. Their knowledge of market trends, their technical capacity to identify necessary developments in products and processes and their knowledge of and capacity to use international best practice all need to be strengthened. In summary, the capacity of managers to initiate and manage change - in products, processes and markets - is central to overall economic performance. This in turn implies the capacity to identify opportunities and mechanisms to increase the skill base of the workforce, and changes in the organisation of work to enable the skills to be applied to best effect. The upgrading of human resource management skills and the development of a positive role for trade union representatives in the change process are important aspects of this approach.

These findings suggest that the satisfaction expressed by employers on the supply of skills in Ireland is misplaced and may be based on a lack of

awareness of the standards prevailing abroad. This suggests that the basic problem in training in Ireland is at management level; the ignorance of Irish managers of prevailing best practice abroad, and their consequent reluctance to invest in training as a source of productivity growth and competitiveness.

6. POLICY ISSUES

(i) Initial Education and Training

International education statistics suggest that while education expenditure in Ireland as a percentage of GNP is not out of line with international patterns, expenditure on both first and second level education is substantially below European averages, reflected in differences in pupil teacher ratios at first and second levels.

We have noted above that almost a quarter of those leaving school each year do so with either no qualifications whatsoever, or with the minimal Group or Intermediate Certificate. These school leavers are ill-equipped to compete on the labour market, and show high levels of unemployment and unstable employment patterns. About 45% of school leavers go on to further, post-secondary education. This suggests that there is a strong case for altering the balance of funding in initial education to reduce the outflow of poorly qualified young people from the education system. This is not to recommend increased resources across the board for initial education. Rather, it calls for a targeted and limited intervention to provide resources for schools serving disadvantaged children to encourage/facilitate them to remain in school through the senior cycle of second level. The funding could be used to reduce student/teacher ratios in specific schools and to promote curricular change, strengthen support services, fund other initiatives, such as the allocation of special teachers, and fund other interventions, such as the currently limited Home School Liaison Project.

The benefits of a strategy designed to reduce early school leaving would, of course, accrue over the long-term, and in the interim, labour market measures must remain in place to train the unemployed and meet current and prospective skill needs. However, failure to tackle the issue of early school leaving at the earlier stages of initial education will ensure the continued outflow of poorly qualified young people, ill-equipped to compete either in the labour market or for access to further education and training - generating continuing problems of social exclusion.

Enrolment in higher education in 1990-91 was about 70,000, while the Green Paper projected that enrolments would expand to 100,000 by the end of the decade; an increase of 30,000. Even to maintain the standards of provision would therefore entail substantial infrastructural investment. Given the evidence of unemployment among graduates, particularly at higher degree levels - albeit at much lower levels than among the less well qualified - the Council believes that such a major expansion of the system should take place in the context of structural consultation on a continuing basis with economic interests and should take account of forecasts of projected skill needs. While recognising that the forecasting of skill needs is extremely difficult given the openness of the Irish labour market, current and forecast skill needs should be reviewed frequently, and the direct economic impact of infrastructural investment should be maximised by providing infrastructure which is flexible, and whose use can therefore be changed as economic circumstances dictate.

The Council has made recommendations on a wide range of issues in educational policy, many of which arise from the Green Paper on Education. These are set out in NESC Report No. 95 and the Council's views on the principles to guide educational policy are set out briefly here.

(ii) Educational Policy

Ireland is unusual in not having an extensive legislative basis for the delivery of educational services. Whether for this or other institutional reasons the review of policy and performance over the long-run suggests that educational policy has tended to lack a certain rigour and coherence. **It is the Council's view that a more rigorous approach to the formulation of educational policy would result in more successful attainment of stated objectives.** The Council notes the steps currently being taken to address this issue.

The record suggests that, in the past, educational policy has not been based on a complete or coherent view of the educational process. Ad hoc initiatives and schemes exist at all levels, but there has been little linkage or continuity between the various initiatives. In particular, there is a need to reflect a more complete view of the education process in policy and practice, rather than treating each level as a self-contained unit.

(iii) The Teaching Resource

The most important resource in formal education is the teaching profession. New initiatives and programmes, as well as the successful implementation of educational policy, demand a well-prepared teaching staff. The success

of educational policy and of planned changes in policy depend on the capacity and co-operation of the teachers in the classroom. Similarly, the quality of the education received by children is heavily dependent on the performance of teachers, which in turn reflects the organisation and culture of schools. The qualifications and performance of the teaching profession in Ireland are widely respected as reflecting very high standards. Educational policy must ensure that this valuable teaching resource is developed and deployed to continue to provide a quality service and that effective mechanisms exist to support such quality. It is the Council's view, therefore, that in-service training should be an institutionalised, regular component of teacher training, rather than a facility provided at times of dramatic change.[131]

(iv) Local Education Structures

The Council supports the view that there is a need for local education structures, as a basis for more effective service provision and more efficient use of available resources. It is envisaged that local education structures would cover both primary and post-primary levels. The organisation of specialist services, on an area basis would allow for more efficient use of resources across a range of schools and services, as students' needs require.

Local education structures would also be of benefit in the face of demographic changes and falling student numbers. Schools may end up competing with each other for students and providing an inadequate service if the response to the demographic changes and the scope for integration or amalgamation are left to individual schools alone. A support and evaluation service could be provided through a local education structure to provide a structured basis for effective liaison with individual schools, especially as they embark on the provision of new vocational subjects and new programmes.

The Council is of the view that, in addition to developing appropriate school based educational strategies, greater emphasis must also be placed on the workplace as the other part of the school/work equation. One of the most strikingly distinctive features of the Irish vocational education and training system from an international comparative perspective is the limited amount of structured training which occurs in the workplace and the peripheral role of employers in the education and training system. The Council is of the view that it is necessary for a senior cycle option based on the senior

131 The Council notes the provision of £40 million in the National Development Plan in respect of in-service training.

certificate to emphasise and structure a link with employers and the labour market in order to ensure that the programme will not become a poor relation to the Leaving Certificate. Carefully designed and well planned programmes of study are essential, but they are not enough. Agreement amongst the social partners must safeguard the movement of young people with specific levels of education and training into appropriate positions in the labour market. Such an agreement would have a number of important beneficial effects: (1) it would recognise the value of all forms of education and training; (2) it would motivate employer interest and involvement in vocational education and training; and (3) it would restrict to some degree the rise in credentialism, which shuts off jobs to the least educated and under-uses skills acquired through the education system.

(v) Training of Those at Work

With regard to *continuing training*, the material reviewed above suggests that while Irish firms do not report a shortage of skilled labour, there is, nevertheless, evidence to suggest that Irish companies are poor trainers and that Ireland lags behind best practice abroad. Greater efforts need to be made to increase the level of training of workers in general and of management in particular. At least some of the skills training of the unemployed gradually upgrades the skills of the employed workforce - to the extent that trainees are subsequently hired.

As already stated, Ireland is unusual in terms of the limited amount of structured training that occurs in the workplace. This under-training permeates all skills levels; shop floor workers, crafts people, technicians, supervisors and management. Product ranges and corporate and management strategies are key to a firm's demand for skills. In the light of the evidence reviewed in this Report, **the Council recommends that public support for the development of indigenous enterprises should give priority to the development of managerial capacity in the areas of marketing and product and process development.** The Council therefore endorses the proposal of the Industrial Policy Review Group that appropriate commitments to undertake management and supervisory training should be a prerequisite for access to state services and aids.

There are particular categories of skills on the part of both management and the workforce generally whose development should be pursued as a priority, in parallel with an emphasis on management development generally. These include design, basic product and process R&D, and plant and machine maintenance. More generally, the development of technical

competence on the part of first-line supervisors is likely to represent a significant contribution to productivity. It follows that **the Council endorses proposals to shift the emphasis in public support to firms from general grant assistance to providing incentives for greater use of research and development, design and other business services and the development of in-house skills**.

The Council believes that the methodology of the matched plant analysis, described by Hitchens and Birnie in the Council's recent Report on education and training policies, should be applied across other sectors of the economy as a means of identifying the priorities for those providing and supporting management development programmes. Equally, the Council believes that individual firms and trade associations should take the initiative to ensure access to first-hand experience of the comparative strengths in products and processes of their best practice counterparts in other countries.

The Council notes with approval the detailed sectoral studies which are being conducted by FÁS as a basis for developing strategies to be pursued both by FÁS and by the industries concerned to develop the skills necessary for competitive success. The Council also notes that, under the National Development Plan it is anticipated that 275,000 employees will participate in structured training supported by the State training agencies. It must be acknowledged, however, that the impact of improvements in the education system and in continuing training are primarily experienced in terms of improved international competitiveness. As such they may contribute to increased employment and reduced unemployment in the medium to long-term. Such upgrading of skills should not be regarded as a solution to the immediate unemployment crisis.

(vi) Training of the Unemployed

Training of the unemployed is effective in reducing unemployment to the extent that there is a mismatch between the skills of the unemployed and jobs which are available or about to become available (NESC, 1990). Given the extent of labour surplus in Ireland, and the apparent absence of skills shortages, it is unlikely that training alone can eradicate Ireland's extremely high level of unemployment. Nevertheless, certain categories of the unemployed clearly do suffer from inadequate skills - mainly those who are poorly qualified. On this basis, it makes sense to provide training and education for the poorly qualified, particularly the poorly qualified long-term unemployed and early school leavers. Such training, however, represents primarily a policy of redistributing job chances, rather than reducing the absolute level of unemployment. Such policies are likely to be most effective in reducing the incidence of long-term unemployment.

It is central to the Council's strategy that greater effort be devoted to tackling long-term unemployment. Present policies are insufficient in scope and this points to the need for a rebalancing of some of the considerable resources now devoted to education and training, as well as some well-targeted initiatives. In particular, there is evidence of weakness in programmes targeted on marginalised groups - including women returning to work, early school leavers, and the long-term unemployed - in facilitating progression to further education and training. There seems little point in providing training programmes for those least well-equipped to compete in the labour market where the support simply ceases on termination of the training programme. The information from placement and tracking data indicates that, in general, marginalised groups experience the greatest difficulty in obtaining work on completion of training programmes. The return to unemployment, or withdrawal from the labour market, is likely to lead to the depreciation of whatever augmentation of human capital that was achieved on the course. The poor integration of programmes directed at marginalized and poorly educated groups with the rest of the education and training system represents a major barrier to the long-term success of interventions to assist disadvantaged people. The problem appears to relate to the certification system, the nature of course provision and the way in which courses are run. Reforms appear to be warranted in three areas: (1) Assessment and certification procedures need to be established to allow those who successfully complete a basic training course access to further education and training; (2) Appropriate courses need to be established and provided to those exiting from basic level "feeder" courses such as Alternance and Early School Leavers measures; and (3) Guidance and counselling on further education and training should be included as part of the curriculum of "feeder" courses. The proposal to establish a national education and training certification board represents an opportunity to address these issues.

