

SUMMARY OF KEY POINTS

A Strategy for Competitiveness, Growth and Employment

National Economic and Social Council

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A Strategy for Competitiveness, Growth and Employment

— Summary of Key Points —

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OVERVIEW

The over-riding objective for economic and social policy in Ireland over the coming years must be to secure faster employment growth and reduce unemployment. All policies should be judged by their ability to contribute towards this goal.

While employment and unemployment have always been an important concern of the Council, this report places them for the first time at the top of the policy agenda. It is this direct focus on employment and unemployment which distinguishes "A Strategy for Competitiveness, Growth and Employment" from earlier Strategy reports prepared by the Council. In 1986, for example, when the Council published its first strategic overview entitled "A Strategy for Development", priority had to be given to correcting the serious imbalances in the public finances which then prevailed. Unemployment at that time was seen as an important, but secondary, objective. Four years later, in 1990, the Council published its second Strategy report entitled "A Strategy for the Nineties". By that time, significant progress had been made in putting the public finances back on a sustainable course. The Council argued that the priority must be to continue with that progress, while at the same time beginning to implement a series of structural reforms which would place the economy on a higher growth path. This, it was felt, would provide the best means of raising employment and tackling unemployment.

"A Strategy for Competitiveness, Growth and Employment", reconfirms many of the messages in the Council's earlier Strategy reports. Its central message has been developed and extended in important ways however: the Council still believes that there is scope for significantly improving the performance of the economy by implementing a consistent set of economic and social policies which links macroeconomic strategy, income developments and structural reform. The policies required to do this are set out in detail in the report and are presented here in summary form. The Council believes that the improvement in economic performance which would result from implementation of these policies would contribute substantially to a faster rate of employment growth. It does not believe, however, that faster economic growth will of itself be enough to eliminate Ireland's unemployment problem. It argues, in particular, that the problem of long-term unemployment is such that direct action targeted on the long-term unemployed will be required. Such direct action costs money and therefore has implications for other policy objectives, including taxation policy.

In "A Strategy for Competitiveness, Growth and Employment", the Council seeks to balance the various objectives of economic and social policy within an overall framework which aims to maximise employment growth and reduce unemployment. The strategy set out in the report is designed to foster the growth of competitiveness and employment in the economy, while at the same time supplementing this approach with direct policy intervention aimed at addressing specific structural aspects of the unemployment problem. This two-pronged approach constitutes, in the Council's view, the best possible means of achieving our objectives of faster employment growth and a significant reduction in unemployment.

The broad thrust of the Council's approach is set out briefly below and is elaborated upon in the remaining sections of this Summary. For a more detailed discussion of particular topics, or for information on areas covered in the main report which are not included in this Summary, the reader is invited to refer to Annex 1, at the back of this document which provides a full listing of the contents of the main Strategy Report.

MAIN POLICY PROPOSALS

The Council's proposals cover all aspects of economic and social policy, including macroeconomic policy, developmental policies and social policies. The need for consistency and coherence both within and between these different policy areas is emphasised in the report. The Strategy attempts to integrate the many diverse elements of public policy within a single comprehensive framework capable of providing the basic parameters for the evolution of economic and social policy in Ireland in the medium-term.

With regard to *fiscal policy*, the Council argues that there is very little scope for reducing the overall tax burden, but that public expenditure should be subject to firmer control than in recent years with a view to achieving a steady reduction in the debt/GNP ratio (from an estimated 104% at end 1993 towards 95% by 1996). The Council's approach provides for a small real increase in public expenditure, below the rate of increase over recent years, in which priority is to be given to the needs of the long-term unemployed. On *exchange rate policy*, the Council reaffirms its support for European Monetary Union and for a non-accommodating exchange rate strategy.

With regard to *income developments*, the Council sees a need for wage moderation as an important dimension of competitiveness. It emphasises, however, the need to supplement and enhance basic cost competitiveness by developing strengths in other non-cost areas,

including technological capacity, innovation and product and market development. With regard to *structural measures*, the Council reviews the scope for tax reform. It favours measures to reduce the tax burden on low to middle incomes as being most likely to enhance employment. It sees a need for increased taxation on property in order to finance this shift. It also calls for a restructuring of PRSI in favour of those on low incomes.

The Council reviews policy and performance in the main sectors of the economy. It highlights the importance of strengthening the competitiveness of Irish enterprises and primary producers in all areas of the economy. The Report discusses the policies required for the successful development of the Agriculture/Food sectors and for the Industrial sector. It points to the significance of the Services sector, including Tourism, for future employment growth. The financing needs of new and developing enterprises are also analysed.

