

CHAPTER 5

WAGE BARGAINING

1. INTRODUCTION¹

In this chapter the Council considers the second element of a consistent and effective overall approach to economic policy: a system of incomes development which ensures a continued improvement in competitiveness, a successful resolution of distributional conflicts and which accords with ideas of fairness. Section 2 presents an analytical review of recent international research on the relationship between the institutional structure of the labour market and economic performance, Section 3 provides an overview of wage developments in Ireland since 1945, focusing in particular how wage levels have evolved over the period of the three national programmes, 1987-1996. Section 4 places Ireland in context, drawing on the concepts outlined in Section 3. It includes an analysis of public sector pay bargaining. Section 5 looks at wage bargaining in the context of European economic and monetary union (EMU). The prospect of EMU without sterling has prompted some to argue that Ireland needs to abandon or modify its centralised and co-ordinated system. These views are discussed and found to confront certain factual, conceptual and practical difficulties.

2. THE WAGE BARGAINING PROCESS – AN ANALYTICAL REVIEW

In preparation of its *Strategy* report, the Council undertook a review of analytical studies of the role of wage bargaining in national economic performance. Five main ideas emerge from that survey. These concern:

- (i) The superiority of extreme centralisation and decentralisation;
- (ii) The need to shift emphasis from *centralisation* to *co-ordination* and *encompassing* arrangements;
- (iii) How ‘market conformity’ is achieved in successful European economies;

¹ The Council is grateful to Sara Cantillon, of the Department of the Taoiseach, and Colm O’Reardon, of Wolfson College, Oxford, for assistance in preparation of this chapter.

- (iv) Wage dispersion may have a negative or positive effect on total employment;
- (v) The dominant role of co-operative behaviour in shaping positive outcomes.

These ideas are briefly outlined below. They are explained in more detail in the background paper, 'Wage Bargaining', prepared by the Council Secretariat.

(i) The Superiority of Extreme Centralisation and Extreme Decentralisation

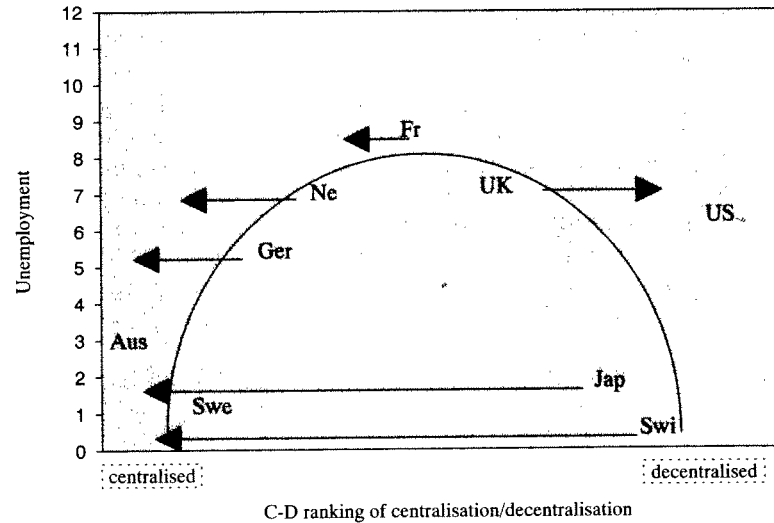
An important study, published in 1988, reopened economic analysis of the role of institutions in wage bargaining and linked economics to more political and sociological studies of comparative policy and performance. Calmfors and Driffill (1988) showed that by ranking the wage bargaining institutions of countries on a scale ranging from 'decentralised' to 'centralised' a hump-shaped relationship with unemployment was established. Wage bargaining systems that were either highly centralised (e.g. Austria and Sweden) or highly decentralised (e.g. the US, Japan and Switzerland) performed better than countries with 'middling' systems (UK, Germany, France and Italy). This relationship is shown in Figure 5.1, in which the location of each country name or abbreviation indicates its degree of centralisation/decentralisation (ignore arrows until Section (ii) below).

The reasoning behind the C-D argument is as follows. A trade union which achieves an increase in money wages at either company or industry level has two effects: it raises real wages and it reduces employment, since the company or industry price level will rise. The increase in real wage would be similar at either company or industry level. But the reduction of employment is likely to be larger at company level – since the demand for a single company's output will be more responsive to a rise in price, than the demand for a whole industry's output. Consequently, given unions' desire to avoid unemployment, more moderate wage setting behaviour can be expected at company level than at industry level.

If bargaining occurs at national level, another factor is introduced. An increase in money wages will apply to all workers in the economy, leading to equi-proportionate increase in the price level. Consequently, the first effect noted above, does not operate: there is no increase of real wages. Although relative prices don't change, employment will fall, since the economy wide rise in wages and prices reduces the real money supply. Consequently, the union setting wages at a centralised level will behave more moderately. This core argument – that both centralised and decentralised systems are superior to moderately centralised bargaining

– is the starting point of much recent analysis of the role of institutions in wage bargaining.

FIGURE 5.1
Calmfors-Driffill U-Shaped Relationship



Source: NESC Secretariat.

(ii) From Centralisation to Co-ordination

An important development of this approach is one which shifts the emphasis from centralisation/decentralisation to the concepts of *co-ordination* and *encompassing* agreements. This approach leads Soskice (1990) to the view that Calmfors and Driffill: (i) exaggerate the benefits of decentralised bargaining; and (ii) inadequately characterise more successful bargaining systems.

Some of the countries classified as decentralised by Calmfors and Driffill have, in fact, highly *co-ordinated* wage bargaining systems. In Japan, Switzerland, Germany and the Netherlands, formal negotiations are conducted below national level, but a variety of mechanisms ensure a high degree of co-ordination in wages across the economy. When these countries are reclassified (see arrows in Figure 5.1), the Calmfors-Driffill result tends to collapse, with only the US achieving low unemployment by means of a truly unco-ordinated wage bargaining system.

Soskice further challenges the merits of decentralised bargaining by showing that the assumptions which underlie the theory rarely apply. In particular, wages in weak firms tend to follow those set in more profitable firms. The reality in the UK is a 'perversely co-ordinated' system in which wage push in some sectors becomes generalised across the economy, producing overall wage growth ahead of productivity, with negative consequences for inflation and the exchange rate. Consequently, there is no longer any reason *a priori* to favour decentralised over industry-level bargaining.

Overall, the concept of *co-ordination* seems more important than the idea of centralisation. A key idea in explaining the success of co-ordinated wage bargaining systems is the concept of *encompassingness*. More encompassing organisations and bargains tend to take greater account of the economy-wide effects of any given action.

(iii) How 'Market Conformity' is Achieved in Successful European Economies

Crouch (1994) argues that a highly co-ordinated approach is successful, *only where* it combines a growing strength of institutions (necessary to give discipline and achieve encompassingness) with mechanisms for acquiring organisations to come to terms with market forces (independent central bank; export competitiveness for small, open economies; company level institutions; state-company relations etc.). From an Irish perspective, his survey reveals two points worthy of note. First, one relatively successful approach is the combination of co-ordinated wage bargaining with an independent monetary policy. Second, although globalisation weakens the institutions of co-ordination, it reinforces the needs for, and rewards from, co-ordination. This may be creating a trend towards active government support for co-ordination.

Both Austria and Germany are good examples of the combination of co-ordinated wage bargaining with an independent anti-inflationary policy. In the case of Austria, the link to the D-Mark has imposed a tough discipline guaranteeing market conformity, and the economy has maintained its strength, as well as relatively low unemployment, despite this constraint. At company level, market sensitivity is reinforced by works councils which, while closely related to trade unions, are formally independent of them and have a responsibility to work for the good of the employing company. Crouch believes that a similar approach – combining co-ordinated bargaining with market conformity – is achieved in several other small open European economies. Provided that organisations capable of responding strategically are in place, labour market actors are forced by the obviousness of the need to be competitive

in export markets not to try to solve their problems by protectionist behaviour.

Globalisation and technical change are undoubtedly weakening institutional structures in the labour market. On the other hand, global competition 'reinforces the need to co-ordinate and the rewards to be gained from co-ordination'. One result is that 'attempts to sustain various forms of co-ordinated bargaining will in future need more or less "artificial", that is state-generated rather than institutional support' (Crouch, 1994, p.192). These include state pressure for synchronised and encompassing bargaining and, more generally, support for social partnership institutions. In this, small open economies may be leading the way. With the rapid internationalisation of the economy, 'all European economies are now subordinate to international markets in a way that has long been the case for the Belgians and Danes'. This is an important observation, which challenges the argument that national factors have become irrelevant and the view that co-ordination and consensus are threatening to, rather than supportive of, international competitiveness.

(iv) Wage Dispersion May have a Negative Effect on Total Employment

In surveying analytical issues concerning wage bargaining, it is necessary to take account of wage dispersion. First, empirical evidence shows that wage differentials are much larger in some countries than others, and that bargaining structures have a significant influence on the level of dispersion. Second, an important argument against centralised bargaining is that greater wage flexibility is necessary in order to increase employment, especially of low skilled workers.

The dispersion of earnings across 15 to 25 industries in 17 advanced OECD countries has been calculated by Rowthorn. Most European countries have rather similar levels of wage dispersion and are in the middle range by international standards. Countries which adopted centralised wage bargaining systems in the post-war period, tend to have low levels of wage dispersion, reflecting a deliberate policy of squeezing differentials. Wage dispersion is generally much higher in the decentralised economies of Japan and North America. Taking all industrial workers together, wage dispersion has narrowed between 1973 and 1985 in most OECD countries. The narrowing of the male/female wage gap is the main factor responsible for the widespread reduction in wage dispersion over this period. However, wage dispersion has been increasing amongst men and women considered separately.

On the relationship between wage dispersion and employment, conflicting views exist. One school of thought argues that high wage differentials, by producing low pay at the bottom end of the scale, encourage the absorption of unskilled workers. The implication is that relative wage flexibility promotes employment and is a factor behind the rapid growth of jobs in the United States and certain other countries (Klau and Mittelstadt, 1986; Burda and Sachs, 1988). This view has not gone unchallenged.

Critics point out that regulatory mechanisms, such as centralised bargaining or incomes policies, have a complex impact on wages. While such mechanisms may keep wages up at the bottom end of the scale, they may also hold down wages at the top end. These two features have opposite implications for employment, and the job stimulating affect of wage restraint at the top end may conceivably outweigh the negative effect of high wages at the bottom. This is an empirical question to which no general answer is possible (Rowthorn, 1992 p.511).

Indeed, studies of the US economy in the 1970s and 1980s found that relative wage flexibility had a negative impact on total employment (Bell and Freeman, 1985; Freeman, 1995). The explanation for this may have relevance for Ireland: 'The upward flexibility of wages in technically dynamic industries predominated over downward flexibility in stagnant industries, so the net impact of flexibility on employment was negative'. Rowthorn's own econometric estimates provide limited support for the view that relative wage flexibility has a positive impact on employment. Moreover, he suggests that high wage dispersion does not appear to be the main reason why highly decentralised economies have performed relatively well in employment terms in recent years. Controlling for wage dispersion, he found that the performance of these economies still looks fairly good by international standards. Similar results were obtained in a study of several EC countries by Dewatripont (1988), and in comparison of the US and Europe by Glynn (1996).

(v) Co-operative Behaviour More Important than Centralisation/Decentralisation

Calmfors and Driffill assume that a union is concerned about wages and employment in those industries which it organises, but has no concern about conditions in other industries. Rowthorn explores how the effects of decentralisation are altered if more co-operative behaviour is allowed. His simulations suggest that the effect of even partial co-operation is dramatic. Unemployment at all levels of centralisation/decentralisation

is cut by approximately two thirds, and wage dispersion becomes almost negligible:

This outcome indicates how sensitive the Calmfors-Driffill model is to modification in its assumptions about the nature of bargaining. If only a moderate degree of altruism is introduced – motivated by consideration of long-term self interest, social responsibility or what have you – economic performance may be radically altered (Rowthorn, 1992 p.520).