Training policies to combat long-term unemployment must be combined with the creation of demand in the labour market *specifically targeted on the long-term unemployed*, if such training policies are to be effective. Accordingly, employment incentive and subsidy schemes that are so targeted, such as the Employment Incentive Scheme, should be maintained - otherwise training and placement programmes simply represent a break in a spell of unemployment, without generating any lasting effects for the participants. The Council has also recommended in Chapter 3 the creation of opportunities for meaningful work in meeting community needs for the long-term unemployed who have little realistic prospect of securing open employment.

CHAPTER 17

Health Policy

HEALTH POLICY

In *A Strategy for the Nineties*, the Council examined trends in health spending and analysed the proposals for reform which had been published by the Commission on Health Funding. The Commission's proposals and the Council's comments and recommendations both focused on policy strategies which might effectively reconcile the need, on the one hand, to address the demand for more and improved health care services while, on the other hand, containing health care costs within limits which are compatible with resource constraints, including constraints on public expenditure. These pressures do not change, nor are they confined to Ireland. This chapter outlines recent trends in health care policy and spending and reviews the scope for policy changes which could advance social goals in respect of health care. It begins, however, with a review of international trends and experiences which provide a useful context within which to view the range of policy options at home.

1. INTERNATIONAL TRENDS IN HEALTH EXPENDITURE

Ageing populations, new medical technology and heightened public expectations continue to place greater demands on health care systems worldwide. The evidence suggests that these causes add almost half a percentage point per annum to the growth of the health bill in OECD countries. Ireland is no exception to this trend and, as Table 17.1 illustrates, expenditure on health as a proportion of total domestic expenditure approximately doubled between 1960 and 1980. During the 1980s, however, health expenditure in Ireland stabilised and then declined. This downward trend, already in evidence in the early to mid-1980s, accelerated sharply from 1987/1988, with exchequer spending on health being held broadly constant in nominal terms from 1987 to 1989. The year 1990 marked a return to rising expenditure so that by 1991 exchequer spending on health was close to the OECD average and, indeed, was higher than in a number of more developed countries.

All western countries experienced very significant increases in public expenditure on health care over the past 25 years. This expenditure growth was associated with significant extensions in coverage of the population by publicly-funded health care programmes, which in turn was associated with the rising technical sophistication and higher quality of available health care, in turn increasing the unit cost of delivering health services. The rising health budget was accommodated by generally high and stable economic growth rates until the economic shocks of the oil crises of the 1970s prompted curbs in the rate of growth of public expenditure. This general downward pressure on expenditure levels was complemented by a growing concern that the benefits of health spending might not be increasing as fast as health spending itself.

TABLE 17.1

Health Expenditure Growth in the OECD Area 1960-1991

	Share of Total Expenditure on Health in Total Domestic Expenditure (%)				
	1960	**1970**	**1980**	**1990**	**1991**
Australia	4.8	5.6	7.1	8.3	8.6
Austria	4.4	5.5	7.7	8.4	8.5
Belgium	3.4	4.2	6.5	7.9	8.1
Canada	5.3	7.2	7.5	9.5	9.9
Denmark	3.6	5.9	6.7	6.7	7.0
Finland	3.8	5.7	6.4	7.8	8.9
France	4.3	5.9	7.5	8.8	9.1
Germany	4.9	6.0	8.4	8.8	9.1
Greece	2.6	3.7	4.0	4.9	4.8
Iceland	3.4	5.4	6.5	8.5	8.3
Ireland	3.8	5.1	8.1	7.6	8.0
Italy	3.6	5.2	6.6	8.1	8.3
Japan	3.0	4.6	6.5	6.7	6.8
Luxembourg	—	4.7	6.8	7.0	6.6
Netherlands	4.0	5.9	8.0	8.4	8.7
New Zealand	4.2	5.1	7.2	7.1	7.7
Norway	3.2	4.9	7.1	8.0	8.4
Portugal	—	3.0	5.1	6.1	6.2
Spain	1.6	3.6	5.4	6.4	6.5
Sweden	4.7	7.1	9.2	8.6	8.8
Switzerland	3.3	5.1	7.0	7.9	8.0
Turkey	—	—	3.7	3.8	4.1
United Kingdom	3.9	4.6	5.9	6.0	6.6
United States	5.3	7.4	9.2	12.2	13.3
Europe	3.7	5.1	6.8	7.5	7.8
OECD TOTAL	3.9	5.1	7.0	7.8	8.1

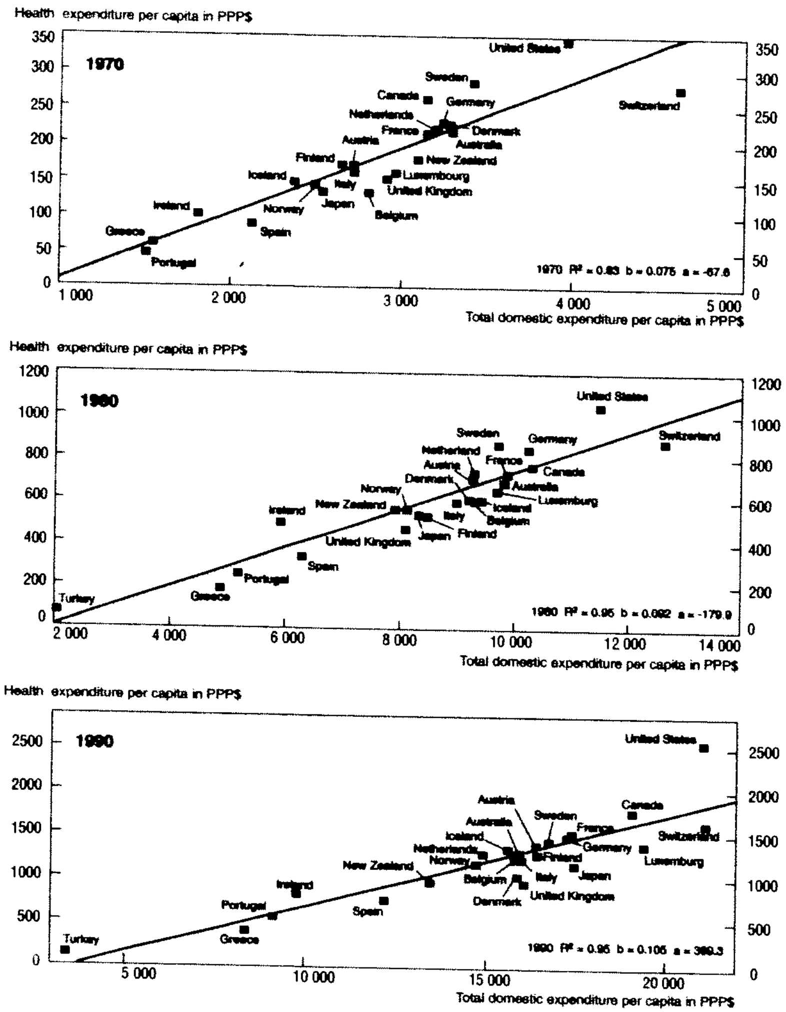
Source: *OECD Health Systems*, OECD 1993, Paris.

Nevertheless, over the long-run - a 30 year period since 1960 - the evidence suggests a strong correlation between the amount countries spend on medical care and the level of resources available to them. Figure 17.1 shows the relationship between health spending and total domestic expenditure per head. Given that the latter is an indication of living standards, the figure suggests a progressive convergence over time towards the trend line. Some countries, such as Ireland, diverge from this trend either temporarily or because of divergent social preferences or political choices. The progressive convergence towards the trend over time suggests the presence of somewhat similar policy choices in different countries which have the effect of keeping increases in health spending in line with available resources. These will be discussed below.

It must, of course, be remembered that definitions of the coverage of health expenditure are not standardised. International comparisons must therefore be viewed with caution. Nevertheless, the concentration of health to total expenditure ratios in the range of 7 to 8% suggests that the broad picture presented by these comparisons is reliable. Similar ratios of health expenditure do not imply uniformity of provision: Figure 17.2 shows the significant variation in health expenditure per head associated with similar ratios of total health spending.

FIGURE 17.1

Health Spending and Income per Capita



Source: OECD Health Systems, Facts and Trends, 1960-91.

TABLE 17.2

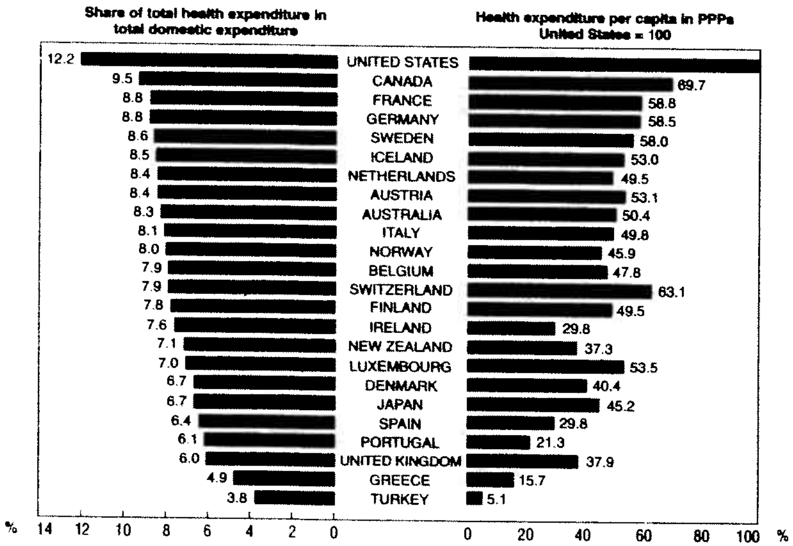
Elasticity Of Health Expenditure Growth in the OECD Area 1960-1991

	Elasticity of Total Expenditure on Health Growt Total Domestic Expenditure Growth		
	1960-70	1970-80	1980-9
Australia	1.08	1.21	1.11
Austria	1.27	1.45	1.13
Belgium	1.31	1.46	1.27
Canada	1.28	1.01	1.21
Denmark	1.47	1.05	0.93
Finland	1.46	1.12	1.16
France	1.31	1.20	1.19
Germany	1.32	1.44	1.11
Greece	1.31	1.05	1.12
Iceland	1.31	1.07	1.10
Ireland	1.37	1.17	0.96
Italy	1.48	1.07	1.16
Japan	1.30	1.27	1.03
Luxembourg	—	1.44	1.05
Netherlands	1.35	1.24	0.96
New Zealand	1.16	1.26	1.06
Norway	1.47	1.27	1.09
Portugal	—	1.20	1.1
Spain	1.63	1.21	1.0
Sweden	1.54	1.22	0.8
Switzerland	1.70	1.63	1.1
Turkey	—	—	1.0
United Kingdom	1.23	1.15	0.9
United States	1.41	1.21	1.3
EUROPE	1.37	1.25	1.0
OECD TOTAL	1.41	1.24	1.0

1. Elasticities are based on nominal (current) prices.
2. A few 1980-90 elasticities are projections of a likely outcome.
3. The elasticities are not always consistent over time due to discontinuities in the underlyin
4. The European and OECD averages are arithmetic. Both exclude Turkey and, Luxembourg and Portugal.