The Council recommends continued progress towards the achievement of priority objectives in social policy within the fiscal framework it proposes. Recent developments and priority areas for further action are discussed in relation to policies on social welfare, housing, education and training and health care.

The Council emphasises the need for special measures to tackle the problem of long-term unemployment, over and above measures to stimulate employment growth generally. It argues that the modest real increase in public expenditure which it envisages as part of its macroeconomic strategy should be applied primarily to creating work opportunities in the voluntary and community sector for the long-term unemployed who have little prospect of open employment. This would be in addition to targeted measures to increase the education and skill levels of the long-term unemployed, thereby improving their potential to compete for open employment.

The Council believes that the best framework within which to secure these strategic requirements is a consensus negotiated between government and economic and social interests. Earlier Strategy reports prepared by the Council have provided the backdrop to the Programme for National Recovery 1987-1990 and the Programme for Economic and Social Progress 1990-1993. This latest Report, "A Strategy for Competitiveness, Growth and Employment", has been prepared by the Council as part of its ongoing contribution to the development of medium-term economic and social policies in Ireland.

STRUCTURE OF THE REPORT

The report is built around five main blocks:

(i) **A Review of Recent Economic Policy and Performance** (Chapter 2):

This provides the backdrop to the subsequent policy recommendations in the report, highlighting the key issues which need to be tackled and the context within which future policy decisions are likely to be made.

(ii) **Analysis of Labour Market Developments and Competitiveness:**

These are two important contextual chapters (Chapters 3 and 4) which provide the rationale for the subsequent priority attached in the report to: (a) the need for specifically focused labour market policies targeted on the long-term unemployed and the form which such policies might take, and (b) the importance of building competitiveness in all its dimensions across all sectors of the economy as the key to sustained economic growth.

(iii) **Macroeconomic Strategy:**

A series of individual chapters in the report outline the Council's macroeconomic strategy including fiscal policy (Chapter 5), exchange rate strategy (Chapter 6), and taxation policy (Chapter 7).

(iv) **Developmental Policy:**

Individual chapters in the report set out the Council's proposals regarding the development of the industrial sector (Chapter 8), the agricultural sector (including the food industry and rural development - Chapter 9) and the services sector (Chapter 10) - with a separate discussion of tourism (Chapter 11). The issue of financing the development of Irish businesses is discussed in a separate chapter (Chapter 12).

(v) **Social Policy:**

The final section of the report sets out the Council's views on the development of social policy in the areas of social welfare (Chapter 14), housing (Chapter 15), education (Chapter 16), and health (Chapter 17).

A full listing of the contents of the report is given at the back of this summary and may serve as a quick reference guide to the main text. What follows is a brief synopsis of some of the key messages to emanate from each of the five sections of the report identified above.

1. RECENT PERFORMANCE AND THE CONTEXT FOR FUTURE POLICY

The first section of the Report reviews economic performance over the period 1990-1993, reflects on the adequacy and appropriateness of the policies pursued during those years and outlines the prospects for the economy in the years ahead.

Economic Performance 1990-1993

Economic growth slowed after 1990 following a period of rapid growth in the late 1980s. Average GNP growth in 1990-1993 was about 3.3% per annum in real terms, compared with 5.5% per annum in 1986-1990. Despite this slowdown, Ireland's growth record over the past three years has been good by international standards and represents a creditable performance when viewed against a backdrop of falling international growth rates and a recession first in the UK (in 1991 and 1992) and, more recently, in Continental European markets.

The reduction in economic growth and, in particular, the slowdown of growth in domestic demand after 1990, was reflected in a weakening of Ireland's labour market performance. The level of total employment has remained stable over the past three years - a not insignificant achievement, given that average employment in the EC fell substantially in 1992 and 1993. Unemployment rose sharply however, reflecting a substantial increase in labour supply following the cessation of emigration. The latter reflected the downturn in the UK economy and the closing off of job opportunities overseas. Average unemployment in 1993 rose to reach a new peak of 295,000.

Assessment of Economic and Social Policy Developments

The report reviews the main policy developments of the past three years and considers the extent to which they were consistent with the strategy set out by the Council in 1990¹. That strategy was built around three broad principles:

- (i) Consistency of fiscal, monetary and exchange rate policy to achieve economic stability;
- (ii) An incomes policy which accords priority to employment; and
- (iii) A radical policy programme of structural reform.

The development of *fiscal policy* since 1990 has not followed all of the recommendations of the Council. The target of reducing the debt/GNP ratio to 100% was met in 1992, slightly ahead of target, and while there was an increase in this ratio in 1993 reflecting the effects of the January devaluation, the underlying trend remains downwards. There was, however, a significant real increase in current public expenditure and some increase in the exchequer borrowing requirement.