This is so even at intermediate levels of centralisation which, in Calmfors-Driffill approach, are always characterised by high levels of unemployment. Such moderately centralised bargaining is the norm in most countries of the European core. A second important result is that with even a moderate level of co-operation, there is only a small difference between the outcomes with centralised, moderately centralised and decentralised bargaining. Consequently, the precise nature of the bargaining structure – upon which Calmfors-Driffill place total emphasis – is only important when behaviour is assumed to be largely non-co-operative. Where behaviour is more co-operative, the centralised/decentralised structure has only a minor influence.

This suggests that an important difference between centralised and moderately fragmented bargaining structures is their vulnerability to external shocks. When things are going well and the future seems clear, moderately fragmented structures may perform just as well as more centralised economies. Their success depends crucially on the general mood of play, 'which in turn depends on the subjective mood of the various parties involved'. In the face of a major shock these parties may revert to less co-operative forms of behaviour, which in economies of this type may have very serious consequences. By contrast, Rowthorn concludes that in more centralised economies, the extent of such a reversion is limited by the existence of very large organisations which can then ensure a fairly high level of internal co-operation. 'Moreover, even if a reversion to non-co-operative behaviour does occur, its effects in a highly centralised economy may be relatively small'. Indeed, this approach is consistent with the finding that co-ordinated bargaining produces greater *overall flexibility* and responsiveness of aggregate wages to economic conditions, even if it produces less flexibility in *wage differentials*. This underlines the importance, in Irish discussion, of distinguishing between different dimensions of flexibility.

While consistent with the Calmfors-Driffill findings, Rowthorn's research takes some of the emphasis off the centralised/decentralised bargaining structure and places it, instead, on the degree to which unions pursue a wider national interest and their own long-term self interest. The

Irish experience suggests that such a co-operative mood of play is, in turn, shaped by the existence of a wide-ranging national programme which aligns economic actors to particular policy approaches and provides trade union members with guarantees on non-wage issues, such as taxation and social provision.

(vi) Conclusions from the Analytical Survey

This review suggests three conclusions:

- (i) The case for co-ordinated wage bargaining is strong, on both empirical and analytical grounds;
- (ii) Co-ordinated wage bargaining must be led by the private, exposed, sector of the economy;
- (iii) The success of co-ordinated bargaining is dependent on the wider policy framework, including exchange rate policy, taxation, public provision and the extent to which unions adopt a long-term and national perspective.

3. OVERVIEW OF WAGE DEVELOPMENTS IN IRELAND

(i) Pay Determination from 1945 to 1987

The experience of wage bargaining and income determination in Ireland from 1945 to 1987 – as documented in studies by Hardiman (1988), Roche (1994) and Sheehan (1996) – underlines the relevance of the concepts discussed above. First and foremost, it confirms the need to go beyond a simple distinction between centralised and decentralised bargaining. A recent study emphasises that Irish collective bargaining has ‘largely been a story of failure both in regard to centralised pay bargaining and decentralised or “free for all” bargaining’ (Sheehan, 1996, p.21). Periods of centralised bargaining were characterised by significant wage drift above the norm, government difficulty in holding the line and, most importantly, divergent understandings of the economic conditions and mechanisms. Thus, the Irish case confirms that centralised bargaining is, on its own, not sufficient to produce a desirable economic outcome and underlines the concept of co-ordination and the need to consider institutionalisation. Likewise, it confirms that decentralised bargaining can be ‘perversely co-ordinated’, in ways which generate wage leadership and inflation. Periods of decentralised bargaining were marked by pay increases well ahead of inflation, industrial conflict and, occasionally, falling real incomes. The experience also shows how the wage bargaining system interacts with the broader framework of macroeconomic policy. Indeed, the Irish story is one of growing government involvement and

growing recognition of the need to link income determination to wider economic strategy. Likewise, Ireland confirms Rowthorn’s suggestion that the co-operative, or non-co-operative, ‘mood of play’ is at least as important as the centralisation/decentralisation of wage bargaining.

Despite the problems noted above, the period since the second World War saw many developments and innovations of a positive kind. These included the establishment of the Employer/Labour Conference in 1962, the development of two-tier picketing in the wake of the maintenance strike, the establishment of the National Industrial Economic Council and its focus on income and price issues, and the growing recognition that wage bargaining requires to be consistent with, and closely integrated with, wider economic and social policy. Indeed, many of these developments can now be seen as part of the evolution towards the more successful social partnership approach of recent years. A striking feature of this, and other aspects of Irish experience, is that the same basic elements which produce highly destructive outcomes in one context, can be supportive of success in another context. The key factor would seem to be the presence or absence of a consistent overall policy framework and a sufficiently shared understanding of key mechanisms, as discussed by the Council in its 1990 and 1993 *Strategy* documents and elsewhere in this report.

(ii) The Partnership Approach: An Overview

Since 1987 income developments have been conducted within the framework of negotiated national programmes and, as such, have become an integral part of a much wider policy agenda. What distinguishes income developments since 1987 from previous national wage bargaining agreements is the explicit linking of agreement on wages to agreement on the evolution of taxation, social security, social equity, public finances, and exchange rate and monetary policy. This marks a major change from previous periods of centralised bargaining, in which the various actors frequently operated with inconsistent views of the underlying economic realities and had more divergent agendas.

Pay Developments under the Social Partnership Programmes

The pay terms of the three national programmes are set out in Box 5.1, distinguishing between the private and public sectors. The evidence suggests fairly close adherence to the agreed pay norms. Figure 5.2 compares weekly earnings in manufacturing with the terms of the agreements and the inflation experience over the period 1987-1996. It suggests that during the PNR, pay drift (from the terms of the agreement) averaged about 1.5 per cent, but was significantly less under the PESP.

Under the PCW there has been some convergence of both the pay deal and actual rise in earnings on the inflation rate. Research by Durkan and Harmon suggests that the rate of wage inflation has been moderated by the social partnership agreements (Durkan and Harmon, 1996).

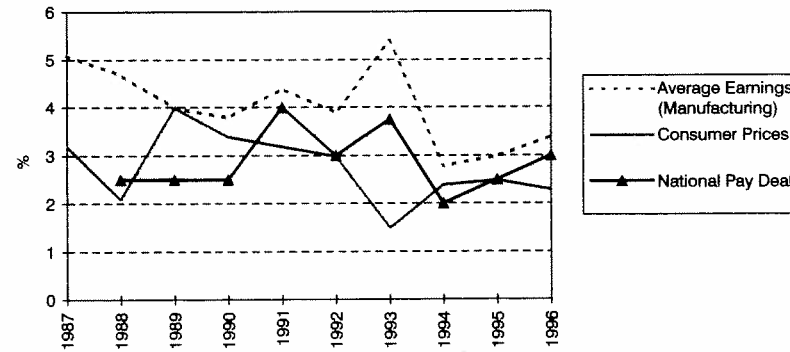
BOX 5.1

Pay Terms of PNR, PESP, PCW

| | Private | Public |
|--|--|--|
| PNR 1987-1990 | <ul style="list-style-type: none"> 3% on first £120 of basic weekly pay. 2% on any amount over £120. Guaranteed minimum increase of £4 a week. Started end of 1987 – concluded February 1989. Working hours reduced from 40 to 39. “Inability to pay clause”. | <ul style="list-style-type: none"> Overall shape of pay arrangement same. Public service agreement was for 36 months. Phasing in timetable to cover payment of any “special awards” made under C&A system. |
| PESP 1991-1993 | <ul style="list-style-type: none"> Basic agreement of 10.75% over 3 years (4% year 1, 3% year 2, 3.75% year 3). Guaranteed minimum increase of not less than £5, £4.25 and £5.75 in each of 3 years. Limited degree of local bargaining which allowed for local negotiations for a further increase of up to 3% in year 2 of programme. Industrial peace clause “Inability to pay clause” | <ul style="list-style-type: none"> Same basic pay increases. Local bargaining clause translated to “grade restructuring” or option to pursue “special claim” through C&A but limited to maximum of 3% to be paid in 3rd year of programme. |
| PCW 1994-1996 Under PCW separate pay agreement for construction industry | <ul style="list-style-type: none"> Pay agreement based on 4 phases: 2.5% for 12 months; 2.5% for 12 months; 2.5% for 6 months and 1.0% for 6 months. Minimum increase of £3.50 in respect of 2nd and 3rd phases of agreement. New clause dealing with training and employee involvement. “Inability to pay clause” Five months pay pause 39 month agreement 2 per cent for 12 months (after 5 month pause); 2 per cent for 12 months; 2 per cent for 4 months; 1% for 3 months; 1% for 3 months | <ul style="list-style-type: none"> Public service pay agreement: 2% for 12 months (after 5 month pause); 2% for 12 months; 1.5% for 4 months; 1.5% for 3 months; 1% for 6 months, minimum pay of £2.80; £2.10 in phases 3 and 4. 3% outstanding under local bargaining clause of PESP. 1% paid up front, the remainder depending on local negotiation. This to encompass unfinished business arising from the PESP. Public service agreement spread over 42 months. |

FIGURE 5.2

Earnings, National Pay Agreements and Inflation



Source: Department of Finance.

Surveys undertaken by *Industrial Relations News* and by the Research Department of SIPTU suggest very high levels of adherence to the pay terms set out in the three agreements, with between 90 and 95 per cent of all firms in the private sector conforming to the pay discipline of the national programmes since 1987. Furthermore, the data suggest that the trend setters or early starters adhered to the agreements. In the few cases where the terms of the pay deals were exceeded, no “headlines” were established for others to follow. Pay deals that breached the national terms did not have any significant knock-on effects for individual companies or sectors of industry (Sheehan 1996).

As discussed in Chapter 1, the period since 1987 has seen the number of industrial disputes reduce dramatically. The trend in days lost in industrial dispute has also been downward with an acceleration in the trend since 1993.

Increases in Take Home Pay

The pay aspect of the social partnership programmes was one element of a broader economic and social strategy. The fairly moderate pace of wage developments was compensated for by changes in the tax system (most notably income tax), and, indeed, by lower inflation.

TABLE 5.1
Changes in Real Take Home Pay, 1978-1996
(Average Manufacturing Earnings)
Annual Percentage Change

| Year | Single | Married (1 Earner, 2 Children) |
|------|--------|-----------------------------------|
| 1977 | - | - |
| 1978 | 6.97 | 10.47 |
| 1979 | 9.34 | 9.96 |
| 1980 | -6.15 | -7.03 |
| 1981 | -4.21 | -6.06 |
| 1982 | -5.02 | -4.94 |
| 1983 | -3.98 | -3.35 |
| 1984 | 0.67 | 0.91 |
| 1985 | 1.0 | 1.53 |
| 1986 | 4.66 | 3.48 |
| 1987 | -0.14 | 0.32 |
| 1988 | 4.17 | 2.42 |
| 1989 | 2.03 | 1.26 |
| 1990 | 1.73 | 1.15 |
| 1991 | 1.27 | 1.46 |
| 1992 | 3.21 | 1.86 |
| 1993 | 1.3 | 2.09 |
| 1994 | 3.16 | 2.4 |
| 1995 | 2.54 | 1.87 |
| 1996 | 1.85 | 1.79 |

Source: Department of Finance.