FIGURE 17.2

Distribution of Health Spending
1990



Source: OECD Health Systems, Facts and Trends, 1960-91.

The progressive convergence on the trend ratio of health to total expenditure implies successful efforts to limit the rise in health spending in response to increases in total national income. Table 17.2 shows that the elasticity of total health expenditure growth to total domestic expenditure growth declined progressively between the 1960s and the 1980s. In each decade, the elasticity of health expenditure in Ireland was below that of the OECD as a whole. The similarity of trends regarding total health expenditure disguises significant variations between countries in policies towards, and expenditure on various components of health care, reflecting historical, institutional and cultural factors. These will be referred to below.

TABLE 17.3

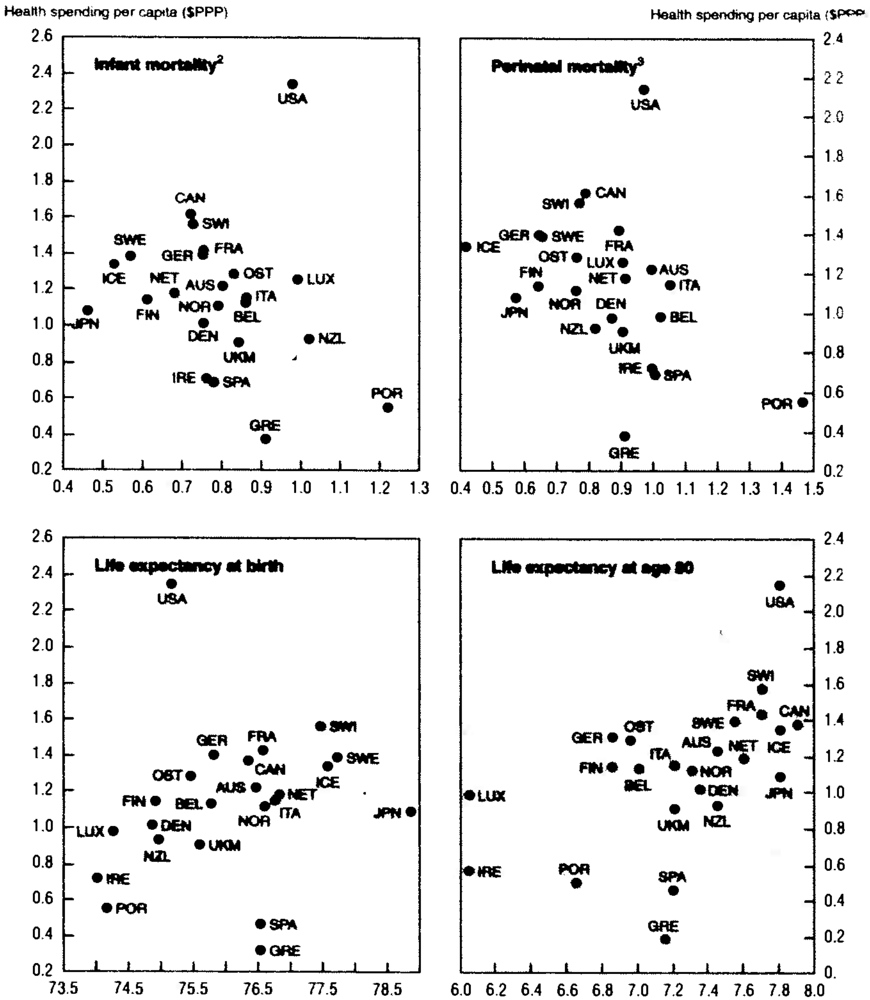
Prices and Volume in Health Expenditure Growth, 1980-1990
(Average Annual Rates of Increase, in %)

	Share of Total Expenditure on Health in TDE 1980	Nominal Health Expenditure Growth	Health Price Deflator	Total Domestic Expenditure Price Deflator	Medical Specific Price Increase	Health Care Benefits Volume Growth	Population Growth	Per Capita Health Benefits Growth	Share of Total Expenditure on Health in TDE 1990
Australia	7.1	11.8	7.6	7.3	0.3	3.9	1.5	2.3	8.3
Austria	7.7	6.6	5.1	3.7	1.4	1.5	0.2	1.2	8.4
Belgium	6.5	7.9	4.9	4.2	0.6	2.9	0.1	2.7	7.9
Canada	7.5	10.7	6.9	5.1	1.8	3.5	1.0	2.5	9.5
Denmark	6.7	7.2	6.1	5.9	0.2	1.0	0.0	1.0	6.7
Finland	6.4	12.7	8.8	7.1	1.7	3.5	0.4	3.1	7.8
France	7.5	10.4	5.2	6.2	-0.9	5.0	0.5	4.5	8.8
Germany	8.4	5.0	3.4	2.6	0.7	1.5	0.3	1.2	8.8
Greece	4.0	22.6	16.9	18.3	-1.2	4.9	0.5	4.4	4.9
Iceland	6.5	40.1	32.9	32.3	-0.2	5.4	1.2	4.2	8.5
Ireland	8.1	7.7	9.1	6.8	2.2	-1.3	0.3	-1.6	7.6
Italy	6.6	14.8	10.7	10.0	0.6	3.8	0.2	3.5	8.1
Japan	6.5	6.0	2.4	1.5	0.9	3.6	0.6	3.0	6.7
Luxembourg	6.8	8.7	5.4	5.0	0.4	3.2	0.4	2.8	7.0
Netherlands	8.0	4.4	2.5	2.0	0.5	1.8	0.5	1.3	8.4
New Zealand	7.2	12.3	11.5	9.8	1.6	0.6	0.7	-0.1	7.3
Norway	7.1	10.0	7.1	7.2	-0.1	2.8	0.4	2.4	8.0
Portugal	5.1	22.6	17.5	17.1	0.4	4.3	0.0	4.3	6.1
Spain	5.4	14.4	9.3	8.9	0.4	4.6	0.4	4.2	6.4
Sweden	9.2	8.9	7.1	7.6	-0.6	1.7	0.3	1.4	8.6
Switzerland	7.0	7.1	4.4	3.5	0.9	2.6	0.6	1.9	7.9
Turkey	3.7	51.7	47.9	45.0	2.0	2.6	2.4	0.2	3.8
United Kingdom	5.9	9.8	7.6	6.1	1.3	2.1	0.2	1.9	6.0
United States	9.2	10.4	6.9	4.1	2.7	3.3	1.0	2.3	12.2
EUROPE	6.8	12.3	9.1	8.6	0.5	2.8	0.4	2.5	7.5
OECD TOTAL	7.0	11.8	8.7	8.0	0.7	2.9	0.5	2.4	7.8

1. Medical-specific inflation is defined as the excess of health care price increases over those on goods and services.
2. A few 1990 ratios and 1980-90 rates are projections of a likely outcome.
3. The underlying statistical series are consistent for the full decade but unobserved discontinui cannot be precluded.
4. The European and OECD averages are arithmetic. Both exclude Turkey.

FIGURE 17.3

Health Spending and Health Outcomes[1]



1 The level of health spending per capita for individual countries can vary between the diagrams as the end year of the health indicators is not always the same.

2 Deaths in the first year per thousand live births.

3 Number of late foetal deaths (after 28 weeks of gestation) plus infant deaths within seven days of birth divided by the number of live births plus late foetal deaths.

Source: OECD, (1992) Progress in Structural Reform: An Overview.

The rate of increase in health expenditure slowed in the 1980s as countries had by then achieved near - universal coverage of health care programmes. However, health spending remained sensitive to trends in unit costs as well as to improvements in the quality of services available. Table 17.3 shows that Ireland and Sweden were the only two countries in which total health expenditure fell as a share of domestic expenditure in the 1980s. Ireland also had, after the United States, the highest rate of medical-specific price increase in the 1980s. As a result, both the total volume of health care services and the per capita consumption of health benefits in Ireland fell during the 1980s, the only European country where this occurred. However, the share of total spending devoted to health, although equal to the OECD average in 1970, grew 1½ times faster in the 1970s than in the OECD area as a whole. The reduction in the 1980s reflected the efforts to arrest the rate of increase in expenditure, as well as the more general need to restore fiscal balance.

Concern that improvement in health should be roughly proportionate to increases in the level of health spending has played a significant role in shaping the design of policy in many countries. While indicators of health outcome are underdeveloped, those that are available - such as infant and perinatal mortality and life expectancy at birth and at age 80 - show steady improvement, although at a slower pace in the 1980s compared to the 1970s. Figure 17.3 shows that the relationship between health spending per head and the infant and perinatal mortality indicators is rather weak, although there is a considerably stronger relationship between health spending and life expectancy, especially among the elderly. Spending in other areas is obviously equally relevant.