1992 and 1993 saw considerable pressure in the area of *monetary and exchange rate policy*. Despite the extent of flux in the European exchange rate system, the conduct of Irish exchange rate policy over this period was compatible with the Council's basic principle which favoured an explicit non-accommodating exchange rate policy. Overall, the Council believes that the operation of fiscal, monetary and exchange

1 See NESC Report No. 89 "A Strategy for the Nineties: Economic Stability and Structural Change".

rate policy in Ireland *have* been broadly consistent over the past three years.

The *development of incomes* in the past three years has not secured the required improvement in competitiveness. Competitiveness was broadly maintained against the EMS narrow-band countries, which represents a continuation of the pattern of the late-1980s. The difference between the past three years and preceding years is that there was no gain in competitiveness against the UK. This reflects a lowering of the differential between Irish and UK wage inflation and a depreciation of Sterling. In this sense, the evolution of incomes in the economy was not consistent with the principle of according priority to increasing employment over improving living standards. The extent to which this was the case is not uniform across all sectors of the economy.

With regard to *structural reform*, the pattern is mixed. There was progress in specific matters identified by the Council, especially in many areas of social policy and in the development of an area based strategy to combat long-term unemployment and social exclusion. However, the general programme of radical policy reform envisaged by the Council did not take place and many of the structural reforms advocated in 1990 are reiterated in this Report.

Context for Future Growth

The context for Irish economic growth is expected to improve slowly over the next year or two, as the world economy moves out of recession. The recovery in world output growth is expected to strengthen and consolidate in the latter half of the 1990s, providing Ireland with a more positive environment for growth than that which existed in the first three

years of the decade. The pace of international growth in the medium-term will be influenced by developments in a number of key areas, among them the impact of the recent GATT agreement² and the evolution of policy within the European Union.³

The Government's National Development Plan suggests that Ireland's rate of economic growth could be upwards of 3.5% per annum over the period 1994 to 1999. The Plan envisages growth in non-agricultural employment of about 12,000 to 14,000 per annum to the end of the decade. This increase would be partially offset by a continued decline in agricultural employment, so that the increase in *total* employment in the economy might be of the order of 9,000 to 11,000 per annum. While such an employment performance would be significantly better than recent years, it would still fall far short of Ireland's employment needs. Given the existing level of unemployment and the strong underlying growth in the labour force, with potential growth of 25,000 per annum to the end of the decade, substantially stronger employment growth will be needed if high levels of involuntary emigration and continued high levels of unemployment are to be avoided.

The need to secure faster economic growth, and in particular faster employment growth, than that anticipated in the National Development Plan underlines the importance of measures designed to increase the competitiveness of the economy in all its aspects. The strategy outlined by the Council aims to push Irish economic performance *above* current projections in order to achieve an employment outcome more in line with our requirements.

2 The GATT Accord of December 1993 was agreed *after* the Council's Strategy Report had been published.

3 Since ratification of the Treaty on European Union in November 1993, the EC has become known as the European Union.

2. LABOUR MARKET DEVELOPMENTS AND COMPETITIVENESS

Throughout the Report, two themes recur: firstly, the need for a broadly-based improvement in competitiveness throughout all sectors of the economy in order to boost economic growth and accelerate the rate of employment creation; secondly, the need for a specific focus on the labour market to ensure that the benefits of faster economic growth work their way through to the unemployed and that appropriate policy action is taken in cases where structural barriers are seen to be impeding this effect. Two chapters early on in the Report (Chapters 3 and 4) outline the Council's thinking in both of these areas.

Labour Market Developments

Scale of the Unemployment Problem

Since 1990, stagnant employment levels and the virtual cessation of net emigration, both reflecting in large part the impact of worldwide recession, have combined to push unemployment to unprecedented levels. The problem of reducing the general stock of unemployment is compounded by the existence of a very substantial core of long-term unemployed persons, who are unlikely to benefit significantly from any general improvement in labour market conditions. Moreover, the current age structure of the Irish population is such that, in the absence of net emigration, the potential for labour force increase is very substantial. *The Irish labour force has the capacity to expand by between 20,000 and 25,000 each year (1.5 to 2.0 per cent), and this situation will continue to prevail until the end of the 1990s.*

The Report describes recent trends in population, labour force and migration flows and discusses the prospects for future labour force

growth. It lays particular emphasis on the problem of long-term unemployment. In October 1992, 124,000 (44.1%) of those unemployed had been out of work for one year or more, and of those, 54,400 people had been unemployed for over three years. The evidence for Ireland and for other countries shows that *the probability of 'escaping' from unemployment diminishes rapidly as the duration of unemployment increases.* In Ireland, those experiencing the highest risk of remaining unemployed for a further year are males in the 45-54 year age group who have been unemployed for two years or more - in 1991, they had a 90% probability of remaining unemployed for a further twelve months. The risks of remaining long-term unemployed are only slightly lower among males aged 25-44 who have been unemployed for two years or more.