The figures in Table 5.1 show that real take home pay did increase considerably between 1987 and 1996, especially when compared to the early 1980s. In 1978 and 1979, the real take home pay of a married worker (one earner, 2 children on average manufacturing earnings) increased by over 10 per cent. In 1980 the same worker received a sharp fall in his/her net take home pay. The fall in real take home pay that characterised the

first half of the 1980s turned into steady, if moderate, increases from 1989 onwards. While the increases in take home pay may be regarded as moderate in a period of historically high economic growth, they need to be considered within the overall macroeconomic strategy that guides the partnership approach. The moderate wage developments unfold in parallel with reductions in personal income tax, which in turn are related to an unprecedented rate of employment growth. The importance of recognising the broader economic and social context and strategy – encompassing a centralised wage agreement and a shared understanding of the relationships between the different objectives in the Irish economy – cannot be over-emphasised.

Relative Wages or Wage Competitiveness

The economic stability, and adherence to the moderate pay terms arising out of the three national programmes, has enhanced the competitiveness of the economy. Table 5.2 shows indices for Business Sector Earnings for Ireland, the UK, the US, Germany, France and Ireland's main trading partners as a group (UK, USA, Germany, France, Italy, Japan, Netherlands, Belgium and Denmark). Between 1987 and 1994, manufacturing weekly earnings in Ireland, adjusted for exchange rate movements, grew at a slower rate than earnings for our main trading partners as a group. Gains of a similar magnitude were made against the UK over the same period. In 1994 and 1995 there was some loss of competitiveness, especially against the UK. In 1996 earnings growth in Ireland is expected to increase at a slower rate than those of our main trading partners, which should allow for marginal gains against the UK, the EU and our main trading partners as a group.

TABLE 5.2
Hourly Earnings in Common Currency

| Year | UK | USA | Germany | France | Main Partners | Ireland |
|------|-------|-------|---------|--------|---------------|---------|
| 1986 | 98.0 | 115.0 | 94.0 | 99.0 | 99.0 | 101.0 |
| 1987 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1988 | 114.8 | 102.6 | 103.1 | 102.7 | 106.9 | 104.3 |
| 1989 | 123.0 | 113.6 | 106.4 | 107.2 | 114.0 | 108.2 |
| 1990 | 127.4 | 103.2 | 111.9 | 114.4 | 116.1 | 114.4 |
| 1991 | 140.6 | 110.3 | 117.4 | 118.6 | 124.9 | 120.8 |
| 1992 | 139.9 | 111.0 | 131.1 | 125.1 | 129.2 | 127.4 |
| 1993 | 135.4 | 127.2 | 142.9 | 132.0 | 134.4 | 128.3 |
| 1994 | 139.7 | 129.7 | 149.1 | 134.6 | 138.7 | 133.9 |

Note: The 1994 estimate for Irish earnings is based on data for the first three quarters.

Source: *Economic Review and Outlook*, various issues.

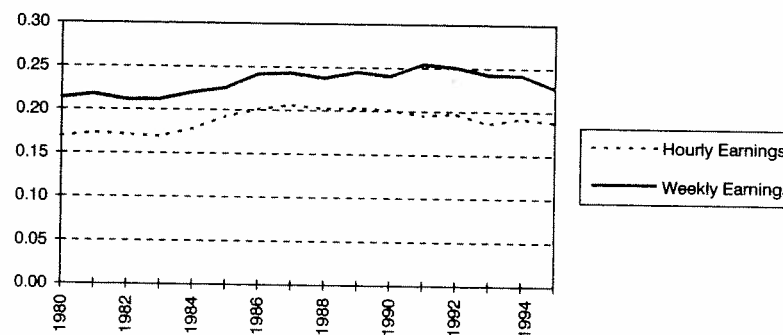
(iii) Wage Dispersion

It was noted in Section 2 (iv) that economists working on labour market developments in the advanced economies have increasingly focused attention on wage dispersion. The dispersion of earnings in Ireland has attracted little research attention to date (but see Nolan, 1993). This section takes a preliminary look at wage dispersion in Ireland, while emphasising that a rigorous examination is not possible without more detailed income data.

In reporting trends in wage dispersion in the private sector, we use data on average earnings in industry, from 1980 to 1995, derived from the CSO's *Quarterly Industrial Inquiry*. Changes in wage dispersion in other sectors, or changes due to the changing composition of employment across sectors, are not captured. This is particularly unfortunate, given the growth in the services sector, which may be of major significance in increasing wage dispersion. Moreover, measures of dispersion calculated using the available data cannot capture changes in the dispersion of earnings *within* sectors, which have also been identified as important in other countries. The measure of dispersion most commonly used in similar studies is the coefficient of variation – the standard deviation

divided by the mean. It has the advantage of being invariant with respect to the units of measurement employed. Hence one can make international comparisons of wage dispersion without adjusting for exchange rates between currencies, and one can compare changes in the dispersion of earnings in a given country over time without having to adjust for changes in the price level. The trends in inter-industry earnings dispersion using aggregate data are shown in Figure 5.3 below.

FIGURE 5.3
Inter-Industry Wage Dispersion, All Employees 1980-1995
Co-efficient of Variation



Source: CSO.

The dispersion of both hourly and weekly earnings increased from 1982 to 1986/87, the period of decentralised bargaining between the last National Understanding and the PNR. Thereafter, there is evidence of a downward trend in the weighted hourly data. The dispersion of weekly earnings remained roughly constant from 1987 to 1990, increased significantly between 1990 and 1991, and then began to decline.

Rowthorn (1992) places considerable emphasis on using the average earnings of male and female employees in each sector as separate data points in calculating inter-industry wage dispersion. Trends in the coefficient of variation calculated with separate observations on average Irish male and female earnings show a similar trend to that discussed above, although the absolute level of wage dispersion is, as one might expect, generally higher. Once again, the level of wage dispersion is higher for weekly than for hourly data.

Given the limitations of the data, and the complexity of the trends revealed, only tentative conclusions are possible. The main trends provide some confirmation for the view that decentralised bargaining increases dispersion and centralised bargaining limits it. However, the sharp rise in dispersion in 1991 is contrary to this, and remains to be explained. Further conclusions on the relationship between social partnership programmes and earnings dispersion awaits a more extensive analysis drawing on individual income data, and including the services sectors, such as may be available from the CSO *Household Budget Survey*.

Data on public sector pay suggest that wage dispersion within the public service has widened over the duration of the three national agreements. Pay of senior and managerial civil servants increased at a much faster rate than pay for clerical staff. Percentage increases for Secretary, Assistant Secretary and Principal Officers have ranged from 80 to over 100 percent between 1987-96, while the percentage increase for Clerical and Administrative staff ranged from 35 – 47 percent over the same period. A Clerical Officer's maximum as a percent of a Secretary's maximum decreased from 22 per cent in 1987 to 15 per cent in 1996. Developments in public sector pay are discussed in more detail in Section 4(iv) below.

4. INTERPRETING IRISH DEVELOPMENTS

(i) Wage Bargaining in a Sterling Regime

It has been suggested above that the Irish experience in much of the post-war period, illustrated failure of both centralised and decentralised wage bargaining. While this experience was a most unhappy one, there was one important mitigating factor. Irish wage bargainers were struggling to find a suitable system for a rapidly changing economy, in a difficult macroeconomic context. That context – the link with sterling – was one which made achievement of a consistent overall policy approach virtually impossible. This aspect of the context was discussed in the Council's 1990 *Strategy* report. The failure of the British combination of macroeconomic policy and income determination to control inflation became acute at just the time when Ireland's trade relations were shifting away from the UK. This produced threats to Ireland's wider competitiveness and imparted an inflationary bias to Ireland's income determination process. Severing the link with sterling and joining the EMS provided the basis for a more suitable macroeconomic policy approach.

(ii) Wage Bargaining in the EMS Regime

The decision to join reflected the belief that a hard currency peg was the best policy instrument for achieving low inflation in a small and extremely open economy. The role of social partnership in relation to participation in EMS has been a beneficial one. The implications of EMS were embodied in the PNR, the PESP and the PCW, and since the widening of the ERM balance in 1993, the social partners have remained committed to a credible, non-accommodating, exchange-rate policy. While technical arguments suggest that this is the best exchange rate regime for a country such as Ireland (compared with a crawling peg or free float – Honohan, 1993), developments in Ireland and other EU countries show that technical mechanisms can only be effective where the relationship between inflation, incomes and public expenditure is resolved. Adopting this approach, Ireland has made major advances in economic management and economic performance. In particular, consensus on this long-run strategy has taken the exchange rate, and therefore inflation, outside political competition and industrial relations conflict. The relationship between wage bargaining and exchange rate policy is discussed further in Section 5, below.

(iii) Criticism of Centralised Wage Bargaining and Partnership

Criticism of Ireland's experiment in social partnership has come from some economists. The social partners are seen as 'insiders', whose arrangements are responsible for Ireland's continuing high level of unemployment. Walsh and Leddin express these views as follows:

It could be argued that centralised agreements have protected the pay and conditions of work of those who have jobs in the public sector and the unionised private sector at the expense of the outsiders who would work for less. This has the effect of increasing the supply of labour to the unprotected sectors of the economy (which include the informal or "black" economy) where pay and conditions of work for young job seekers have probably deteriorated, and raising the level of unemployment and emigration (Walsh and Leddin, 1992).

This argument requires careful consideration. At least two qualifications seem warranted.

First, the proposition – implicit in the above quote – that centralised agreements have prevented the unemployed undercutting the wage of existing workers and has, thereby, increased unemployment, is questionable. In *The Labour Market as a Social Institution*, Robert Solow,

the Nobel prize winning economist, examines the fundamental features of labour markets. Among those fundamental features, observed almost everywhere, is the absence of wage under-cutting by unemployed workers:

I focus on what has always seemed to me to be one of the main puzzles about the labour market and one of the main reasons for doubting the validity of the standard view. That is: when there is a non-trivial amount of unemployment, why is there not active competition for the limited number of jobs, and why does that competition not force wages down quite promptly? This is what we expect from artichokes and rental departments, and it is roughly what we get (Solow, 1990, p.4).

Solow develops a conceptual framework – containing notions of fairness and institutional norms – which explains why wage under-cutting is no more in the interest of firms, than it is of workers or unions:

This is a powerful result. It resolves an important paradox. When there are a lot of unemployed workers, you might expect employers actively to solicit competitive wage cutting on their part. It rarely happens. The cases when it does happen ... are striking enough to call attention to the fact that it does not happen in run of the mill recessions (Solow, 1990, p.37).

Thus, Solow shows that in *normal* labour markets, there are norms which prevent wage under-cutting. These serve to prevent a sort of Hobbesian competition in which life in the labour market would be very unpleasant – ‘nasty, brutish and short’. Consequently, it seems inaccurate, on the part of Walsh and Leddin, to attribute the absence of wage under-cutting in Ireland with the existence of *centralised* agreements in the past decade.

Second, in arguing that social partnership arrangements are maintaining a high level of unemployment, these economists ignore the fact that without national programmes, income determination will remain a non-competitive, highly collectivised, process, with tendencies to monopoly power on both sides of industry. Ireland is unlikely to move to the atomistic bargaining which underpins the analytical argument. It remains to be explained how, in a world of partially decentralised, sectional and non-political bargaining, agents acting in their own self interest will take *greater* account of the problems of the unemployed and other marginalised groups.

(iv) Public Sector Wage Developments

Concerns Over Public Sector Pay

Given the centrality of public finance issues, it is natural that public sector pay is an important factor in Ireland’s overall economic strategy. In recent times, concern has been expressed by various commentators that the PNR, the PESP and the PCW have given rise to excessively large increases in public service pay. While the meaning of ‘excessive’ is not always clear, it might refer to: (i) pay rises faster than in the private sector; (ii) overall pay increases faster than is appropriate in public finance terms; or (iii) pay increases faster than are warranted by performance within the public sector. In order to clarify this issue, and to identify an approach to future policy, it is important to establish some facts concerning public sector pay under the PNR, the PESP and the PCW. This is done in the next section. Following that, the Council offers a general interpretation of the direction of change in public sector pay bargaining. Finally, it makes some recommendations concerning future developments.