2. POLICY MEASURES TO CONTROL HEALTH EXPENDITURE

As noted above, the slow-down in the rate of increase in health expenditure in the 1980s may have been associated with limited scope for furthe coverage of the population. However, it is clear that policy measures als contributed significantly to this outcome. One example of this relates to th acute hospital sector, where the combination of financial pressure and mor sophisticated medical technology induced governments to rationalise th number of hospital beds, with significant consequences for the type c hospital care provided, as shown in Table 17.4.

Changes such as this reflect underlying changes in the institution arrangements governing the planning and delivery of health care. These i turn have resulted from concern at the long-established trend for increase health expenditure and also from evidence that institutional arrangemen can have significant effects on spending levels. For example, Gerdtham, (1991) provides evidence to suggest that health systems with a larger public expenditure component tend to have lower, rather than higher *total* health spending, with every 1% increase in the share of public health expenditure associated with a decrease of 0.23% in per capita health spending. Similarly, Gerdtham suggests that countries operating fee for service payment systems tend to have expenditure levels which are, on average, 12% higher than those which do not.

TABLE 17.4

Trends in Acute Hospital Care

	Beds per 1000 Inhabitants		Admission Rates		Length of Stay		Occupancy Rates	
	1980	1990[a]	1980	1990[a]	1980	1990[a]	1980	1990[a]
Canada	4.7	4.5	11.7	13.3	8.2	8.9	78.0	80.3
Denmark	5.7	4.7	17.6	20.5	9.1	6.6	76.5	80.4
Germany	7.7	7.3	16.3	18.7	14.9	12.4	83.3	85.2
Ireland	5.6	3.4	17.6	14.9	9.7	6.9	79.2[b]	85.1
Netherlands	5.2	4.3	11.2	10.3	14.0	11.2	83.5	73.2
Norway	5.4	4.2	14.3	14.4	10.9	7.8	79.3	77.1
Switzerland	7.2	6.5	13.6	13.6	14.2	13.4	77.9	79.8
United States	4.4	3.8	15.9	12.4	7.6	7.3	75.4	66.8

a Or last year for which the data are available.
b 1982.
Source: OECD, Table 1.

A recent review (OECD, 1992a) has examined the experience of seven countries (including Ireland), which introduced health care reforms during the 1980s. A number of patterns emerge from the analysis. Firstly, countries with health care systems which still had significant reliance on reimbursement of patients for medical bills, with no connection between the providers and the insurers or third-party payers, had most difficulties with cost containment. Countries where health care was mainly delivered by providers who were independent of but contracted to third-party funders often suffered from lack of competition and excessive regulation. Countries characterised by ownership and management of health care providers in an integrated, public service model tended to suffer from managerial inadequacies and lack of responsiveness to consumers. The characteristics of each country's system reflected historical patterns of development.

Significantly, the reforms undertaken during the 1980s in the seven countries studied addressed key features of this institutional inheritance, but none attempted any reduction in the scope of public coverage for health care needs.

Despite some resort to cost-sharing with patients, most of the reforms which aimed at containing costs were concentrated on the supply side. In particular, the determined application of prospective, global budgets especially for hospital expenditure was a strong common theme. More generally, the reforms examined in that review represented a combination of tighter central control of public expenditure; alterations to health system structures in order to link resources more closely to performance; supply-side controls, such as reduction in the capacity of the hospital system; and the introduction of a range of micro-efficiency measures, such as case-mix management and contracting for services. These trends have been associated with greater reliance on a strategy of formal contracting between health care providers and third-party funders, including the State. The principal objective has been to preserve limits on overall expenditure, while enhancing the quality of care and patient choice, and linking payments to providers more closely to the type and quantity of services provided.

While the details of the reforms vary significantly from one country to the next, their common characteristic is that they seek to stimulate competition between providers in order to maximise the efficiency with which health care resources are used, while preserving overall public regulation and guaranteeing access to necessary health care. In order to achieve this goal, contracts for delivery of health care place service providers on an objectives-based, monitored and not necessarily renewable form of funding. Their effectiveness, therefore, depends upon (i) the adequacy of the statement of objectives formulated by those funding services, (ii) the extent to which performance can be and is monitored across the various relevant dimensions, and (iii) the extent to which non-renewal of funding or other penalties can credibly be applied. A particular challenge arises from the tension between encouraging the innovation and variety which competitive pressures should produce, while preserving the effectiveness of strong central control over aggregate health spending. For example, contracts which seek to control unit costs, such as payment in respect of episodes of hospital care on the basis of the patient's diagnosis may be effective in controlling unit costs, but on their own they would not prevent increases in total hospital expenditure unless the *number of admissions* was simultaneously controlled.

It is clear that the international search for effective institutional, information and remuneration arrangements will continue in response to a variety of pressures, including the effects of demographic change, the continuing flow of medical advances, the pressure of rising expectations, the continuing pressure on public expenditure, and changes in the nature of demand associated with, for example, new disease entities such as Aids, or with the consequences of increased female labour force participation.

3. HEALTH CARE POLICY IN IRELAND

In the light of this review of international trends and issues, the Council's conclusions in *A Strategy for the Nineties* will be examined. Account will also be taken of developments in policy of the last couple of years.

Firstly, the Council's view that private health systems are less efficient at expenditure control than public systems is borne out by the international evidence. The Council argued that there is a strong case on **efficiency** grounds for substantial non-market allocation in health, not least because of the absence of the basic preconditions for the efficient functioning of a market for health care. The Council rejected the principal alternative method of funding, namely private health insurance. It did so primarily on efficiency grounds, given the rising administrative costs, especially information costs, and the tendency for volume increases to recoup the unit price reductions which may be associated with private insurance. By contrast, publicly financed services which are largely free at the point of use can compensate for the lack of consumer information which inhibits the funding of private markets in health care. The pervasive problems of lack of insurance or inadequate cover on the part of the poor or the chronically ill cannot arise in a tax-based system. Furthermore, despite the thrust of some public debate, administrative costs are likely to be lower in a tax-based system. Finally, the allocation of resources for health care can be directed *as a matter of policy* towards reducing the strong differentials in health status which exist between socio-economic groups. This includes the targeting of services and their redesign to benefit those socio-economic groups with systematically lower levels of health and higher premature mortality rates. A centrally-managed, publicly funded health care system is also more likely to secure a reorientation of services away from institutional care towards community care, and from acute care towards chronic care, in line with the needs of patients and the implications of analysis of best practice in the delivery of care.

On grounds both of equity and efficiency, therefore, the Council reaffirms its support for a continuation of health care primarily based on public finance through a progressive general tax base.

With regard to *eligibility* for publicly-funded services, the Council welcomes the abolition of the three-tier system of eligibility which previously applied. The former Category (III) - under which persons above a certain income were entitled to free accommodation in public wards of public hospitals but were liable to pay their hospital consultant - was inequitable and institutionalised unequal access to public hospitals. This change, allied to changes in the organisation and management of hospital services discussed below, should enable greater efficiency and greater equity to be achieved in the acute hospital system.

The Council does not support universal entitlement to free primary care services. It considers that the cost of providing general practitioner services and the cost of prescribed drugs, taking account of the drug subsidisation scheme, does not represent a significant burden, such as is likely to deter utilisation of necessary health care, for most non-medical card holders. However, the Council considers that the primary care services available to the population outside the medical card category require review in two respects. Firstly, the boundary between Categories (I) and (II) should be reconsidered. At present, the value of a medical card may figure significantly in the evaluation of the net return from employment on the part of an unemployed person. When account is taken of the value at market prices of the services typically received by a medical card holder and his/her family, it is clear that the potential loss of a medical card may constitute a significant element of the unemployment trap. Furthermore, the security and peace of mind associated with guaranteed access to valued medical services may have a greater influence on behaviour than their cash equivalent would suggest. The Council notes that the income guidelines for granting a medical card are now applied on income net of PRSI, rather than a gross income basis. Furthermore, discretion exists for the issue of a medical card even when the income guidelines are exceeded if hardship would otherwise arise. Nevertheless, the Council favours a review of the income guidelines for grant of a medical card as part of its over-riding concern to remove obstacles to rapid employment growth. The Council recognises that any extension of medical card eligibility will have a cost implication for the Exchequer. Such cost implications must be adequately assessed and given due weight before any decision should be made on increasing medical card eligibility. However, at least part of the cost implications could be addressed by limiting the extent to which possession of a medical card confers automatic entitlement to other, non-medical services. Furthermore, the cost implications could also be reduced somewhat by addressing the second of the Council's concerns in this general area.

Under the Long-Term Illness Scheme persons suffering from one or more of a list of illnesses are entitled to obtain, free of charge and irrespective of income, necessary drugs or appliances prescribed for them. Under the Refund of Drugs Scheme, health boards refund the excess over £32 per month spent by non-medical card holders on prescribed drugs. The Council considers that subsidisation of drug costs should be designed to keep liability for drugs expenditure down to a reasonable level. The Council considers that it is anomalous that this level should vary depending on the category of illness concerned. The Council proposes that drug costs be met either through a medical card, where low incomes warrant this approach, or else subsidised through the Refund of Drugs Scheme. The cost of the Long-term Illness Scheme in 1992 was £11.8 million and a significant saving might be anticipated from its integration with the other drug schemes, which could be applied towards the cost of a modest adjustment in income guidelines for grant of medical cards..

With regard to *efficiency* the Council recommended in *A Strategy for the Nineties* that hospitals should receive budgets based on their service role and their geographical catchment area. This would be based upon a **case-mix analysis**, under which their activities would be classified into diagnostic related groups (DRGs), enabling hospital budgets to be based on actual levels of activity and costs. The Council recommended that this approach to hospital budgeting be complemented by **clinical budgeting** within the hospital system. This requires that providers of services be given budgets which are appropriate for the quantity and type of services which they are expected to deliver and that they be allowed the discretion to deploy the budget flexibly to produce services to the required standard. The development of explicit hospital budgets reflecting case-mix and the operation of clinical budgeting within hospitals would be in line with the international trend towards the use of explicit contracts linking resource allocation and service provision. The use of the budget allocation system to promote competition and efficiency is a way of harnessing market-type pressures for efficiency to activities which are necessarily outside the market. The extent of the present variation in unit costs between institutions and practitioners, for example with regard to average length of stay for specific procedures or the proportion of surgery for particular conditions carried out on a day rather than an in-patient basis, suggests that increased efficiency can be achieved without sacrificing quality of care.