For the long-term unemployed, constraints on effective labour market participation derive from a number of factors: many are educationally disadvantaged, with 80% of the long-term unemployed having no qualifications or only a Group/Inter Certificate. Stigmatisation and the absence of recent work experience also militate against their chances of competing successfully against other labour market participants. Finally, the effectiveness of job search tends to diminish as the duration of unemployment increases, reflecting both the reduced probability of finding employment and the progressive demotivation of the unemployed. *These factors highlight the need for targeted intervention on the part of the State to assist in the reintegration of the long-term unemployed into the labour market.*

Policy Response Required

The Report discusses the rationale for an active labour market policy and the role of education and training as a response to unemployment. It reviews existing measures in these areas.

The Council believes that the implementation of a programme of structural reforms aimed at improving the economy's internal efficiency and international competitiveness, combined with the likely upturn in external trading conditions, can produce a significant acceleration in employment growth over coming years. It is also likely that any recovery in external economic activity will be accompanied by a resumption of substantial net emigration, although this would in no way represent a satisfactory means of resolving Ireland's unemployment problem. However, *even a very significant reduction in general unemployment is likely to have little impact on the high incidence of structural unemployment. It is in tackling the latter problem that a clear role for active labour market policies arises.*

The Council believes that *active labour market measures should aim to minimise the risk of drift into long-term unemployment, while at the same time seeking to prevent the long-term unemployed from becoming trapped on the margins of the labour force. The first requires an active programme of early intervention at the time of redundancy or other job loss, or on entry to the labour force. Counselling, job-search skills and skill development generally should be the focus for such intervention.* It has been suggested that participation in such programmes should be a condition of eligibility for income maintenance payments. The Council believes that it is more effective to encourage such participation through the design and delivery of attractive and effective programmes, participation in which should not entail any reduction in effective entitlements. There is a particular need to focus on the needs of young people entering the labour force with low levels of educational attainment and correspondingly poor employment prospects. The effectiveness of measures in this area should be enhanced, in particular through improving the accreditation arrangements for the training provided and the structural linkages between such programmes and mainstream education and training services. The Council therefore recommends that, as an alternative to signing on the Live Register, new

entrants with low levels of educational attainment should be provided with the possibility of continued education or training leading to an accredited qualification. There is a need to expand provision for a somewhat broader range of disadvantaged young people and more generally to enhance the guidance and placement services available to them at the point of registering for unemployment assistance.

With regard to the existing stock of long-term unemployed, policy should aim to increase their active engagement with the labour market through an integrated approach to work experience, training, counselling and placement. Such a strategy is dependent for its effectiveness on the quality of the interventions. Effectiveness is also likely to be enhanced by the operation of financial incentives including employment subsidy schemes, which consistently favour the recruitment prospects of the long-term unemployed.

The Council recognises that, even if all of its recommendations were applied comprehensively and if the external environment were to prove benign, the labour market prospects of many of the long-term unemployed will remain bleak. Given this, the Council believes that a more direct response to their needs is warranted.

It argues that there is a case for public resources to be used, within prudent fiscal limits, to provide meaningful work, social purpose and a basis for progression through the labour market for those who otherwise would face the grim prospect of decades of enforced idleness. The Council believes that transfer payments to support many of the long-term unemployed will require to be funded in any event. This expenditure could be made available and supplemented so as to generate the resources required to create opportunities for meaningful work in areas such as community services, care of the elderly, environmental improvement and other necessary activity, which would provide a basis

for satisfying work for those who may not be otherwise likely to enter gainful employment.

Competitiveness

For an open economy like Ireland, growth and employment are dependent upon competitiveness. *The Council emphasises the need for a broad concept of competitiveness, embracing the development of innovation and efficiency in the economy, as well as the pursuit of cost and wage competitiveness.*

The pace of change - in technology, in markets, in products and in the efficient organisation of work - make it imperative to focus on ways of strengthening flexibility and adaptability as the key to long-run competitiveness. This competitive strength is best expressed as *innovation*, and the test of a country's competitiveness as its capacity to promote and sustain innovation. Strengthening and developing this capacity is a responsibility of both the public and private sectors.