Developments in Public Sector Pay

Under the PNR and the PESP similar general increases were provided for in the public and private sector, but the timing of increases was less favourable in the public sector.

Each of the three agreements contained provisions for dealing with public service claims for the improvements in pay and conditions (often referred to as “special” or, more recently, “local bargaining” claims) beyond general increases. It is these provisions which are the key to understanding public sector pay developments in the period of social partnership. When the PNR was being negotiated, a series of “special” increases was already well under way in the public service under the traditional industrial relations procedures. The PNR allowed for the processing of these claims. However, for cost and budgetary reasons, it provided for phased implementation. This spread payment of the increases over a long period from 1989 to 1992. It is this which explains much of the bulge in the overall exchequer pay and pensions bill shown in Table 5.3. It shows the breakdown between general and special increases, and highlights the significance of special increases in the period 1990-93. Although these increases were paid during the partnership period, they provide limited grounds for a general critique of the PNR or PESP as social partnership agreements, since they reflect the pre-PNR system of comparability – a point made by the Council in its 1993 *Strategy* report. Another factor causing an increase in total public sector pay is the changing composition of the sector. The number of highly skilled people is rising in proportion to the number in general grades.

TABLE 5.3
Reasons for Increases in the Exchequer Pay and Pensions Bill,
1987-1996

| Year | Total Bill £m | Increased Over Previous Year £m | Of Which General Rounds £m | Of which Special Increases £m | Of Which Residual (see below) £m |
|----------------------|------------------|--|-------------------------------------|--|---|
| 1987 | 2,759 | | | | |
| 1988 | 2,845 | 86 | 89 | 42 | -45 |
| 1989 | 2,914 | 69 | 70 | 40 | -41 |
| 1990 | 3,160 | 246 | 70 | 99 | 77 |
| 1991 | 3,382 | 222 | 135 | 110 | -23 |
| 1992 | 3,750 | 368 | 75 | 132 | 161 |
| 1993 | 4,087 | 337 | 209 | 70 | 58 |
| 1994 | 4,356 | 269 | 106 | 18 | 145 |
| 1995 | 4,567 | 211 | 32 | 43 | 136 |
| 1996 | 4,806 | 239 | 95 | 67 | 77 |
| Increase 1987 – 1996 | | 2,047 | 881 | 621 | 545 |

Notes: The residual element is accounted for by a number of factors, other than pay increases which affect the Exchequer Pay and Pensions Bill. These are mainly:

- increases in numbers employed, arising from commitments in PESP, Programme for a Partnership Government and PCW (e.g. hospital waiting list initiatives, law and order programme and extra provision for teachers to reduce class size);
- variations in timing of ESF and other offsetting receipts;
- drift due to structural changes;
- increments;
- variations in the number of pay days in the calendar year in question;
- variations in the pay/non-pay classification of expenditure from time to time;
- in 1994, the addition of the May-Day bank holiday.

Source: Department of Finance.

At the time of the PESP negotiations, most public service groups had further special pay claims down for consideration. In the case of the public

service, the PESP local bargaining clause was seen as covering these special claims. The negotiation of these 'grade restructuring' agreements – deriving from the PESP, as modified by the PCW – has been protracted. Many of the recently reported public pay negotiations and ballots have their origin in the PESP local bargaining clause as it applied in the public sector. It is important that this is understood.

How do public sector developments compare with the private sector? As noted above, the general increases were similar in both sectors, although the timing was less favourable in the public sector. Comparison of the local bargaining outcome is more difficult. As described above, few settlements have been reached under the PESP local bargaining clause in the public service but they are emerging under the PCW. Private sector developments are varied and not entirely transparent. Most private sector employees have benefited from the 3 per cent local bargaining clause. However, this is not true in all cases. In some firms, pay increases have been considerably less. In other cases, major "productivity" deals involving significant pay increases have been negotiated.

Interpretation

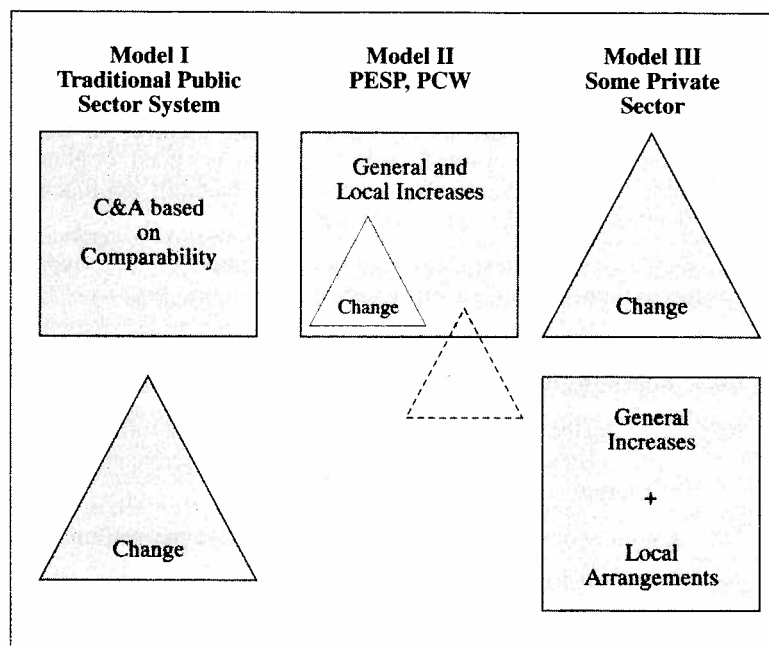
Some commentary on developments in public sector pay under the PNR, the PESP and the PCW has not been well founded. First, there has been insufficient recognition of the extent to which the PNR period was influenced by awards granted earlier, under the Conciliation and Arbitration (C&A) machinery, and insufficient recognition of the way in which unresolved issues under the PESP have coloured developments under the PCW. Second, certain, widely publicised, comparisons of the increase in 'average' pay in the public sector with increase in average industrial earnings are of doubtful value.

Understanding the *origin* of current public sector pay negotiations, does not imply satisfaction with the *system* or acceptance of the *outcome*. The public sector pay system has undoubtedly undergone an important evolution in the period under review. Prior to 1987, the system was based on an established C&A process. This generally involved arbitration on the basis of comparisons with private sector developments. Most importantly, in granting increases based on comparability with the private sector, no conditions were attached concerning change in work practices, organisation or efficiency. Indeed, certain changes were seen as grounds for additional pay awards. In comparison with this, the PESP constituted something of a change. While it allowed for the processing of further special claims, it provided that full account had to be taken of the need for flexibility and change. Indeed, the PESP local bargaining clause became a negotiation of 'grade restructuring', involving negotiations on

flexibility and change. The PCW constituted further evolution, by capping local bargaining settlements and underlining the idea that these must be paid for with increased efficiency and effectiveness. In this regime, the older comparability principle has certainly been suspended, but two difficult features remain. First, the inclusion of change in the payment of local bargaining is proving difficult. Second, relativities across the public sector are still closely studied and cited in negotiations.

This evolution might be represented schematically in Figure 5.4. This shows three possible ways in which general and special pay increases might be determined and how they might relate to change in work practices. The old system of conciliation and arbitration (Model I in Figure 5.4) was one which did not explicitly include change, as represented schematically. The PESP and PCW constituted a significant evolution, because the negotiation of local bargaining and special increases was deemed to include change. This might be seen as a step towards a system more akin to that which operates in some parts of the private sector: in which ongoing change is delivered by management and workers without necessarily being rewarded in pay increases, and in which performance-related reward systems are becoming more common (as depicted on the right-hand side of Figure 5.4). However, the Council is concerned that this new system has not fully taken root and is not adequately understood and accepted. Thus, the correct schematic representation of the PESP/PCW system in the public sector might be shown by the dotted triangle, which is not entirely encompassed within general and local pay bargaining. Thus, far from moving to Model III in Figure 5.4, the public system seems not to have securely reached Model II. In this, it is the element of change, rather than the rates of pay increase, which seem most contentious.

FIGURE 5.4
Three Models of Wage Determination



Source: NESC Secretariat.

Council Recommendations

The Council accepts that public sector developments have formally accorded with *procedures* laid down in the PESP and the PCW. It is, nonetheless, concerned that the *outcome* of those negotiations should produce an increase in overall pay which is consistent with the needs of the economy and society. In that context, the Council believes that there must be greater change in the organisation and efficiency of the public sector. In this regard, it highlights the principles outlined in Chapter 1. Private sector pay has, in the past decade, been shaped by two strong disciplines. The first is the discipline of market competition, which does not operate in the public sector. The second is the discipline of social partnership, which has curbed wage growth, even in profitable sectors, and limited tax reductions to those which are consistent with increased social spending. The extent to which this second discipline has operated throughout the public sector is not entirely clear. Social partnership has

two dimensions: inter-dependence and solidarity. As outlined in Chapter 1, one aspect of inter-dependence is recognition that the fate of the market economy is strongly shaped by the cost and quality of public services. One aspect of solidarity is recognition that public sector pay growth ahead of that in the private sector – or beyond what is appropriate in public finance terms, or faster than is warranted by performance – directly limits the possibility of tax relief for low paid workers, and directly curtails the possibility of improving the living standards and chances of those suffering unemployment and social exclusion. There is a need for greater dissemination of the meaning of the social partnership approach – particularly inter-dependence and solidarity.

In the Council's view, the next national programme must produce a public sector wage settlement which achieves six things:

- (i) Settlements in line with those in the private sector;
- (ii) Adherence to the terms on the Treaty on European Union;
- (iii) Implementation of the Strategic Management Initiative and other reform programmes so as to deliver effective services at minimum cost;
- (iv) Closer synchronisation of public and private pay settlements;
- (v) Promotes national competitiveness;
- (vi) Supports achievement of the fiscal policy recommended by the Council.

The first of these requirements for any new national programme is of the utmost importance. The increase in public sector pay should be no greater than the increase in private sector pay, and should be determined by the growth of earnings in the exposed, competitive, sectors of the economy.

The public sector pay provisions of the new national programme must ensure Ireland's continued adherence to the Maastricht criteria for participation in EMU. Furthermore, the public sector pay settlement must do this while allowing room for the priorities – on social inclusion and taxation – outlined elsewhere in this report.

Public sector pay settlements must incorporate the Strategic Management Initiative and other reform programmes. The SMI implies radical and extensive change in the organisation of the public sector. This change is vital in order to secure Ireland's competitiveness and provide Irish citizens with the quantity and quality of public services which they deserve. As noted in Chapter 1, these institutional dimensions of the non-traded sector are important determinants of economic and social

success in the globalised economy. While the SMI clearly poses challenges to public sector workers and their unions, the Council strongly believes that, overall, the change involved can increase job satisfaction. The SMI also poses a challenge to public sector managers, in pay bargaining and in other areas (see Chapter 12).

Fourth, the Council recommends closer synchronisation of public and private sector settlements. It could be argued that this prolonged spreading of pay increases, combined with a series of deferrals, is one cause of current difficulties in public service pay. The sense of frustration over the dragging out of the process, grievance over perceived unfairness, combined with rising expectations in the light of a historically buoyant economy, has arguably created a worse situation now, than if the increases had been settled promptly under PESP. If this argument is accepted, it suggests that private and public pay settlements should be more closely synchronised. The empirical and analytical studies, surveyed in Section 2 above, underline the dangers which unsynchronised pay settlements can create. In an unsynchronised process, what one group sees as a 'catch up', another group sees as a pre-emptive advance. In the Council's view, the issue is not to seek a definitive answer on the origin of any given public sector settlement, but to devise a system which prevents the emergence of leap-frogging claims.