However, to achieve greater efficiency through the budgetary process and through improved contracts for services reliable information on the cost of activities and their outcome must be available. Without reliable, standardised information the results achieved may be no better, and may

indeed potentially be worse than allocations based on historical patterns or other arbitrary influences. Without confidence in the information upon which explicit allocations and rationing are based, the allocation system itself may be called into doubt. Furthermore, the use of formal contracts, which link the quantity and types of services to be provided to a given budget, involves a significant shift in the culture of health care provision. Rationing decisions are currently largely implicit rather than explicit, patient - rather than service - based, and legitimised by clinical judgement rather than by formal budget criteria. In an explicit budgeting situation, clinical judgement is required to tailor consumer demand to the contracted supply of health care. As Salter (1993) points out, the legitimacy of the priorities and allocations explicitly made by public authorities, rather than implicitly by clinical practitioners, may come into doubt. The reliability and validity of the information upon which decisions are based will be a minimum requirement for public acceptance of such arrangements. Paradoxically, however, information on activity levels, costs and outcomes are likely to be credible and reliable only when they are *in fact* relied upon for resource allocation purposes. The Council therefore welcomes the gradual progress which has been made towards the application of the case-mix approach to setting hospital budgets. The Council notes that in 1993 there was a small adjustment in allocations to the larger hospitals on the basis of case-mix criteria and that it is intended that the amount of the adjustment will be increased on a phased basis over the next 3-4 years. The Council endorses this approach. The Council also notes the provisions in the new contract for hospital consultants which facilitate the introduction of clinical budgeting and related arrangements. However, in the Council's view there are strong grounds for accelerating the establishment of transparent arrangements for evaluating health care information and performance. The Council endorses the central importance assigned by the Commission on Health Funding to the role of good quality information. The Council recommends that priority now be accorded to establishing arrangements which will validate the process by which information becomes a basis for resource allocation within the health care system.

With regard to *organisational structure*, the Council in *A Strategy for the Nineties* accepted the critique of the organisational structure of the health services put forward by the Commission on Health Funding, but did not offer a definite view on the specific structure which should replace it. It argued then, and repeats now, that it is essential that the structure should facilitate the planning and management of the system as a whole and should allow appropriate autonomy to apply national policies in a local context. In addition, the structures should have effective representation from service users.

One of the principal organisational problems identified by the Commission was the sizeable proportion of the hospital system not integrated with the rest of the health care service in its area, but dealt with and funded directly by the Department of Health. The voluntary and independent public hospitals are concentrated in Dublin and Cork. The arrangements for delivery of acute hospital services in both cities have recently been the subject of reviews which confirmed the inadequacy of present arrangements, especially the absence of explicit statements of service roles for hospitals in the budget allocation process and the isolation of these acute hospitals from other services in their catchment area. The Council notes that it was announced in 1991 that reorganisation would take place arising from the reports of the Commission on Health Funding, the Dublin Hospital Initiative Group, the efficiency review of acute hospitals and the Advisory Expert Committee on Local Government Reorganisation and Reform. It was proposed then that a single new authority would be appointed to be responsible for all health and personal social services in the Dublin Region taking over the present functions of the Eastern Health Board, as well as some of the functions of the Department of Health. The services would be managed in the region through 5 local area units, which would contract with voluntary bodies for the provision of services. It was envisaged that the Department of Health would be freed from its involvement in the management of individual services, allowing it to concentrate on the setting of overall health objectives, the negotiating of resources, the determination of financial allocations for the new authority and the other regions, and the evaluation of service and financial performance against national objectives. It was announced that the health board structure in the rest of the country would remain, but that legislative amendments would clarify the roles, relationships and accountability of health board members, their Chief Executive Officers, the Minister and Department and the other agencies involved in the delivery of services.

The Council recommends that action be taken as a matter of urgency to provide a clear legislative basis for the efficient management of the health care system and that definite arrangements be put in place at an early date which reflect the principles set out above and which promote the efficient delivery of care.

With regard to the *public/private* mix in health care, the Council recommended that privately financed care should have a role which is complementary to the public system. The Council recommended a continuation of provision for private care in public hospitals, but without subsidisation by means of inappropriate tax allowances or under-pricing of

private care. Access to hospital care should be based on need, rather than on patient status.

The Council welcomes the arrangements announced in 1991 and introduced under the Health (Amendment) Act to control and identify more clearly the level of private practice in public hospitals. This is being achieved by confining private practice, in general, to designated beds in private and semi-private accommodation. The designation of beds for private practice is required to take account of the level of demand from public patients, ensuring ready access to necessary care for public patients. Furthermore, under the revised contract for hospital consultants, the extent of private practice is reflected in the remuneration arrangements and the balance between services to public and private patients is supported by the provision that consultants furnish an annual practice plan to the hospital authorities. These arrangements are subject to routine monitoring and changes in the designation of beds, as between public and private use, require the approval of the Minister for Health. While it is premature to evaluate the impact of these arrangements, the Council considers that they should have the effect of ensuring equal access on the basis of need to the separate categories of public and private patient. It will be a matter for ongoing review to ensure that the proportion of beds designated as private in individual hospitals ensures this parity of access.

As noted earlier, changes have also been made to the conditions of eligibility for hospital care, so that the entire population is now eligible for free treatment in public ward accommodation. Furthermore, increases in the charges levied for private accommodation in public hospitals are reducing the degree of cross-subsidisation of private patients in public hospitals. The principal element in the proposals of the Commission on Health Funding for greater equity in the public/private mix which has yet to be acted upon is the abolition of tax relief on health insurance premia. The Commission argued that this was desirable on equity grounds and that it would not require an increase in public expenditure on health services in order to meet the needs of the population. The Council endorsed this approach in *A Strategy for the Nineties*, but urged caution with regard to the cost implications of abolition of tax relief, not least in terms of uncertainty regarding the likely continuing demand for health insurance in the absence of tax relief. Nolan (1991) has clarified some of the issues involved. A survey of VHI members revealed that the majority subscribe in order to guarantee security and speed of access to quality care. In the context of reduced health care budgets and a reduced public hospital bed stock during the 1980s, it is not surprising that this motivation resulted in an increase in VHI enrolment, despite higher premia.

Furthermore, in the early 1980s higher marginal tax rates on average earnings reduced the net cost of VHI membership. Reductions in marginal tax rates have increased the net cost of VHI membership in recent years, but the perception of continued pressure on the availability of hospital treatment has sustained membership. It follows that the effect of the abolition of tax relief on VHI enrolment would be mediated by the perceived availability of free public treatment. Should the VHI's effective monopoly of health insurance prove unsustainable as a result of liberalisation of insurance markets, and in particular, if community rating cannot be secured as the basis for health insurance for the future, the real cost of insurance for elderly and other high risk patients could rise significantly. The total numbers insured for private treatment might, however, remain unchanged. Whether those with the greatest health needs would continue to be insured would depend on the real cost of insurance premia and the perceived availability of good quality public care.

On balance, the Council considers that the pressures on public health expenditure are such that waiting times for public hospital treatment in *non-urgent* cases will not decline to those of private care. The majority of those on relatively high incomes who value speedy access and other aspects of private care are likely to continue to be insured, even at a higher net real cost. When allied to the negative implications for equity of allocating health care resources by way of tax expenditures to subsidise VHI members, rather than through the public health system for the population as a whole, the Council is of the view that tax relief on health insurance should be restricted and the additional revenue applied to the public hospital system to meet the costs of the likely additional demand for public care. The restriction of tax relief on health insurance accords with the Council's overall approach to tax reform, but the Council's position is based primarily on considerations of equity and efficiency within health policy. However, the Council believes that, in view of the changing situation arising from liberalisation of insurance markets, the implementation of this recommendation should take account of the implications for the Exchequer of the timing of reductions in tax subsidies.

The Council's approach to health policy has favoured the development of community-based services[132]. The Council has argued that the consequent restructuring of health care, which necessarily entails reallocation of resources, requires management, organisational and other changes. The Council accepted that in specific instances increased expenditure in the

132 See NESC Report No. 84, 1987.

short-term might be justified to facilitate transition situations or new initiatives, but only where long-term savings have been clearly identified and quantified. The Council notes the commitment under the PESP to a seven-year programme to effect developments in community-based and associated programmes, in accordance with settled policy objectives.

The Council has noted that public financing of health services does not automatically entail direct public production and provision. In community care services, substantial provision is by voluntary organisations in receipt of full or part public funding. It is therefore vital that the arrangements governing the relationship between state agencies and voluntary bodies should serve to maximise efficiency, flexibility and effectiveness. Faughnan and Kelleher (1993) present evidence that the lack of a policy framework may be frustrating that objective in many cases, while Mulvihill (1993) demonstrates that there may be difficulties at an operational level even when, as in the case of the care of the elderly, a reasonably well developed framework exists. The Council notes that a Charter for Voluntary Organisations is currently in preparation under the aegis of the Department of Social Welfare. The Council believes that more effective arrangements for co-operation between the voluntary and statutory sectors are important not only for the development of community care services, but also for initiatives such as the area-based approach to tackling social exclusion set out in Chapter 13.

4. IMPROVING HEALTH STATUS

It is a matter of concern to ensure that the substantial resources devoted to health care are reflected in improved health status and equitable access to and utilisation of health care for the population as a whole, as well as for the various priority groups. In Ireland, as in many OECD countries, significant health gains have undoubtedly been made, in the form of lower periods of disability, longer spells of healthy life for most older people, reduced pain and suffering. Length of stay in hospital is declining and day surgery is increasing its share of unavoidable invasive procedures. In several areas, invasive procedures, in turn, are yielding to less-invasive and non-invasive therapies.

Trends in avoidable premature death shown in Table 17.5, reveal encouraging declines for the Irish population, with relatively high potential male and female years gained in Ireland between 1960 and 1989 compared to the OECD as a whole. Despite this progress, life expectancy at birth in Ireland is among the lowest in the OECD and has shown relatively little increase over the past thirty years. A similar pattern is evident in terms of life expectancy at ages 40 and 60. Indeed, life expectancy for men aged 60 has actually declined since 1960. An indication of the reasons for this relatively poor health status can be found in the causes of premature deaths in Ireland. Diseases of the circulatory system account for a very substantially higher number of premature death of both males and females in Ireland relative to most other OECD countries. Cirrhosis of the liver among males and breast cancer among women are also strikingly more common causes of premature death in Ireland than elsewhere.