Competitiveness is also enhanced through the operation of an efficient domestic market. The Report discusses the steps which need to be taken to promote greater efficiency in the public and private sectors. It emphasises the importance of *competition policy* in an open economy like Ireland and notes that competition measures assume an added importance in this country because of the extent to which high input prices, direct and indirect, may impinge upon the competitiveness of the traded sector. The Council recommends an expansion of the role of the Competition Authority to include additional powers to initiate investigation and pursue actions through the courts, if necessary. It also recommends a systematic review of public regulatory constraints.

With regard to *cost competitiveness*, the Council emphasises that income levels must be shaped by the need to preserve and deepen competitiveness against our main trading partners. This requirement applies equally to the public and private sectors. The pros and cons of different types of wage formation systems are discussed in some detail in the Report. The Council argues that, given the structure of the Irish economy and the competitive position of firms in both the traded and non-traded sectors, there are strong grounds for believing that decentralised bargaining would produce strong wage pressures, with higher settlements in high productivity or low competition sectors being transmitted rapidly to the rest of the economy. On balance, the Council is of the view that a negotiated consensus between the social partners on a wide range of issues - covering the evolution of public expenditure and taxation, the maintenance and implications of Ireland's exchange rate strategy, specific policies to promote the growth and employment performance of the economy, (including initiatives to increase employment opportunities for the long-term unemployed), *and* the evolution of incomes - is likely to represent the most effective mechanism for securing improved employment performance over the next few years.

Throughout the Report the Council takes the view that a focus on only one dimension of competitiveness - such as wage competitiveness - would be insufficient to build the type of competitive strengths needed for the Irish economy. On the other hand, it notes that a lack of cost - including wage competitiveness - would undermine the pursuit of a higher rate of sustainable employment growth, as well as jeopardising in the short-run the employment of those for whom cost competitiveness is currently the key to survival. In this context, the Council argues that the desired approach to wage determination would be a system which:

- (a) delivered moderate wage increases relative to our trading partners, especially the UK;

- (b) reduced the incentive to substitute capital for labour; and
- (c) insofar as it influenced wage dispersion, flexible work patterns and worksharing, facilitated the active labour market participation of the unemployed, including the long-term unemployed.

For the medium to long-run, it would be desirable that the wage determination system would support measures to strengthen competitiveness through increased productivity and innovation.

3. MACROECONOMIC STRATEGY

The Report reviews the conduct of macroeconomic policy since 1990 and sets out the Council's views on the future strategy required in respect of fiscal policy, exchange rate strategy and taxation policy.

Fiscal Policy

Despite the progress which has been made in recent years, Ireland's debt/GNP ratio remains high. Further reductions in the debt ratio are required in order to reduce the burden of debt service, free up resources to apply to other policy priorities and reduce the vulnerability of the economy to external movements in interest rates and exchange rates.

The Council believes that under a baseline assumption of 3% real growth per annum over the next three years, *a balanced target would be to reduce the debt/GNP ratio to around 95% by 1996 from the 104% anticipated at end-1993.* If pursuit of a coherent strategy of economic stability and structural reform as recommended by the Council results in a faster growth rate, the proceeds should be used to secure further reductions in the debt burden. This requires reducing the EBR below its 1993 level (the budgeted level of which is 3.3% of GNP when privatisation receipts are excluded). These budgetary targets can only be achieved by a significantly greater restraint on public expenditure than has existed for the past three years, particularly in relation to current expenditure.

The Council's budgetary targets permit of a very modest real increase in public expenditure, at a rate significantly lower than in the recent past. On the basis that effective restraint will be applied to public spending

generally, *the Council believes that priority within this modest increase should be given to direct resources targeted on the long-term unemployed.*

Exchange Rate Strategy

Exchange rate stability is an important element in securing the strong and sustained growth required to produce more rapid employment growth. It provides a foundation for low inflation and low real interest rates. However, the stability of an exchange rate is ultimately dependent upon its compatibility with economic conditions and the credibility of economic policy. Such credibility is, in the Council's view, most effectively secured by adhering to a *clear non-accommodating exchange rate strategy*. The prime distinguishing characteristic of such a strategy is that it does not seek to maintain international competitiveness by allowing the exchange rate to change in response to increases in domestic costs.