These outcomes – reflecting the principles of inter-dependence and solidarity – are necessary so that inevitable structural and procedural differences between the public and private sectors do not undermine the possibility of a coherent national approach to both competitiveness and unemployment.

5. WAGE BARGAINING IN THE CONTEXT OF EMU

In recent years, it has been suggested that movement to EMU will have implications for Irish wage bargaining. While this is often discussed as an aspect of EMU, the real issue is the Sterling factor and, in particular, the possibility that the UK may not join EMU and the additional possibility that Sterling may suddenly weaken. The *extent* of Irish exposure to a sudden weakness of Sterling has been analysed in the recent study by the ESRI (Baker *et al*, 1996). Given that study, the Council's concern is how Ireland should address any problems which might arise from excessive volatility of Sterling.

Two arguments have been put forward in recent years:

- (i) Centralised wage bargaining is 'inconsistent with a fixed exchange rate policy' (O'Leary and Leddin, 1996);

- (ii) Irish wage contracts (at national or firm level) should be related to the Sterling exchange rate (Geary and Honohan, 1995; de Buitléir, Halpin and McArdle, 1995).

In the Council's view, these proposals for abandonment of co-ordinated wage bargaining, or direct relation of wages to the sterling exchange rate, confront certain problems of a factual, conceptual and practical nature.

(i) **Factual Issues**

Factually, these proposals would seem to be based on the misapprehension that the PNR, the PESP and the PCW are entirely inflexible arrangements, which prevent managers and workers addressing problems arising from the weakness of sterling. All the evidence suggests that this assumption is unwarranted. Under each of the national programmes, there are numerous ways in which particular difficulties are addressed by both management and workers. There is clear evidence of this, even if we confine ourselves to wage flexibility. Deferrals of pay increases, invocation of inability to pay clauses, and even the settlements below the norm, have been common responses to commercial difficulties (Sheehan, 1996).

When we consider other dimensions of flexibility – such as numerical flexibility (hiring and firing) and functional flexibility (the organisation of work) – this point is underlined. Indeed, one of the striking characteristics of the social partnership developed in Ireland in the past decade, has been the combination of disciplined national-level arrangements with rapid and highly flexible changes in organisation and technology at the level of enterprises (Teague, 1995; Taylor 1996; Jacobson, 1996; Sabel, 1996).

(ii) **Conceptual Issues**

Conceptually, these proposals would seem to confront problems. Several of them would seem to be based on a conceptual framework which does not acknowledge the role of national programmes in making Ireland's ERM parity and low inflation policy work. Consequently, there is little recognition that in abandoning the current wage bargaining system in order to address the *residual* problem – created by the *possibility* of a sudden fall in the value of sterling – Ireland could undermine its *main* macroeconomic policy – low and predictable inflation via ERM and EMU. If one adopts an analytical approach which sees little virtue in co-ordinated wage bargaining, then there is no trade-off, and hence no difficulty, in proposing downward money wage flexibility to accommodate possible future excessive fluctuations of sterling. It is

notable that those who propose that Irish wages be linked to the Sterling exchange rate have said little about what should happen in the event that Sterling *strengthens* against the Irish currency or the Euro.

Low Inflation via Exchange Rate Policy and Co-Ordinated Bargaining

As noted in Section 2, there is evidence that co-ordinated wage bargaining, as part of a wider consensus, can play a significant role in maintaining low inflation by means of a hard currency peg. Accounts of the complex German system indicate that – despite the absence of a formal system of discussion at national level between the social partners, the government or the Bundesbank – co-ordinated wage bargaining and exchange rate policy are closely related. As Crouch says:

Far from being contradictory, corporatism and the Bundesbank play complimentary roles; organisations within the former, knowing that the latter cannot be brought within their influence, accommodate its requirements (Crouch, 1994, p.178).

A similar relationship between co-ordinated wage bargaining and exchange rate policy is evident in countries which shadow the Deutschmark, such as the Netherlands and Austria. Indeed, these cases are particularly relevant to Ireland.

Correct Exchange Rate Plus Correct Incentives

There are further connections between co-ordinated wage bargaining, inflation and the exchange rate, which suggest that Ireland's exchange rate policy is aided, rather than undermined by, co-ordinated bargaining. With non-co-ordinated bargaining and a union approach focused on short-term real wage increases:

A fixed exchange rate, if credible, has the *opposite* effect to that desired, as far as the union bargaining behaviour is concerned. By contrast to the desire of the German engineering union for a low real exchange rate to preserve long term competitiveness and hence employment – favouring low nominal wage growth – UK unions will prefer high nominal wage growth since the fixed exchange rate translates that into a higher real wage. (Soskice, 1990, p.59).

It is most important to recognise that exchange rate policy can create incentives for either moderate wage growth or high wage growth, depending on the wider institutional framework within which wage bargaining occurs. These considerations may not have been taken adequately into account in proposals that Irish membership of ERM and

EMU requires abandonment of the partnership approach developed over the past decade or a direct link between Irish wages and the value of Sterling.

(iii) Practical Issues

In their discussion of how Ireland should deal with the sterling issue de Butléir, Halpin and McArdle say:

Our proposal to deal with the problem is that the payment of a portion, perhaps up to 10% of the pay bill in both the public and private sectors be in the form of a bonus linked to exchange rate movements.... Given the importance of getting the principle of pay flexibility accepted, consideration should be given to the introduction of a limited and temporary tax incentive if this helps to make the proposal more acceptable (de Butléir, Halpin and McArdle, 1995).

The Council does not believe that this is a practical possibility. Since this impracticality is a major drawback of these proposals, it is important that this point is made clear.

The improbability of labour contracts embodying flexible wages is a long-standing theme in the study of labour markets. In *The Wealth of Nations*, Adam Smith noted that:

The wages of labour do not in Great Britain fluctuate with the price of provisions. These vary everywhere from year to year, frequently from month to month. But in many places the money price of labour remains uniformly the same sometimes for half a century together (Smith, 1776, p 83).

Drawing on observation of labour markets and the work of economists who have studied them in detail, Solow (1990) identifies four important characteristics. First, wherever buyers and sellers have a durable relationship, notions of fair treatment are likely to make an appearance. Second, wage rates and employment are profoundly entwined with social status and self esteem. Third, fair wages will tend to be sticky wages, and analysis of labour markets must try to understand, rather than criticise, the relative inflexibility of wages. Fourth, since management and labour are in an ongoing relationship, complex patterns of co-operation tend to emerge. This raises some doubts about the 'importance of getting the principle of pay flexibility accepted', and the feasibility of a national pay agreement incorporating a bonus linked to exchange rate movements.

A similar conclusion is reached by Geary and Honohan in their discussion of various proposals for addressing problems which might arise from a

sudden weakness of Sterling. In arguing that it is hard to see such a nation-wide scheme being enforceable outside the public sector, they cite a large body of analytical literature which explains why wage contracts seldom make provision for wage cuts during bad times. Indeed, they emphasise that employers are no more anxious for such arrangements than unions:

The key feature of these models is precisely that the efficient solution involves fixed wages, with output variations being absorbed through variations in employment. Thus, they appear to provide little support for the idea that variations in wages could be used for the insurance purpose (Geary and Honohan, 1995, p.8).

This would seem to underline the impracticality of specifying downward wage flexibility as the mechanism for dealing with the possibility of excessive volatility of Sterling.

Nevertheless, despite the considerable, if imperfect, ability of foreign exchange markets to assist hedging – Geary and Honohan propose that exchange rate linked wage contracts at firm level might assist Ireland in addressing the sterling problem (Geary and Honohan, 1995). But their careful discussion of what such contracts would have to achieve tends to raise further doubts about their feasibility and desirability. They note that wages should be indexed on UK prices as well as on the nominal exchange rate. If the contract does not give back to the worker the benefits of exchange rate pass-through to domestic UK prices, then the wages that emerge will be seen as having drifted in an unfair manner and prove to be unacceptable as a base line for the new contract. As well as involving less co-ordination of Irish wage settlements, introducing unsynchronised behaviour and establishing a most unusual wage contract, this may allow a return of the type of inflation-based bargaining which proved so destructive in previous decades. In addition, linking wage settlements to the sterling exchange rate, could alter the incentives which Irish workers face. This could weaken the national consensus on the use of a credible, non-accommodating, exchange rate in the transition to full EMU.

(v) Conclusion

In the Council's view, there are four major requirements for dealing with the possible occurrence of Sterling weakness in the context of Irish membership and UK non-membership of EMU. First, it is necessary that, in the face of a rapid depreciation of Sterling, the relevant Irish partners have sufficient trust to address the problem in a timely and effective way. In the Council's view, co-ordinated wage bargaining, in the context of a

negotiated social partnership programme, which is operational at the level of the individual enterprise, is the environment most likely to guarantee the necessary degree of trust, information-flow and burden-sharing. The existing arrangements for monitoring national programmes could be utilised to provide a mechanism for review should this be necessary. Second, every effort must be made – in public policy, individual enterprises, IBEC, ICTU and other associations – to strengthen the underlying competitiveness of Irish businesses. Third, it is necessary to achieve further reduction in the non-wage costs of labour, through reform of tax and PRSI. Fourth, it is necessary to assist Irish enterprises to make maximum use of financial market hedging instruments, while recognising that these instruments will not provide complete cover.

Profit sharing arrangements can have significant benefits at both enterprise and macroeconomic level. Where these are developed, they can also assist the handling of problems arising from downward movement in Sterling.

6. CONCLUSION: PAY IN THE IRISH ECONOMY

Applying these analytical and practical conclusions to Ireland, indicates some features of a desirable pay system. The pay determination system in Ireland is one which must:

- (i) Recognise the need for improvements in competitiveness and employment;
- (ii) Take account of tax reform measures in facilitating wage moderation, while providing for increased take-home pay;
- (iii) Assist restructuring in enterprises and public sector organisations;
- (iv) Utilise performance related reward systems and share achieved gains;
- (v) Facilitate the active labour market participation of the unemployed.

The Council sees a pay bargaining system which meets these goals as a fundamental element of national economic and social strategy. Several aspects of such a pay system can be identified.

Past experience shows that decentralised wage bargaining can result in higher settlements in high productivity or low competition sectors being transmitted to the rest of the economy. 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, co-ordinated bargaining – in the context of a negotiated national programme – is the approach most likely to yield appropriate settlements across the economy. There are strong arguments for the view that, in the Irish context, a negotiated consensus – with a non-accommodating exchange rate as the sheet anchor of macroeconomic policy – must include agreement on the evolution of pay, taxation, the public finances, the exchange rate and monetary policy, and the level of publicly provided services and social welfare.

PART III

**Priority Action for
Structural Change**

CHAPTER 6

ENTERPRISE AND COMPETITIVENESS

1. INTRODUCTION

A major theme of this report is the link which exists between social exclusion and exclusion from the labour market. It is beyond doubt that the performance of measures to overcome unemployment will be improved in a climate of buoyant economic growth and job creation. Public policy has a number of roles in creating such an environment. This chapter looks at the sectors with the highest potential for job creation and suggests a number of policy responses to maximise this potential.

Industrial development policy in Ireland has traditionally concentrated on manufacturing industry with considerable success in terms of the number of jobs generated in this sector. However, the major source of job creation in recent years, and for the foreseeable future, is the service sector. Section 2 of this chapter identifies the scope of this sector, the opportunities which service sector growth offers to Ireland and the issues which need to be addressed by policy. Many services have become internationally tradeable and FDI has become important. Ireland is well placed to avail of these opportunities. In addition, services play a key role as inputs to manufacturing industry and enhance the competitiveness of Irish manufacturing exports. Non-traded services are also important and, due to the broad range of skills required, have an important role to play in reintegrating the unemployed into the labour market. In addition, a competitive local service sector enhances the welfare of consumers.