This suggests that health policy in Ireland should focus more effectively on the development of positive health, with health promotion strategies targeted on those forms of behaviour - such as diet, smoking and alcohol - which are clearly implicated in Ireland's relatively low overall status. It is the Council's view that a strategy of prevention is likely to be far more effective, as well as far more sustainable, than one which emphasises treatment of individuals for the advanced symptoms of an underlying unhealthy lifestyle.

This is not to say that achievement of a more healthy population is not dependent on the efforts of the health care system. For example, the relative significance of breast cancer as a cause of premature death among Irish women suggests significant scope for enhanced screening, diagnosis and treatment services.

Thusfar attention has been primarily focused on trends for the population as a whole, giving us little indication of variation by socio-economic group. Regarding health status, Table 17.6 presents the pattern of self-reported illness across the various social classes.

TABLE 17.5

Declining Trends in Avoidable Premature Death, 1960-1989
(Years gained per 100,000 female population or per 100,000 male population, ages 0-64)

	Female Life Years Gained	Male Life Years Gained
Australia	2935	3967
Austria	4928	6632
Belgium	3416	4995
Canada	3654	5233
Denmark	2013	2139
Finland	3349	5128
France	3299	3919
Germany	4519	5931
Greece	5231	5129
Iceland	1655	4296
Ireland	4456	4602
Italy	6321	7423
Japan	6825	8398
Luxembourg	3967	4631
Netherlands	1998	2838
New Zealand	2551	2912
Norway	2070	3369
Portugal	11619	12500
Spain	5353	5522
Sweden	2353	2766
Switzerland	2785	4045
Turkey	—	—
United Kingdom	2606	3868
United States	3207	4321

Note: (a) The entries for Australia and Spain apply to the period 1960-1988, for Belgium to 1960-1986, for Greece to 1961-1989, for Luxembourg to 1967-1989.
(b) The differences shown need to be interpreted with caution, as the starting levels were very dissimilar.

Source: *OECD Health Systems*, OECD 1993, Paris.

TABLE 17.6

Physical Illness and Social Class by Age Range

Percentage Reporting Major Illness by Age Range	Social Class					
	Higher Professional	Lower Professional	Other Non-Manual	Skilled Manual	Semi-Skilled Manual	Unskilled Manual
15-34	5.1	2.9	5.3	9.2	7.9	10.0
35-44	5.6	5.8	9.4	11.2	15.4	12.3
45-54	11.0	13.0	16.7	19.2	23.5	27.0
55-64	23.5	22.0	28.2	28.9	32.6	44.7
65 and Over	21.8	33.6	30.8	37.6	36.3	33.4
All	10.5	10.5	13.9	17.0	19.0	24.6

Source: B. Nolan. *The Utilisation and Financing of Health Services in Ireland.* ESRI No. 155, 1991.

There are significant differences in the health status of different socio-economic groups. As Table 17.6 shows, Nolan found that the two professional/managerial classes have fewer than average reporting illness, at about 10%, and the percentage then rises steadily with declining socio-economic status to reach 25% for the unskilled manual class. Although this is partly attributable to the fact that there are relatively few elderly people in the professional/managerial group, the table also shows that the relationship between reported illness and social class generally persists within age ranges. It is least pronounced for the elderly, but for other age groups the unskilled manual class has about twice as many reporting serious illness as the professional/managerial classes. Similar results are reported in respect of psychological health status.

In summary, sharp differentials across the social classes in the percentage reporting chronic and psychological illnesses are evident: as in other countries, those from semi-skilled and unskilled manual backgrounds are considerably more likely than others to report such illnesses. These results have major implications for the analysis of influences on health service utilisation, and it is to this analysis that we now turn.

Income, occupation, socio-economic background, social class and educational level are generally regarded as significant influences on demand for and utilisation of health services. Income obviously affects ability to pay in systems where the patient is charged for GP visits etc., and would therefore be expected to be related positively to demand. However, as noted above, health status is inversely related to income, with those on lower incomes

experiencing more illness. Occupation, socio-economic background, social class and education affect demand because they act as proxies for permanent or long-term income, and partly because they may be related to willingness or ability to seek care.

Returning to Nolan's study, the overall variation in GP visiting rates by social class, and the extent to which these persist within age groups, are presented in Table 17.7. The average number of GP visits increases steadily with declining social class position, from two visits for higher professional/managerial to just under five visits for the unskilled.

TABLE 17.7

Average GP Visiting Rates by Social Class and Age

Age Range	Higher Professional	Lower Professional	Other Non-Manual	Skilled Manual	Semi-Skilled Manual	Unskilled Manual	All
Under 5	2.8	2.7	3.1	3.4	2.6	3.1	3.0
5-24	1.3	1.0	1.8	1.7	1.9	2.0	1.7
25-64	2.3	2.3	3.1	4.1	4.7	6.6	3.9
65 and over	4.6	5.0	5.5	7.6	8.6	7.5	7.0
All	2.1	2.1	2.7	3.4	3.8	4.8	3.2

Source: B. Nolan. *The Utilisation and Financing of Health Services in Ireland.* ESRI No. 155, 1991.

Significant differences in the age composition of the social classes contribute to these sharp differentials. However, significant differentials persist *within* age ranges, the largest being for persons aged between 25-64, where the unskilled manual category has on average 2½ times the number of visits of the higher professional class. Classifying by broad socio-economic group, farmers etc. have an average visiting rate similar to that of other non-manual/skilled manual groups, at about 3 per year, well below that of the unskilled manual group but higher than the professional/managerial group.

Similarly with regard to the utilisation of hospital services, classifying persons on the basis of the income of their households reveals that those towards the bottom of the income distribution were more likely to have had an out-patient visit than those at higher income levels. This remains the case when income levels are adjusted for household composition, though the differences are much less marked. Analysing use of hospital services by socio-economic group and social class, there are two principal features.

Those from a farming background were less likely to have had an out-patient visit than others, and those in the professional/managerial groups had relatively few visits. These results are largely to be expected given that the number of out-patient visits is likely to be positively correlated with the number of GP visits. However, these differentials do not hold for hospital in-patient stays, since there is no strong relationship between income level and the number of admissions or the average number of days spent in hospital. There is also little variation in overall levels of utilisation across socio-economic groups or social classes, even when controlling for age. It is striking that although lower socio-economic groups report a considerably higher incidence of physical and psychological ill health, their usage of in-patient hospital care is broadly in line with that of other socio-economic groups.

In conclusion, the evidence presented suggests that growing expenditure on health care in Ireland has been accompanied by a corresponding rise in the health status of the population as a whole as reflected, for example, in the significant decline in avoidable premature deaths. However, indicators of health status suggest that, overall, there is scope to improve very significantly the health of the population. Furthermore, sharp differentials across the social classes in the percentage reporting physical and psychological illnesses are evident - with semi-skilled and unskilled manual social classes considerably more likely to report such illnesses. Such differentials in health status are, however, largely reflected in differential utilisation of GP and hospital out-patient services which, the Council believes, is a positive reflection of the accessibility, availability and equity of the health care system. The Council is of the view, however, that the pursuit of equity in health care requires much more comprehensive measures of health status, and ideally of capacity to benefit from health care. Comprehensive survey-based information on health status, which could be related to the socio-economic status of the respondents and to their use of the health services, would be one of the most important means of addressing gaps in our knowledge. For this reason, the Council believes that such survey research, combined with other epidemiological data, should be a major component of the improved information system which it has identified as a requirement for more effective health care planning and delivery. More generally, the Council believes that a preventive strategy should inform health policy-making to a greater extent than in the past. The Council notes that a health strategy document is being prepared at present by the Department of Health and recommends that the implications of a more preventive approach should be addressed fully in that document.

APPENDIX

UNDERSTANDING ECONOMIC GROWTH[133]

1. THE NEOCLASSICAL MODEL OF ECONOMIC GROWTH

At the heart of the neoclassical theory of economic growth is the production function, which links the output of an economy to the amount of capital and labour employed. The theory makes two assumptions about the production function. Firstly, there is the assumption of diminishing returns. This assumption means that adding capital to any given labour force, or labour to any given stock of capital, will yield successively smaller increases in output. Secondly, there is the assumption of constant returns to scale. This assumption means that if all inputs (labour and capital) are doubled, then output will also double.

The assumption of diminishing returns implies that in the long-run the capital/labour ratio is constant which means that if, for example, the labour force is growing by 2% per annum, then the capital stock will also grow by the same 2%. This implies that in the long-run, equilibrium output per worker is constant. This means that one of the key facts of modern economic growth, rising productivity/ output per worker, cannot be explained by this basic model. This problem can be resolved by the introduction of technological progress to the model, which is referred to as total factor productivity.

This neoclassical growth model, which was developed by Solow (1957), spawned a literature of growth accounting. Researchers estimated the increase in output which could be ascribed to increases in labour and in capital and the residual, which could not be explained by either of these inputs, was a measure of technological progress. Using this methodology, Solow estimated that over 80% of the growth in gross output per man hour in the US private non-farm sector could be assigned to technological progress. This exercise has been repeated and refined many times since Solow's initial work. In a recent paper Hulten (1992) made allowances for quality changes in capital and found that approximately 20% of the residual growth of quality adjusted output could be attributed to technological change which is embodied in capital. However, the basic result remains valid: technological change is the major source of economic growth.

133 This appendix draws on Bradley, Whelan and Wright, (1993).

An important aspect of the neoclassical growth model is that technological change is regarded as exogenous: it occurs as a natural by-product of economic activity. An important policy implication of the neoclassical model is that it predicts convergence in incomes per head over time. If there are divergences in technological knowledge across countries, it is assumed that the process of diffusion of technological knowledge will promote convergence. Capital formation is also seen as an important force in promoting convergence. Countries with lower income per head will also have lower capital/labour ratios. Given diminishing returns, this implies that the marginal product of capital will be higher in low income countries. This should promote a flow of capital from high income countries to low income countries until the difference is eliminated.