The Council reaffirms its view that EMU is ultimately the most appropriate exchange rate regime for Ireland and it urges an active approach by the Irish authorities to advance that objective. It favours the earliest possible restoration of the ERM narrow-bands, managed to take into account the experience of recent months, and Ireland's resumption of membership as soon as they are restored. It must be admitted that the prospects of such a development in the short-term seem slim. Should that prove to be the case, the Irish authorities will be required to conduct a policy within the very broad bands of fluctuation currently permitted. The Council considers that utilising these bands to their full extent would not be desirable in that it would represent a very weak nominal anchor for policy and for the economy. In these circumstances - and having regard to its core recommendation for a non-accommodating exchange rate - the Council favours the pursuit of low inflation via a fluctuation

zone within the ERM considerably narrower than the currently-permitted ERM band, but without rigid enforcement of this zone. It emphasises that the evolution of domestic policy, including incomes policy, will be a critical influence on the achievement of the goals of exchange rate strategy, both now and in the future.

Taxation Policy

The scope for tax reductions is limited given the needs of the population and the need to reduce the debt/GNP ratio. However, *there is considerable scope for tax reform to contribute to the growth of sustainable employment.*

The Council's priority with tax reform is to increase sustainable employment and to reduce unemployment. It considers therefore that *the focus should be on reducing effective tax rates on earned income.* The Council further believes that reducing the cost of employing lower paid workers relative to the cost of other factors of production would make the most direct contribution to reducing unemployment. This is because: firstly, high unemployment is heavily concentrated among those workers classified as "unskilled". Secondly, there is evidence of a secular decline in the demand for unskilled jobs. Thirdly, the demand for unskilled labour is the most cost sensitive: at higher levels non-cost factors become more significant. For these reasons, the Council considers that *reductions in taxation on earned incomes should be focused mainly on persons with low-to-middle incomes.*

The Council's approach to tax reform requires base widening measures to fund income tax reduction directed towards these target groups. The most significant base widening measure required is the introduction of a comprehensive property tax. However, there are also other base widening opportunities. In particular, if it is decided not to introduce a

comprehensive property tax, then the Council recommends restrictions on mortgage interest relief. Other feasible base widening measures include the abolition of exemptions for capital gains tax or the introduction of a carbon tax.

Any income tax reductions made possible by the widening of the tax base should be directed towards those in the lower to middle range of the income distribution. This can be achieved in a number of different ways: by increasing the standard rate band, by increasing personal allowances/exemption limit, by reducing the standard rate (or, more radically, by replacing personal allowances with tax credits). These changes would improve both efficiency and equity.

The Council believes that, as part of its overall programme of tax reform, *a restructuring of PRSI can contribute to improved employment performance*. In *A Strategy for the Nineties*, the Council recommended the introduction of a single lower rate of employees' PRSI without an exemption at the lower end or a ceiling at the upper end. The impact on employment of restructuring PRSI could be maximised if the restructuring was focused on achieving greater reductions at lower income levels, although this approach would have to have regard to the potentially negative impact on marginal tax rates. A long-run solution could be to replace PRSI with a more broadly-based social security tax (i.e. including non-wage forms of income in the base). The Council considers that these options for restructuring PRSI merit serious consideration.

The Council recommends the reduction of reliefs in the savings market which discriminate against productive investment. The Council does not rule out the use of tax expenditures to facilitate productive investment, but emphasises that such expenditures need to be subject to the same degree of rigorous control as direct public expenditure. It recommends

that Ireland should support a uniform withholding tax at a European level to address the problems posed by capital mobility.

The Council also recommends that the principle of base broadening and rate reduction should apply to indirect, as well as direct taxation. Where there are adverse distributional consequences, these should be addressed by targeted compensatory measures.

The restructuring of the tax system recommended by the Council is designed to be revenue neutral. It is acknowledged, however, that there would be difficulties associated with implementation. The difficulties arising from base widening measures may be more immediately visible than the gains from lower income and social security taxes. Tax reform requires difficult decisions to be taken but the Council believes that over time the benefits of tax reform would become more visible.

The changes recommended by the Council would have the effect of reducing the cost of labour while simultaneously increasing the incentive to accept employment. While individually each of the measures would have a limited impact on the demand for labour, taken together and combined with moderate income growth, macroeconomic stability, structural reform and the confidence generated accordingly, they could make a significant contribution to increasing the level of sustainable employment.

4. DEVELOPMENTAL POLICIES

The Report looks in detail at existing policies in respect of Agriculture, Industry and Services and sets out the Council's proposals for reform. It includes a discussion of two particular aspects of sectoral development - namely, policies for developing the Tourism Industry and issues relating to the Financing of Business Development.

Industrial Policy

The prospects for sustained employment growth in Ireland in the years ahead will be critically influenced by the performance of the manufacturing sector. In 1992, there were 223,000 people directly employed in manufacturing industry, representing 19.8% of total employment. 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. 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 must be 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. Overseas-owned industry must also play an important role.

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. 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. State support for individual companies in these intangible areas is likely to be ineffective, however, 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 isolated interventions at company level.