Over the past decade or so, research in industrial economics has highlighted the importance of interactions between firms, and between firms and national economic institutions. The Council has recently undertaken research into the way public policy may be able to promote the development of networks between firms as a means to overcome some factors which may inhibit their development and to enhance their competitiveness. Section 3 shows the way in which public policy can stimulate the development of inter-firm networks as a means to encourage the development of indigenous Irish firms.

Despite the ongoing decline in the numbers employed in agriculture, the sector remains a vital part of the Irish economy. In the coming years, as

a result of a number of factors agriculture will be faced with important challenges. Section 4 emphasises the importance of adopting a strategic response to these challenges and the need for Ireland to ensure that the interests of agriculture are protected within any reforms of EU policy.

The Council is concerned that the rate of investment in Ireland has been falling. Investment in both fixed capital and intangible assets is vital for future competitiveness. Section 5 summarises recent work on the determinants of investment and suggests some policy responses. Investment is also important in the area of transport and logistics to enhance Ireland's competitiveness. This is discussed in Section 6.

Concerns about the environment and the importance of pursuing economic development in a sustainable manner have come to the fore over recent decades. Ireland is generally perceived to have preserved a relatively clean environment. Section 7 shows the importance of ensuring that future development occurs in a sustainable manner. In addition, the importance of overcoming current and growing problems of waste management is emphasised.

2. THE SERVICE SECTOR

(i) Classification of Service Activities

Private service activities may be classified in several ways (see Figure 6.1). They encompass activities from high-value professional services, such as the provision of medical or legal services, to much lower value activities, such as cleaning and catering. As a result, their economic impact can vary greatly, as can the value of employment provided. Some service sectors have seen the emergence of oligopolistic practices, although in general the provision of services is largely by small firms, with a few major exceptions. Many operate in highly regulated sectors and deregulation in many activities is still in its initial stages.

Historically, services were considered non-traded, but changes in trade regimes and technological innovations have resulted in the possibility of trade in many services. Traded services have usually been viewed as important for economic development and have thus been favoured in terms of financial and fiscal incentives. Non-traded services, on the other hand, have largely been viewed as depending on the wealth creation of the traded sectors. The Council believes that analysis of the current stage of development of the Irish economy indicates that, in addition to export promotion, which remains important to Ireland's economic development, increased attention must also be paid to the role of non-traded services in overcoming the problem of long-term unemployment.

FIGURE 6.1
Classification of Service Activities

| | Producer | Consumer |
|------------|------------------------------|------------------|
| Traded | Advertising, Data Processing | Tourism, Design |
| Non-Traded | Legal, Accountancy | Health, Personal |
| High Value | Consultancy | Professional |
| Low Value | Security | Hairdressing |

Output which is used as an input into further production, the equivalent of an intermediate good, is classified as a producer service, while output which is directly consumed is distinguished as a consumer service. Within both of these sectors it is found that a wide range of skill levels exists and, while both are predominantly composed of small firms, some industries are dominated by very large firms. In addition, recent years have seen the emergence of intermediate forms of organisation.

(ii) Services in the Irish Economy

In common with most other developed economies, the service sector in Ireland has shown rapid growth over recent decades. Services now account for approximately 60 per cent of total employment in Ireland, compared with only 43 per cent in 1971. In fact, employment creation in services has accounted for the majority of recent new jobs in the Irish economy. The recent Forfás report, *Shaping Our Future* (Forfás, 1996a) forecast that 85 per cent of all new jobs in the future will be created in service industries. The sector accounts for approximately 55 per cent of GNP, which is less than in most other OECD economies. This is partly as a result of the relatively strong performance of manufacturing and the importance of agriculture in the Irish economy.

The changing sectoral composition of employment in Ireland is shown in Table 6.1. The figure for public sector employment is calculated on the assumption that 50 per cent of employees in commercial semi-state companies are engaged in service activities.

TABLE 6.1
Employment by Sector

| | 1988 | | 1991 | | 1995 | |
|------------------|-------|-------|-------|-------|-------|-------|
| | (000) | % | (000) | % | (000) | % |
| Agriculture | 165 | 15.1 | 155 | 13.7 | 139 | 11.3 |
| Manufacturing | 299 | 27.4 | 323 | 28.5 | 342 | 27.8 |
| Private Services | 388 | 35.6 | 416 | 36.7 | 501 | 40.6 |
| Public Services | 238 | 21.9 | 240 | 21.1 | 250 | 20.3 |
| Total | 1090 | 100.0 | 1134 | 100.0 | 1232 | 100.0 |

Source: CSO.

The table shows that in 1995 private services accounted for over half of total employment in the private sector of the Irish economy having grown by 20 per cent since 1991. Employment in manufacturing grew at a rate sufficient to maintain its share of total employment since 1988, while employment in agriculture declined substantially. This rapid growth confirms that overall employment performance is increasingly dependent on employment in the service sectors.

Urban Concentration of Services

It has been recorded in many countries that service employment tends to concentrate in urban areas. There is also evidence of the existence of this urban/rural difference in Ireland. The CSO Labour Force Survey shows that, in 1995, private services accounted for 56.3 per cent of non-agricultural employment in the Dublin region. In areas outside Dublin, employment in these services sectors in 1995 accounted for 47.6 per cent of non-agricultural employment. Service employment grew by over 20.7 per cent in Dublin in the period 1988 to 1995 and by 15.9 per cent in regions outside Dublin partly reflecting regional disparities in economic performance. Evidence from other countries suggests that where such a picture emerges there is a tendency for high value-added services to concentrate in the urban regions, while the lower value services tend to be more evenly dispersed.

Employment Intensity of Growth

Although increases in the output of the service sector generally have a relatively large impact on employment creation, the commonly expressed idea that services employment exists predominantly in low-value

occupations may be a misconception. Productivity gains are possible in services. The opportunities for changes in the technology of production were limited in the past but, as has become clear in recent years from experience in other countries, innovation is as possible, and important, in the service sector as in other sectors. Furthermore, new technologies have now opened up many new service industries, especially those employing advanced telecommunications technologies.

A number of other features of the service sector also make it attractive as a potential source of employment creation. Examination of input/output tables show that the percentage of inputs to services sourced in Ireland, at just under 80 per cent, is considerably higher than that for the manufacturing sector, at 55 per cent. Only agriculture, which sources almost 87 per cent of its inputs in Ireland has a greater impact on domestic demand per unit of output. In addition, over 34 per cent of total costs of the service sector were paid as wages, compared to only 14 per cent in manufacturing firms and less than 4 per cent in agriculture. As a result, incremental growth in the service sector would be expected to have substantial multiplier effects in the Irish economy.

(iii) *Producer Services*

Examination of international trade between 1970 and 1990 shows that the proportion accounted for by many service sectors did not increase greatly. However, the growth of producer services, both in terms of their share of national output and their share of international trade, has drawn attention to their potential for export and employment creation. In addition, this is one sector in which the newly emerging Asian economies, and in particular Japan, have consistently run substantial deficits with the rest of the world. As a result, it is worth examining this sector to identify what opportunities there may be for a country such as Ireland.

Explanations of Growth

One of the explanations put forward for this rapid growth has been a perceived tendency for large corporations to out-source functions previously undertaken in-house. Examples of this would be data processing, legal services or design. A major cause of this is the increasing technical division of labour which exists within firms. As a result of this increasing specialisation, a number of niches have appeared which independent smaller firms can exploit. In addition, the ongoing concentration of capital resources, which has occurred in recent years, has led to an increasingly oligopolistic environment for international commerce. This development has enhanced the need for sophisticated

management structures and ever more complex control systems. This has resulted in a need to concentrate on the core operation of the firm and employ specialised help for secondary operations.

While out-sourcing may be a partial explanation for the growing demand in this market, a number of other factors are also important. The growth in importance of international commerce has enhanced the need to ensure competitiveness through innovation, new forms of organisation and activities such as advertising and R&D. This has led to a growth in the demand for these services which is increasingly supplied by independent firms. New technology has also resulted in the creation of new professional roles, such as information technology consultancy, experts in systems integration and programming. These new services have been the fastest growing producer services in recent years. Finally, changes in institutions such as the business environment, regulation and competition laws have led to an increase in demand for producer services, such as legal advice, data handling and lobbying.

Not all types of producer services are likely to become equally tradeable and geographically dispersed. There is evidence that the higher value-added activities, the so-called front office activities, require face-to-face contact which means that these activities will remain concentrated in the more highly developed regions. Similarly, due to the high labour intensity and lack of innovation possibilities in the lower value-added activities, such as cleaning or security, there is little evidence that any international trade could take place in these services. This leaves a broad range of intermediate value activities, and some high value activities, where the location of the service provider need not be close to the customer base. These activities would include back office services, such as data processing and market research, as well as production inputs, such as software development and design. For many of these activities – in particular, data processing – cost competitiveness remains a crucial attribute of any region attempting to develop an export service industry. Such activities are likely to locate in emerging low cost regions which have attained a competitive level of education and communications infrastructure, possibly in the emerging economies in Central and Eastern Europe.

The main opportunities for Ireland will exist in a number of niche service activities, where qualitative factors outweigh the importance of obtaining very low cost labour, and communications technology means that close proximity to customers is not required. The recent Forfás report – *Shaping Our Future* – identified a number of examples of these services. These include tele-sales and marketing – where language fluency and some knowledge of local European conditions are key attributes – software

development and design. Examination of IDA data for recent years show that while FDI in services accounted for under 5 per cent of total FDI, in value terms, services projects accounted for approximately 50 per cent of projects, with job creation in foreign firms accounting for almost 25 per cent of new employment.

While FDI in services will be an important source of job creation, the development of competitive indigenous firms is important due to the vital role these industries play in aiding the competitiveness of manufacturing industry. As noted above, a number of the major producer services remain non-tradeable and require close proximity between suppliers and customers. Thus, it is just as important to ensure a competitive environment for non-traded producer services as for traded services.

Policy action is required in a number of areas to bring this about. Of primary importance is the avoidance of anti-competitive market behaviour by existing service firms. Because services are generally non-resaleable, many opportunities exist for price discrimination. In addition, there is a general consensus that the service sector remain highly regulated and, as a result competition is restricted. In Ireland, the public sector has also emerged as an important supplier of producer services. Despite progress, the Council believes some sectors still exist in which public firms may be inhibiting the emergence of private sector suppliers. In addition, the traditional argument that service providers have a social role to play, may in fact be counter-productive if it results in the provision of services to industry at non-competitive rates and poorer levels of quality. The public sector is also a major customer for these services. The development of competitive industries means that customers must demand the highest possible quality from suppliers. The strict enforcement of EU laws in relation to public procurement will help in some regard. However, where services are non-tradeable, it is essential that the public sector itself adopts commercial criteria and insists on the availability of competitively priced producer services.

The Council accepts that service firms have received less support from economic development agencies than have manufacturing firms. This includes firms in non-traded services which may have the potential to develop as sub-suppliers to foreign-owned manufacturing and indigenous exporting firms. Policy initiatives should recognise the importance of these firms which make a considerable contribution to the competitiveness of exports. Thus the emphasis on exporting firms should include an emphasis on the development of those service firms engaged in the sub-supply to existing export orientated manufacturing firms. The Council recommends that initiatives for service firms to link more closely with internationally based firms should be explored. Areas which could

... examined include a pilot on extending the National Linkage Programme to the service sector. The Council is also concerned that the competitiveness of Irish based firms may be reduced by having to pay higher prices than firms in other countries for non-traded services. The fact that local services have an important role to play in building competitiveness underlines the need for policy to ensure they are produced in a competitive environment.