Neoclassical theory suggests three factors which will determine a country's growth rate in a world of mobile capital:

(i) *The capital/labour ratio:* the lower the capital/labour ratio, the higher the productivity of capital and thus the return to capital investment;

(ii) *The degree of uncertainty:* if investors are risk averse then a higher level of uncertainty will lead to a lower level of investment;

(iii) *Institutional factors:* factors which impede the free operation of market forces will also hinder convergence. For example, policies which distort factor prices, inefficiencies in the non-traded sector or restrictions on foreign investment will limit a country's ability to converge in terms of income per head.

The main policy prediction regarding economic development which emerges from the neoclassical theory of economic growth is that if a relatively poor country has an appropriate combination of free markets and political stability, it can be expected to experience rapid economic growth and convergence of income per head with richer countries. This thinking is not confined to text books: this analytical model underpins the policy prescriptions of influential organisations concerned with economic development, including the World Bank, the IMF and the OECD.

This theory can be applied to identify the factors which would affect Ireland's ability to converge with the average EC income per head:

(i) *Public finances:* The high debt/GNP ratio (despite the reductions achieved in recent years) may be a potential source of uncertainty for international investors;

(ii) *Labour market:* A variety of factors, including taxation and the integration of the Irish labour market with the UK, put upward pressure on wage costs. Restraint of labour costs could be expected to increase investment;

(iii) *Competition in the non-traded sector:* Policies to induce greater efficiency in competition in the non-traded sectors of the economy are likely to promote investment.

Hence the neoclassical growth theory provides a clear agenda for policy reform. Competition policy is discussed in Chapter 4 and policies in other areas mentioned above are discussed in more detail in later chapters.

However, a serious problem with neoclassical theory is that "it does not appear to fit the facts" (Bradley, Whelan and Wright, 1993). As noted above, the theory predicts convergence of income per head over time. While there has been convergence among some groups of countries, convergence is by no means a universal phenomenon. Barro (1991) estimated the correlation between per capita growth rates and an initial (1960) level of GDP per capita. If convergence were taking place, then those countries with an initial low GDP per capita should have had higher growth rates. This would produce a negative correlation between per capita growth rate and the initial level of income. Barro found, however, that the correlation was close to zero.

The level of factor flows between countries is also inconsistent with the predictions of the theory. Conventional production functions indicate that there is an enormous difference in the marginal productivity of capital between rich countries and poor countries. These should generate enormous capital flows from rich to poor countries. As Lucas (1990) has pointed out, the actual level of capital flows to poor countries is very modest compared to what the theory would predict.

Applying the neoclassical growth model to Ireland, there are key aspects of Ireland's economic development which the theory does not help us understand. There is universal agreement among commentators that a fundamental characteristic of the Irish economy is the dualism in the industrial structure. A highly profitable and productive overseas sector co-exists with an indigenous sector which has much lower productivity and lower profitability. There is now general agreement that the main policy challenge is to secure a better performance from the indigenous sector.

The divergence in performance between the foreign and indigenous sectors is difficult to explain within the framework of the neoclassical growth theory.[134] Technological change is exogenous in the theory, and so should be equally available to the indigenous and the multinational sector. One might appeal to transfer pricing to explain the difference between the indigenous and multinational sector. However, the analysis in NESC Report No. 94 indicates that, while transfer pricing exaggerates output and productivity growth in the multinational sector, it is not in itself responsible for the very high output and productivity growth rates. Another possible explanatory factor for the strong performance of the foreign sector is that it has been driven by tax incentives. However, tax incentives are also available to the indigenous sector, so this cannot explain the diversity in performance.

The fact that, faced with the same environment, the multinational sector has had a much stronger performance implies that neoclassical growth theory as applied to Ireland is overlooking something essential about the nature of indigenous development in Ireland.

To deal with the general weaknesses of neoclassical growth theory identified above a recent literature of endogenous growth mechanisms has been developed. A distinguishing feature of these theories is that technological progress is no longer treated as exogenous. Rather it depends on actions taken by economic agents and so is treated as endogenous. The following section outlines some of the key models of growth which have been developed applying this approach.

2. HUMAN CAPITAL

The inconsistencies between factor flows as they are observed in the real world and the predictions of the neoclassical growth theory motivated Lucas (1988) to develop models of growth based on the effects of human capital externalities and of learning by doing. Lucas distinguishes the following effects of human capital. Firstly, there is the *internal* effect of human capital, that is the effect of an individual's human capital on his/her own productivity. Secondly, there is the *external* effect of human capital. This is the effect of an individual's human capital on the productivity of all the other factors of production. It is an externality with all the usual properties of externalities: the private return to human capital will be less than the social return, so an individual will have insufficient incentive to invest in human capital.

Given the existence of external effects of human capital, this can explain why there is more pressure on migration flows from poor countries to rich

134 McDowell (1992) makes a similar point in the context of commenting on the implicit model used by the Industrial Policy Review Group (1992).

countries than there is on capital flows in the opposite direction. Labour has an incentive to move from a low productivity country to a high productivity country because, due to the external effect of human capital, its productivity will be higher in the high productivity country. On the other hand, capital flows in the opposite direction cannot take advantage of this external human capital effect.

It is evident from ordinary experience that group interactions are central to individual productivity. Most of what we know we learn from other people. Some of this is in a formal pupil/teacher relationship, but most learning is mutual, without any formal distinction between pupil and teacher.

Lucas points out that, based on the usual economic forces, one cannot explain the existence of cities. One would expect capital and people to move outside and combine themselves with cheaper land, thereby increasing their profits. The existence of cities poses the question as to why producers choose high cost locations rather than low cost ones. Lucas argues that the force we need to explain the central role of cities in economic life is of the same character as the external human capital effect. The high cost of locating in a city is justified because of the productivity gain that comes from external human capital. Therefore, Lucas argues that land rents provide an indirect measure of the significance of this force.

This analysis provides a clear suggestion that the free mobility of labour is likely to lead to great pressures for internal migration within the EC and the possibility of depopulation trends on the EC's periphery.

Lucas (1988) developed another model in which the source of endogenous growth is human capital accumulated through learning by doing. Given that different goods have different human capital/learning by doing potentials countries specialising in high learning by doing goods will have a faster growth rate. This is because human capital will increase faster in these goods over time, which results in a higher growth rate. Over time these countries will gain a *cumulative* advantage in producing this high learning by doing good.

This results in an equilibrium with some countries experiencing low growth and others high growth. The advantage of the fast growth countries is reinforced over time due to the effects of cumulative learning, so that there is divergence rather than convergence. This is a neat neoclassical formulation of Kaldor's idea of cumulative causation in economic development, whereby countries which gain an advantage in high productivity goods then continuously obtain an increased growth rate in the human capital required to produce these goods, thus putting them further and further ahead (Kaldor, 1970).

This model also provides a way of thinking about the problems facing indigenous industry in Ireland. Indigenous industry has a tendency to be specialised in low growth areas, with low learning by doing effects. Indigenous industry will face obstacles if it wants to move into higher growth areas because its competitors have, over time, gained a cumulative advantage from this learning by doing effect. Furthermore, since the learning by doing effect is external, private agents will have insufficient incentive to attempt to break into the high growth area. This model is consistent with the thesis advocated by O'Malley (1989) that the main problem facing indigenous industry was overcoming barriers to entry in more profitable industries.

One implication is to suggest a role for policy in picking winners, by subsidising the high learning by doing goods. Of course, in reality there are major difficulties in a policy of picking winners, not least the risk that subsides will provide incentives to engage in rent seeking behaviour. However, this type of analysis does suggest certain policy lessons. It is likely that certain industries are more likely to revitalise the periphery than others. A reorganisation of European industrial policy which allows the periphery a chance to compete in the race to develop these industries could play a major role in encouraging economic convergence.

3. TECHNOLOGY

The Lucas model of learning by doing treats the accumulation of knowledge as endogenous. However, Romer (1990) points out that Lucas still treats knowledge as a public good which is produced as an unintentional side effect of the production of conventional goods. Romer has developed a model in which the intentional investment by private agents in the creation of knowledge plays a key role.

Romer's argument is based on three premises. The first is that technological change - improvement in the instructions for mixing together raw materials - lies at the heart of economic growth. In this respect, his model resembles the standard neoclassical model. The second premise is that technological change arises in large part because of intentional actions taken by people who respond to market incentives. Thus the model is one of endogenous rather than exogenous technological change (although Romer acknowledges that not everyone who contributes to technological change is motivated by market incentives). The third and fundamental premise is that the instructions for

working with raw materials (technology) are inherently different from other economic goods. Once the cost of creating a new set of instructions has been incurred, the instructions can be used over and over again at no additional cost. Developing new and better instructions (knowledge) is equivalent to incurring a fixed cost. This property, of increasing returns to scale or economies of scale is taken to be the defining characteristic of technology.

It is a well established result in economics that increasing returns to scale are not consistent with perfect competition, the model of the price taking firm which is at the heart of the traditional neoclassical growth theory. Increasing returns to scale mean that average costs continue to fall even in the long-run. A price taking firm sets price equal to marginal cost but, with increasing returns to scale, setting price equal to marginal cost will mean that price will be below average cost. If price is below average cost then the firm will make a loss. For example, if disk drives were sold for marginal cost, then revenue would only cover direct payments for the labour and capital that are used in production and there would be no return to the knowledge that is necessary for producing disk drives in the first place.

The only way that all three of Romer's premises can be accommodated is to depart explicitly from the assumption of perfect competition and introduce imperfectly competitive firms who possess some degree of market power. Romer constructed a model of the economy which is based on imperfectly competitive firms, and which has three sectors. The research sector uses human capital and the existing stock of knowledge to produce new knowledge relevant for economic growth. Specifically, it produces designs for new producer durables. An intermediate goods sector uses the designs from the research sector, together with foregone output, to produce the large number of producer durables that are available for use in final goods production. A final goods sector uses labour, human capital and the set of producer durables that are available to produce final output.

Knowledge enters into production in two distinct ways. A new design enables the production of a new good that can be used to produce output. A new design also increases the total stock of knowledge and thereby increases the productivity of human capital in the research sector. There is, therefore, an externality associated with this second aspect of the production of knowledge.

There are two essential elements to capturing the features of knowledge in this model of growth: spillovers and price setting behaviour. There is little doubt that much of the value to society of any given innovation or discovery is not captured by the inventor, and any model that missed the spillovers would miss important elements of the growth process. Yet it is still the case that private, profit maximising agents make investments in the creation of new knowledge and that they earn a return on these investments by charging a price for the resulting goods that is greater than the marginal cost of producing these goods.