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 including: (a) 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; (b) the need to broaden the focus of Ireland's promotional activity to include, in particular, a much wider range of internationally-traded service activities; and (c) the need for a progressive reduction in the overall level of State aids in the European Community, while establishing within this a strong positive differential in the level of State aids available in peripheral regions relative to the core economies.

Agriculture and Food

The long-run trend in agricultural policies worldwide is towards greater liberalisation. The recent GATT Accord underlines this trend and highlights the *growing need for competitiveness in Irish agriculture*. In this regard the Council emphasises the need for effective policies in the areas of education, research and structural reform. Continuous improvements in competitiveness are necessary to safeguard as many

existing jobs as possible in the agriculture and food sectors and to provide a basis for employment growth in those areas which have development potential.

The desired strategic direction of the Irish food industry should be to move up the value chain, from basic commodities towards consumer foods. Previous efforts to develop the industry have had some success, although the industry remains very much commodity and support oriented. The Council agrees with the Culliton recommendation that State incentives for the food industry should be reduced, insofar as this recommendation relates to grants for fixed assets. It supports the reorientation of resources towards intangible assets, and the progressive movement from non-repayable grants to other repayable forms of finance.

The support driven nature of the food 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 changes in GATT. 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. This suggests that a concerted effort to support the development of the food industry could produce significantly better returns than previous efforts in the past.

There are opportunities for increasing employment in other natural resource based sectors, including fisheries (particularly in aquaculture), and in forestry. If the potential for employment growth in these areas is to be realised, existing constraints on development will need to be removed. Specifically in this regard, the Council recommends that the difficulties associated with the licensing system for aquaculture should be addressed and that much greater consistency be applied in national policies which affect land use.

Services Sector

The services sector will be the principal source of employment growth in the years ahead. While much of this growth will arise without the need for special assistance, the Council believes that *support for services development could be enhanced in a number of respects.* The growing internationalisation of the services sector, coupled with an increased awareness of the importance of efficiency and effectiveness in *all* service activities for the performance of the economy and of employment, calls for an appropriate reorientation of public policy.

The Council believes that the current policy of concentrating State assistance to services within the internationally-traded sub-sectors is appropriate. It argues however, that this approach could be supplemented and extended in a number of ways. 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 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.

Secondly, *there is a 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.

Thirdly, the greater exposure of services activity to international competition, and therefore the scope for developing services exports as well as the prospect of greater competition from overseas, requires an appropriate reorientation of policy. 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 aim of policy should be to strengthen the capacity of indigenous service firms to survive and expand to meet the emerging opportunities

Tourism provides one example of a services sector with considerable potential for employment growth. Development of the tourist industry must, therefore, have high priority in any strategy to increase employment. Tourist products must continue to be improved and expanded. This will provide a basis for reducing the seasonality of our tourism, which is a major constraint on employment and investment in the industry. Access must continue to be improved both as regards fares and services. Public policy should accord a high priority to quality control. More packaging of holidays is desirable: packaging helps to reduce the cost of access, which is high for an individual holiday because of our location. 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, to buy from and to visit. The high

cost of car hire is an impediment to growth in tourism and special measures are justified to reduce this cost in the peak season. Accommodation should continue to be improved and in certain categories expanded. The overall strategy for tourism should be to increase tourism earnings and employment. Towards this end, 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.

Financing the Development of Irish Business

While there is no indication of an overall shortage of finance in Ireland, certain aspects of the financing of business development impede the establishment and growth of indigenous enterprises. There is evidence of a *shortage of risk capital* in the economy. In addition, there is a gap between the needs and characteristics of Ireland's financial system and the needs and characteristics of the indigenous business sector. 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.

The Council believes that elements 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. In this context, the Council argues 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.*

The absence of mechanisms for buying in and out of most Irish businesses severely limits their attractiveness to outside investors. *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. The State development agencies could be used to help overcome the "information gap" on small companies and to reduce the high costs associated with researching and assessing a large number of small scale investments. Finally, in addition to its direct role in providing risk capital for Irish business, the State has a role to play in leveraging *private* investment into such companies.

5. SOCIAL POLICY

The final section of the Report looks at the development of Social Policy and sets out the Council's proposals in respect of Social Welfare Policy, Housing, Education and Training and Health. The Report suggests that social policy reform - by which is meant a restructuring of policies, services and subsidies within existing resources - can make a significant contribution to enhancing social equity. It argues that the role of area-based strategies should be developed and co-ordinated within a national framework for local development. The concentrated incidence of unemployment, low incomes and deprivation in certain communities and regions points to considerable scope for area "renewal" and community-based initiatives.