Infrastructure and Competition

To avail of the opportunities, it is particularly important that public policy ensures that the correct physical infrastructure is in place and that competitive practices are followed to ensure that these resources are correctly utilised. There are indications, however, that Ireland is experiencing difficulties in bringing this about. A recent report by Forfás, *Telecommunications and Enterprise: Building and Investing for Our Future* (Forfás, 1996b), found that Ireland is still not competitive in the provision of basic telecommunications services. Rather than being a leading light, it found that policy was generally reactive and inadequate for the requirements of meeting the competitive challenge in this area. This is particularly important since improvements would bring jobs in the telecommunications industry and because of the major effect which it has on many other sectors. This is further underlined by the fact that Forfás believe that the sectors on which telecommunications has some of the greatest impact are those in which Ireland could potentially have competitive advantages due to its educated workforce and the fact that it is an English speaking country. The Forfás report found that some deficiencies exist in our telecommunications infrastructure but, even where these have been overcome, the existing infrastructure is not being utilised in a competitive manner due to anti-competitive regulations. The Council is particularly concerned by findings such as this. It welcomes the move to find a strategic partner for Telecom Eireann but remains concerned that political and vested interests have resulted in a slow pace of change and an inability to adapt flexibly in an industry which is evolving so rapidly. Failure to avail of the opportunities provided by the growth of telecommunications would cost Ireland dearly in the future.

(iv) Consumer Services

Most consumer services are provided locally and are non-traded. The major exceptions are tourism, telecommunications and some financial services, such as credit card provision. Consumer services tend to be concentrated in very small enterprises, but some are provided by very large firms, such as the banks and utility companies. In addition, recent

years have seen the growth of medium sized companies in some sectors such as retailing and hotel chains.

Information technology has resulted in the emergence of some new internationally-traded consumer service industries in recent years. As a result, FDI has grown and Ireland has been among the most successful in attracting inflows of investment. The most prominent examples are in customer backup and advice firms operated by the major computer companies. This FDI has resulted in additional new employment.

Irish economic development policy has concentrated, with considerable success, on export led growth. It is clear, however, that a large proportion of Ireland's unemployed are effectively removed from the labour market through the incidence of long-term unemployment. Further improvements in the competitiveness of the Irish economy, which will result in increased exports, will demand labour predominantly from new entrants to the labour force, rather than from the long-term unemployed. Employment in the local service sector often requires low and moderate levels of training. As a result, growth in this sector, resulting from either the overall expansion of the economy or specific targeted measures, may lead to employment opportunities for the long-term unemployed. In addition, policies which reduce the cost of provision of local services, while ensuring competitive practices are maintained, effectively increase the real incomes of those already in employment. In other words, they achieve a higher level of economic welfare for any given level of money income.

In relation to corporation tax, the lower rate of 30 per cent introduced this year will assist many service firms. Insofar as further changes in corporation tax would lead to an expansion in the output of these firms, such changes should be considered.

The service sector has suffered as a result of high costs in a number of other sectors, in particular, costs such as insurance, administrative burdens and high priced utilities. Thus, efforts to improve competition and reduce regulation in these other sectors will have a direct and important impact on the expansion of the local service sector. A policy role also exists to extend the use of quality indicators such as the Q-Mark and ISO Certification.

Positive effects could also be achieved by the removal of certain regulatory requirements or an easing of the administrative burden, particularly on small services firms. Since local services tend to be labour intensive, measures to reduce the cost of labour in these firms could have positive effects. In this respect, measures to reduce the tax wedge are particularly important. Wage levels in local service providers tend to be

lower than in many other sectors. As such, this provides a strong rationale for measures to reduce taxes on the low paid, as argued elsewhere in this report.

(v) **Tourism**

Performance

The tourism industry in Ireland has a number of distinctive features which warrant its individual attention in this review. First, its size means that it is a major industry in Ireland, accounting for around 7 per cent of GNP and directly employing over 55,000 people in the economy. When the indirect impacts of tourism are included, the total number of jobs in the Irish economy depending on tourism exceeds 100,000. The industry has also contributed a large proportion of the new jobs created in recent years. Second, while predominantly a consumer service, it is one in which revenues from international trade greatly outweigh those from domestic consumption. Third, and unlike many other service sectors, it has been afforded considerable attention by policy-makers in recent years. Strongly growing demand, in addition to EU and state funding, which has resulted in a very high level of investment in recent years, have resulted in rapid growth. In addition, measures have been introduced to liberalise complementary activities, for example, deregulation of air routes.

The value of tourism in the Irish economy and the growth rate achieved in recent years are shown in Table 6.2. These rates are well above the OECD average and contrast greatly with the period prior to 1987 when Irish tourism was relatively stagnant despite rapid growth in world tourism. It is forecast that Irish tourism will continue to grow for the foreseeable future.

TABLE 6.2
Overseas Visitors to Ireland 1989-1995

| | 1989 | 1991 | 1993 | 1995 |
|------------------|------|------|------|------|
| Visitors (000's) | 2732 | 2997 | 3348 | 4231 |
| Revenue (£m) | 661 | 835 | 1014 | 1286 |

Note: Table excludes visitors from Northern Ireland and passenger fare receipts of Irish carriers.

Source: CSO.

The industry is one which has a number of features which make its development particularly attractive for the Irish economy. It is regionally dispersed, employs a wide range of skills and is compatible with part-time employment. In addition, capital requirements are moderate, it is generally perceived to have a low import content and utilises resources, in which Ireland has a competitive advantage, in an environmentally-friendly manner.

Weaknesses

Despite these achievements, a number of problems exist in the tourism industry, which could inhibit its future success. First, the industry is regionally concentrated, and while growth has been recorded in all areas, the greatest absolute increases have occurred in the already strong regions, particularly Dublin. While recognising that Dublin still accounts for a lower proportion of total revenue than is the case for capital cities in many countries, this pattern of growth suggests that tourism remains weak in a number of regions.

Second, the growth which has taken place in tourism has coincided with a fall in the average real revenue received per visitor. This is caused by the growth in the importance of shorter breaks in Irish tourism. However, Ireland has not increased the proportion of higher spending, up-market tourists among total visitors.

The third problem in Irish tourism is the extreme seasonality of demand, whereby visitors are concentrated in a short period during the summer. This problem is considerably worse in the western regions of the country than in Dublin. Improving the seasonal profile is a major target of the Tourism Operational Programme. Seasonality imposes a number of costs on the economy. It leads to overcrowding in the busy season and the virtual disappearance of the industry in many areas in the off-season. It also results in a low level of product utilisation and lower profitability and investment, in the absence of grants. Seasonality also means that a much lower level of full-time jobs are created. In fact, the criticism that tourism is a producer of low reward employment is important, since this could be one cause of labour shortages in the industry in recent years.

Tourism has been shown to be a successful industry in Ireland in terms of growth and job creation. Regional and seasonal concentration contributes greatly to problems of overcrowding which have appeared in the most popular areas during peak months. For growth to be sustainable, it is important that due recognition is taken of an area's carrying capacity in the provision of funds to new enterprises. The Council recommends that a greater emphasis be placed in future on overcoming weaknesses in

lagging areas, although aggregate growth rates may not be as great under such a strategy as they have been in recent years. Targeted promotion will be an important instrument in achieving this.

Current tourism policy in Ireland relies, to a large extent, on the availability of funding from the EU. It is unlikely that this will be maintained on anything like the same level after 1999. As a result, initiatives will be required to ensure the high level of investment in Irish tourism is maintained after this date.

(vi) Recommendations for the Service Sector

The Council believes that there is a need for policy to re-examine the job creation potential of local and sub-supply services and enhance their role in the competitiveness of manufacturing industry.

This approach requires an examination of the taxation system, in particular, the high level of corporation tax on services and the impact of the tax wedge on labour demand. Many services, in particular, local services, are concentrated in low wage sectors. The Council believes that the job creation possibilities of these sectors, and the likelihood that these new employment opportunities would be available to the long-term unemployed, strengthens the case for reforms of the income tax system to assist low wage earners.

The Council recommends exploration of the possible ways in which the development agencies could actively help the growth of service firms. Of particular importance is the possibility of developing the producer service sector as a sub-supply to FDI located in the Irish economy. The Council recommends an increased emphasis on fostering linkages between manufacturing and service firms towards this end.

It is vital that a number of potential deficiencies on the supply-side are addressed and that Ireland's competitiveness as a centre for international services is strengthened. The Council believes that a high priority must be given to ensure an adequate outflow of well qualified graduates with relevant skills. It strongly supports the call by Forfás for a concentration on upgrading the language skills and computer literacy of the labour force. The Council believes that all levels of education must be included in a major programme to enhance these skills. The Council also supports the recent calls by Forfás for the formulation of initiatives to build on Ireland's early leadership in telecommunications and is particularly concerned that policy has been slow to overcome some infrastructural deficiencies and anti-competitive practices in the telecommunications industry.

The Council stresses the importance of overcoming instances of over-regulation and anti-competitive behaviour in all parts of the service sector. These have direct effects on the availability of services, on the welfare of consumers and on the competitiveness of commercial clients.

The tradeability of tourism and favourable demand conditions make it unique in terms of growth potential. The Council observes that although industry is considerably stronger and more vibrant in recent years, a number of weaknesses still exist. The Council strongly advocates that a strategy for the further development of the industry beyond the current phase of structural funding should be developed. It is important that issues relating to the capacity of an area to absorb further inflows must be given prominence in the distribution of subsidies. In addition, action will be required, on the part of both employers and the authorities, to overcome criticisms that the industry often produces low value employment. The resources devoted to human resource development may also need review, recognising that a high quality tourism product requires the creation of high quality employment. It would be particularly disappointing if labour and skill shortages were to damage the growth prospects of an industry in which so much has been achieved.

3. NETWORKING

(i) Policy in Dynamic Regions

In order to deepen competitive advantage and create higher employment, Ireland needs to increase the role of the indigenous sector and its constituent firms and industries in the economy. International research indicates that all firms and industries are not of equal significance to a country's long term competitiveness. This means that the economy should not be considered just a random collection of firms and industrial sectors but, rather, that certain agglomerations of firms and industries are significant in the creation of competitiveness. In addition, empirical research has indicated that certain regions within Europe have experienced long run economic performance which is considerably better than neighbouring regions or Europe as a whole.

The existence of linkages between enterprises, which results in the creation of networks of related firms, may enhance competitiveness by overcoming a series of problems – such as transactions costs, incentives and problems with bargaining – which may tend to stifle economic activity. They are also widely believed to be conducive to innovation which is in itself an important source of competitive advantage. An important feature of networks is the retention and creation of a combination of co-operation and competition. Thus, they retain the

economic vitality which lies in the flexibility and innovation that come from decentralised and autonomous design capabilities, but are aided by public policy which, as research has shown, plays an important role in facilitating and sustaining networks.

The Council decided that examination of certain European dynamic regions could aid in the discovery of certain features of public policy which aid the creation of networks. It is important, however, to note two points. First, it is not intended that Irish policy could simply imitate policy in other areas, although institutional learning or borrowing is certainly possible. Second, it must be recognised that regions in which large world-leading corporations are dominant, or where success is based on expensive, fundamental research and development or around a large metropolitan area would not be suitable candidates from which Ireland could learn.

(ii) Policy Findings

The work undertaken by the Council has resulted in a number of interesting findings which have recently been published (NESC, 1996). All the regions studied have achieved high rates of economic growth and employment creation over a number of years. The presence of networks among small indigenous firms within each region is particularly noteworthy. In addition, it was found that public policy initiatives and a range of other institutions have played a vital role in creating an entrepreneurial climate and promoting innovation. Public policy can help in bringing about collective action including the provision of information and leadership. The Council believes that now is the time to promote collaboration by means of a network programme.