The model predicts that the long-run growth rate will depend on the share of human capital invested in research and on the interest rate. In this model the interest rate affects the growth rate through its effect on the investment of human capital in research. The greater the share of human capital allocated to research, the faster the rate of technological progress and the faster the growth rate. If the level of human capital is too low, so that it is not possible to allocate any human capital to research, then no growth occurs.

In equilibrium too little human capital is devoted to research. This occurs firstly because there are positive external effects associated with research. It also occurs because research produces an input that is purchased by a sector that engages in monopoly pricing. Both of these effects cause human capital to be under-compensated.

To apply such a model as this to Ireland it is first necessary to consider its implications in an open economy framework. The importance of knowledge spillovers in the model points to the advantages to be gained from greater involvement in international trade and economic integration. However, Grossman and Helpman (1990) point out that experience shows that technology flows are anything but automatic. Often it is necessary for local firms to invest resources in order to capture spillover benefits from abroad. They point out the need to learn much more about the mechanisms by which knowledge and technology diffuse across international borders (including the role of multinational corporations), and the incentives that impinge upon the equilibrium rate of technology transfer.

Since comparatively little R&D is done in peripheral countries such as Ireland and firms are less technologically advanced, it is likely that knowledge of available technologies and how to use them may be comparatively poor. This suggests that it is desirable to support national technological education policies or to encourage the location of high technology foreign industries in the periphery.

As is the case of the Lucas model presented above, there are parallels between Romer's model of technology and the work of structuralist economists such as O'Malley. In Romer's model the driving force behind economic growth is the creation of knowledge by private firms which is inextricably linked to

increasing returns to scale and imperfect competition. O'Malley (1989) notes that the most widely recognised source of barriers to entry is increasing returns to scale. Industrial policy needs to take account of the importance of increasing returns to scale and imperfect competition.

Romer's model of growth provides an insight into the duality of the Irish industrial structure. It is possible that the high profitability of the multinational sector reflects quasi rents which this sector can earn by pricing above marginal cost in imperfectly competitive markets. These quasi rents represent a return on investment in knowledge. On the other hand, the indigenous sector may be closer to the textbook model of perfect competition where there is freedom of entry and firms produce standardised goods. Freedom of entry means that firms earn no economic profit above receiving a return on their capital and an appropriate risk premium. This is consistent with the relatively low profitability of the indigenous sector.

4. PUBLIC CAPITAL

Barro (1990) presents an endogenous growth model in which the external effect which drives the model is productive public services. Production has diminishing returns to capital (both physical and human) but it exhibits constant returns to scale when productive public services are included. Productive public services are defined as those which are used as a direct input in private production. The most important element of these is public infrastructure. Diminishing returns are avoided if the necessary public services are increased in line with the increase in private production.

Barro's model also includes government consumption services. These are services which provide utility, but they are not direct inputs in private production. Since they must be financed by distortionary taxes, other things being equal an increase in these services reduces the growth rate in this model.

The model predicts that each government will have an incentive to increase public investment until the effect on the growth rate is zero. This result holds even for a self interested government, because such a government will still have an interest in maximising the tax base. Barro reports empirical results which find an insignificant correlation between government investment and per-capita income growth. This is consistent with his model.

Aschauer (1989, 1989a) has also produced empirical results which appear to show that non-military public capital has had an important influence on productivity in the US. In particular, he suggests that the reduction in US public capital expenditure has had an important influence on the US productivity slowdown. Aschauer's results have, however, been questioned by Ford and Poret (1991) who, when running regressions to test the effect of public capital on productivity, found that statistically significant effects could be found for only half the countries. Berndt and Hansson (1992) is a recent Swedish confirmation of the significance of the role of public infrastructure in increasing total factor productivity, and Rubio and Sosvilla Rivero (1993) using formal cointegration analysis, confirm the effect for Spain.

While Barro argues that most governments come close to providing the optimal level of public infrastructure, this does not necessarily hold true for any particular country such as Ireland. The Industrial Policy Review Group (1992), found deficiencies in Ireland's infrastructure. The Structural Funds provide an opportunity to remedy any deficiencies in this area.

5. GROWTH AND INCOME DISTRIBUTION

Typically policy makers are not solely concerned with achieving an economic growth objective. For example, a reduction in transfers used to finance an increase in infrastructure investment may promote economic growth but may conflict with the policy maker's objectives for income distribution. Policy makers have to find an appropriate balance between conflicting objectives. A number of researchers have tried to formally model the effects of political choices on the distribution of income and the effects of taxes on income in a democracy.

"Typically, this yields the outcome that an unequal distribution of income hampers economic growth. For in a country with an unequal distribution of income the decisive (median) voter is likely to be poor and ask for a high tax on capital income to finance transfers, so that the incentive to save and, therefore, the rate of growth are low. There is strong empirical evidence drawn from a wide range of democracies that a fairer distribution of income and wealth induces the right political decisions for growth promoting policies." (Van der Ploeg and Tang, 1992)

6. ECONOMIC GROWTH IN A SMALL OPEN ECONOMY

The endogenous growth models discussed so far have not been explicitly concerned with a small open economy (SOE) such as Ireland. An SOE model (which is not from the endogenous growth literature) which has been developed by Nolan and Nolan (1991) is outlined below and then related to the endogenous growth literature.

Ireland is generally regarded as a good example of the textbook model of the SOE. The characteristics of an SOE are as follows:

(i) A significant fraction of the goods and services produced are traded goods, in the sense that they are exposed to international competition;

(ii) The traded goods sector of the economy is integrated within the larger economic system so that the domestic economy is a price taker for these goods;

(iii) The domestic financial system is integrated with international financial markets so that domestic interest rates are determined by external rates.

These characteristics have important implications for the process of economic growth within the SOE. Firstly, given financial market integration there is no reason to believe that an increase in saving will lead to an increase in investment within the SOE. Secondly, within the traded goods sector product market integration implies that investment will only take place if the SOE is a more attractive location than alternative possibilities outside the SOE. Investment in the SOE is determined by the level of total investment in the world economy and the SOE's share of this investment. The SOE's share of this investment will depend on its attractiveness as a production location relative to locations abroad. This has an important policy implication: in an SOE, *growth policy is essentially competitiveness policy.*

To understand the determination of output and employment in an SOE it is useful to distinguish the traded and non-traded sectors. The traded sector is that part of the economy which is directly exposed to international competition. It consists of the resource based sector of the economy, manufacturing and internationally traded services. The non-traded sector is that part of the economy which is sheltered from direct international competition. By definition its market is limited to the domestic market. It consists of private and public services (excluding internationally traded services) and construction.

The demand curve for labour in the traded sector is downwards sloping reflecting the law of diminishing returns. The position of the demand schedule depends on a number of factors:

(i) The stock of natural resources (for example, an oil discovery would increase the demand for labour in the traded sector);

(ii) The prices of output from the resource based sector and the manufacturing sector; and

(iii) All of the price factors other than factor cost which determine the competitiveness of the traded sector. These can be described as the stock of know-how/experience in the economy.

Since the non-traded sector depends on the domestic market, the demand for labour in the non-traded sector depends on the size of the traded sector. In the limit if there is no internationally competitive activity within the SOE, there will be no traded sector and hence no domestic market and no non-traded sector. Employment in the non-traded sector also depends on the share of expenditure on non-traded services.

The supply of labour is upward sloping reflecting the fact that at higher wages more people participate in the labour market. This is due to higher participation at higher wage rates and changes in net migration which is the key factor in the SOE.

The interaction of supply and demand then determines the level of employment in this model which in turn determines the level of output.

Employment in this model can be increased by an increase in either the supply of labour or the demand for labour. The supply of labour depends on foreign labour market conditions, restrictions on inter-country migration and the work preferences and age structure of the population. Of more interest are the factors which determine the demand for labour. The demand for labour depends on the price of traded sector output, the stock of natural resources, the share of expenditure on non-traded services and all of the factors other than wage costs which affect competitiveness in the traded sector.

An increase in the price of traded sector output represents a favourable terms of trade shock. This is something which is beyond the influence of policy. Likewise the stock of natural resources is not something on which policy can have much influence, although it is important to have an appropriate legal framework to promote exploration. It is also difficult to see how policy can affect the share of expenditure on non-traded services. This leaves *all the non-wage factors which affect competitiveness in the traded sector as the main possibility for affecting the demand for labour at given wage rates.*

7. CONCLUSION

Given the high rates of productivity growth which have applied in Ireland and given the continuation of present trends, significant employment growth will require the sustained achievement of historically very high rates of output growth. To clarify what policies are likely to support a high rate of economic growth a model of the determination of growth is needed. The neoclassical model of economic growth was presented above. This model provides important policy guidelines. It indicates the importance for economic growth of reducing the debt/GNP ratio, the need to achieve appropriate factor costs and to increase competition in the non-traded sector of the economy.

It was noted that the neoclassical growth model is subject to a number of limitations. In an Irish context the neoclassical model does not offer much insight as to what causes the marked duality of Ireland's industrial structure. Hence, while following the recommendations provided by the model is *necessary* to achieve economic growth this is unlikely to be *sufficient* to achieve the optimum development of the economy, in particular of the indigenous sector.

Growth in a small open economy depends fundamentally on the competitiveness of the traded sector. Competitiveness depends on both cost and non-cost factors. Wage moderation can contribute to the growth of employment and output. However, we do not have a full understanding of what determines the demand for labour in the traded sector at given factor costs. Endogenous growth theory is suggestive of the types of factors which are relevant. The policies most likely to foster growth, derived from endogenous growth models and associated empirical work have been listed by Barro and Romer (1990) as follows: "Support for education; Incentives for investment in physical capital; Protection of intellectual property rights; Support for R&D; International trade policies that encourage the production and worldwide transmission of ideas; and the avoidance of large Government induced distortions in the market."

Some of the endogenous growth models provide insights into the divergence in industrial performance between the indigenous and multinational sector. Endogenous growth theory points to the importance of factors such as increasing returns to scale, imperfect competition and the cumulative effects of learning by doing which are helpful to understanding the challenge facing indigenous industry. In this respect there are parallels between endogenous growth theory and the work of O'Malley (1989). Industrial policy needs to pay attention to these factors rather than assuming that the economic environment is characterised by perfect competition and freedom of entry.

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