Social Welfare Policy

The Report reviews recent trends in social welfare payments and considers the impact of the social welfare and tax systems on the creation of unemployment and poverty traps. The unemployment trap 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. One of the primary causes of this trap in an Irish context is the system of child dependent additions (CDAs) which are paid to unemployed people with children, but are not available to those in employment. Accordingly, *the Council favours a gradual integration of these CDAs into the child benefit payment, within the context 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.

While the unemployment trap refers 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 may in fact yield 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. The problem arises because, in particular circumstances, the higher taxes/levies attracted by the new, increased level of gross income, when set alongside the possible loss or reduction of Family Income Supplement, possible increases in means-tested local authority rents and a loss of eligibility for medical cards, can combine to produce a drop in disposable income. *The Council's approach to the unemployment and poverty traps envisages that Child Dependent Additions (CDAs) and Family Income Supplement should gradually diminish in scope in the child income support arrangements, while the role of Child Benefit should be enhanced.*

With regard to payment levels, 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.*

Housing

The Council's recommendations on housing policy focus on the need to redistribute resources and expenditure both within and between housing sectors in the interests of equity and efficiency. The Report makes specific recommendations on owner-occupied housing, the Shared Ownership scheme, the private-rented sector, local authority housing,

the voluntary housing sector and urban renewal. It calls 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 believes that *general* cash subsidies for owner-occupiers are an inefficient and inequitable instrument and considers that such grants can only be appropriate if selective, and targeted to meet specific housing needs. *The Council believes 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.*⁴ The Council further recommends that, in the absence of a comprehensive property tax, a very restrictive stance of interest relief is justified. It proposes the phased abolition of stamp duties over a period of time as resources permit, when and *only* when the preconditions of property taxes and capital gains taxes are met. It emphasises that the implementation of these proposals must be accompanied by reductions in income taxation.

Education and Training

The Report considers the role which education and training policies can play in promoting employment growth and reducing unemployment, especially long-term unemployment. It notes 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. This calls for a *targeted and limited intervention to provide resources for*

4 The recommendations on the introduction of a comprehensive property tax and the taxation of capital gains on housing are subject to reservation by the CIF.

schools serving disadvantaged children to encourage/facilitate them to remain in school through the senior cycle of second level.

The Council supports the provision of a wider range of options in the senior cycle of second level education, more extensive in-service training for teachers and new local education structures. It points to the existence of a skills gap between Ireland and best practice firms in competitor countries and emphasises the need for management development in bridging this gap. It also recommends better integration of programmes directed at marginalized and poorly educated groups with the rest of the education and training system.

Health

The Report examines international trends in health expenditure and considers a range of options to control expenditure and improve equity and efficiency. *The Council reaffirms its support for a continuation of health care primarily based on public finance through a progressive general tax base. It argues 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. Implementation of this recommendation should take account of the changing situation arising from the liberalisation of insurance markets.* The Council also considers the important role of preventative strategies and recommends that more effective arrangements for co-operation between the voluntary and statutory sectors be put in place, especially in the development of community care services.

ANNEX 1:

TABLE OF CONTENTS OF NESC REPORT NO. 96 "A STRATEGY FOR COMPETITIVENESS, GROWTH AND EMPLOYMENT".

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ANNEX 2:

Information Note on NESC

The National Economic and Social Council was established in 1973. Its primary function is to advise the Government on the development of the national economy and the achievement of social justice. The Council is representative of the major economic and social interests in society, the employers, organised workers and farmers. In addition to advising the Government, the Council provides a forum in which views can be exchanged between people who have a common interest in the development of the economy and in the pursuit of social justice. Members of the Government meet with the NESC from time to time to discuss specific economic and social policy issues.

Over ninety reports on a wide variety of economic and social topics have already been published by the Council on areas such as general economic and social policy, industrial policy, housing, social service priorities and agriculture. The Council has undertaken pioneering work in a number of areas. In the early 1980s the Council's work on industrial policy was the first fundamental review of a set of policies which had been in place since the 1960s. In 1989 the Council published a major review of Ireland's EC membership. This study examined the likely impact of completion of the internal market on Ireland and charted a strategic approach to the development of the European Community.

The Council, in recent times, has concentrated more on strategic issues regarding the Irish economy. A series of recent reports have identified a set of inter-related policy measures which provide an overall framework for the management of the economy in the medium-term. The first of

these was "A Strategy for Development", published in 1986; it was followed in 1990 by "A Strategy for the Nineties" and, most recently, by "A Strategy for Competitiveness, Growth and Employment".

Further information on the Council and copies of the Council's reports are available from the Council or through the Government Publications Sales Office.