An underlying principle of this programme would be that enterprises could get access to the kind of resources which SMEs operating alone would not have at their disposal. The Council envisages that the Irish programme would consist of an information campaign to convince and encourage enterprises to establish networks, the training of network brokers to identify opportunities and initiate co-operation among firms and, finally, some limited financial support to help in initiating the process. However, the final decision on whether or not to participate will be taken by the firms themselves. Co-operation would need to be long-lasting, binding on firms and would be based on a considerable mutual interest in a common group of enterprises.

As a result of the work it has undertaken, the Council believes that it is possible to widen and deepen the nature and range of inter-firm co-operation in Ireland and that on the basis of experience gained from a

pilot project, consideration should be given to the introduction of a network programme in Ireland. This would aim to provide information to firms on the benefits to be gained from networks, to put in place a system of brokers to identify and establish networks, and, where appropriate, to provide finance for the start-up phase of network development. In particular, the Council believes that:

- (i) It is possible to widen and deepen inter-firm co-operation in Ireland;
- (ii) A network programme may have significant benefits;
- (iii) In order to identify the most appropriate arrangements a pilot project should be implemented;
- (iv) The Department of Enterprise and Employment should establish a Steering Group consisting of IBEC, ICTU and the relevant agencies;
- (v) The brief of the Steering Group would be to develop proposals for, and oversee, the implementation of a pilot Network Programme in selected sectors, drawing on:
 - The lessons emerging in the forthcoming NESC report on inter-firm co-operation, business associations and network programmes abroad;
 - Existing Irish experience in facilitating and supporting networking arrangements via State agencies and business associations;
- (vi) The Steering Group would review the pilot programme to determine its suitability for promotion nationally. On the basis of this experience the Steering Group would recommend the appropriate arrangements for an effective National Network Programme, including the role of State agencies, business associations and other social partner interests.

The Council welcomes the recent decision by the Department of Enterprise and Employment to initiate a pilot network programme.

The Network Programme should produce worthwhile results in itself and would also prepare the way for the development of clusters. The Council believes that within a few years of the start of the pilot programme, attention could be given to promoting the concept of broader, looser cluster building.

In addition to promoting networks, mainstream industrial policy requires a renewed focus on certain key challenges. The recent Forfás study,

Shaping Our Future, identifies the need for initiatives to transform indigenous manufacturing industry through innovation, repositioning, development of scale and improved profitability. The Council also supports its call for measures to promote science and technology.

4. AGRICULTURE

(i) Challenges Facing the Agricultural Sector

Agriculture and the food industry are key aspects of enterprise and competitiveness in the Irish economy. Agricultural produce constitutes a significant portion of national exports and, when combined with the food industry, contributes close to 12 per cent of Ireland's GDP. Agriculture has experienced a period of relative stability in terms of EU policy over the past couple of years. However, a number of future events mean that it will face a substantially changed environment and will experience some serious challenges.

Substantial reform of the Common Agricultural Policy is likely over the next decade. Pressures for reform arise from a view by a number of member states that the CAP budget should expand less rapidly than the total EU budget and because the next round of WTO negotiations, which will open in 1999, are likely to continue the process of further reducing protection and support for agriculture. These negotiations are likely to result in a reduction of import protection, export subsidies and internal supports to agriculture.

The Eastern enlargement of the EU will have a profound impact on the future design of the Common Agricultural Policy. Negotiations on accession are likely to begin in 1998, and while it may be impossible to predict the outcome of these negotiations, the large agricultural sectors and dependence on agriculture in these countries, when allied to their current cost structure and relatively low productivity, mean that extension of a Common Agricultural Policy along existing lines would be prohibitively expensive.

Agriculture will increasingly face challenges as a result of changing consumer requirements. This has been forcibly demonstrated recently by the BSE crisis, but the trends which appeared in an exaggerated form in this period mirror longer term changes, which mean that the demand for the traditional products may be undergoing some level of long-term decline within the EU. One of the most important of these trends, to which agriculture must respond, is the increasing demand among EU consumers for high quality products which are produced according to rigorous health, environmental and animal welfare standards.

The EU Commission, in anticipating these developments, has suggested that they mean a greater emphasis must be placed on achieving competitiveness in agriculture, on the integration of agriculture with other rural development policies and on measures to simplify the operation of the CAP. These reflect a new priority of the Commission that, in addition to agricultural management, the CAP should play an important part in terms of its overall rural development strategy, including protection of the natural environment.

(ii) Meeting these Challenges

To meet the challenges which will face agriculture in the coming years will require the acceptance that the market support system currently in place will be adjusted. The EU will have to respond to the demands of its WTO partners for changes in the Common Agricultural Policy, as well as to the internal pressures for change, and those which will result from Eastern enlargement. The Council believes, however, that the EU must adhere to a number of over-riding principles in meeting these challenges.

First, it is important that the EU develops a coherent reform strategy which reflects the vital interests of member states. EU agricultural policy will remain a vital internal policy area both in terms of its immediate objectives, in terms of its wider objectives of rural development and as a force for integration between the regions of Europe.

Second, the Council agrees that radical alteration of the Common Agricultural Policy to achieve a more liberal world market in agricultural products in the medium to long term, must be tempered by the impact of certain values which the EU would wish to preserve. Among these are the strict environmental and health criteria which currently operate within the EU, the specific cost structure within the EU (when compared to the US and other agricultural exporting countries) and the wish to preserve the historically determined family farm ownership structure which exists in the EU. While many of these features may not be the most economically rational in a short-term perspective, their continuation as features of agriculture and the rural economy and society of the EU, although more costly in budgetary terms, are desirable. The desired family farm structure is likely to be comprised of a core of commercial farms capable of generating a farm income comparable to non-agricultural earnings in the region and a group of multi-functional farms, in which the earned income from farming and off farm sources, in combination, provides an income comparable to non-agricultural earnings.

Third, the Council supports the suggestion that measures be implemented to improve the competitiveness of EU agriculture and to integrate

agriculture with general rural development policy. This is likely to involve substantial structural change within agriculture. The Council recognises that such change is costly and recommends, therefore, that the speed of change must be appropriate to accommodate the costs that will be imposed on farming. It must also allow sufficient time for agricultural producers to adapt to the changed situation.

The Council also recognises that agriculture has a high requirement for capital investment relative to the income generated. This investment is required to replace existing fixed capital, to upgrade production facilities in order to reduce production costs and meet strict environmental standards, and to increase scale of production in line with increasing farm viability thresholds in the context of freer trade. The future competitiveness of Irish agriculture is closely linked to its capacity to generate the funds required for reinvestment in addition to meeting normal family living expenses. Public policy can contribute to the competitiveness of Irish agriculture by ensuring the maintenance of a low inflation and interest rate regime, and through the continuation of national and EU measures to promote investment and structural reform, recognising the nature of commercial farming as an industry comprised of capital intensive businesses.

Fourth, the Council supports current government policy that the future existence of the Common Agricultural Policy must be guaranteed. The Common Agricultural Policy is a key ingredient in promoting integration within the EU. In addition, Ireland remains a net beneficiary from the policy and, given the continuing importance of agriculture within the Irish economy, it is essential that Ireland, and other beneficiaries, do not alone pay the costs of increased world trade liberalisation and Eastern enlargement, through reduced transfers. In addition, since the FEOGA Guidance scheme, which operates in the agricultural sector, is included in overall structural funding, changes in Ireland's eligibility for structural funds could have significant implications for the sector. It is particularly important that efforts to simplify the CAP and make its provisions of more relevance to local conditions, do not imply any effort to re-nationalise funding of the CAP. The Council fully supports the Irish government in its determination to maintain Community funding of agricultural policy in the EU.

Finally, observing that rural society is important in Ireland, the Council recommends increased priority should be given to rural development policies at EU level and, in particular, the provision of resources for the training of people in rural areas, including those engaged in agricultural production. The Council is particularly concerned that, in as far as possible, Irish policy should support the EU in the implementation of

programmes which would contribute to preserving rural communities and the rural environment. In this respect, the Council welcomes communications from the EU Commission which, while remaining vague, indicate that radical reform of the CAP to move towards an unregulated market for agriculture will be rejected, while efforts to preserve the status quo are not a practical long term strategy.

5. FINANCING AND INVESTMENT

(i) Fixed Capital

There have been a number of claims in recent years that problems exist in Ireland with the provision of finance for firms wishing to expand. This would appear to be particularly acute in the SME sector. While the precise cause has not been identified, it is clear that the rate of investment in fixed capital in Ireland remains low and has been consistently falling over a long period of years, although there are some indications of an upturn in the last couple of years.

The Forfás report, *Shaping Our Future*, is also concerned about the falling rate of investment in Irish industry. It recommends measures to improve the attractiveness of investing in industry and initiatives to improve the institutions and mechanisms which provide finance. Among the former are measures to improve the profitability and competitiveness of Irish firms, tax reforms and initiatives to create more opportunities to invest. Regarding the latter, the report is highly critical of institutions in the Irish capital market. "In practice, the Irish stock exchange can be regarded as irrelevant to the financing needs of the vast majority of Irish-owned companies" (Forfás, 1996a, p.209). The report recommends that public policy should encourage the growth of the Developing Companies Market and the creation of new investment vehicles modelled on markets in the UK and the US. It also suggests that efforts should be made to establish a corporate bond market.

A number of initiatives have been formulated to improve the availability of finance in recent years. Among these are schemes to alleviate the financing difficulties of SMEs, the access to finance scheme involving the banks and government in providing long-term, fixed-rate financing to companies, the BES and a new seed capital scheme funded by the EU through Forbairt. Lower interest rates have also been beneficial while the high corporation tax rate on service firms results in a lower capacity to retain earnings. A problem has also been encountered due to the reluctance of some SME owners to attract outside investors since this would dilute their ownership.

The Council fully supports the conclusion that Irish capital markets need to become more relevant to the needs of Irish firms. The development of new vehicles, especially those which would target funds to new and fast growth firms, would help relieve a major obstacle to growth. The Council agrees that overcoming deficiencies in the provision of finance requires a joint approach of the public and private sectors to increase investment in Ireland.

As a result of this observation, the Council has undertaken work to study the determinants of the rate of investment in fixed capital in the Irish economy and to discover what factors might be causing this poor performance. The, as yet incomplete, study involved identification of the various determinants of the investment rate at a macroeconomic level and a survey of firms in the Irish economy to gain information on what factors decision-makers see as important in determining their investment intentions. Two facts have emerged. First, that Irish firms appear, by international standards, to be particularly risk averse. The exact nature of this risk and its causes remain to be discovered. Second, Irish firms rely to a very large extent on the availability of retained profits as a source of funding for investment. This is a potentially important finding and indicates either the non-existence or malfunctioning of certain institutions in the Irish economy which would enable firms to raise financing from outside sources.

A problem often emerges, even among the most successful of firms, when they attempt to diversify from the Irish economy to international markets. This emerges whether they are sub-suppliers to multinationals in the Irish economy or directly exporting to other markets. To successfully enter an export market, the firm must attain a critical mass, unless it is operating in a highly specialised niche market with few competitors. In these circumstances, the current size of the firm is determined by the relatively small size of the Irish market. Attaining a size sufficient to enter international markets will in many circumstances require substantial investment. The decision facing the manager at this stage is a high risk strategy to attempt large borrowings, if they are available, to expand to international markets or, a much lower risk strategy, to consolidate its position within the Irish market. The problem is thus arising from the fact that, at some stage, indigenous Irish firms can no longer grow incrementally, but must make a large investment in future growth. The risk associated with this move is greatly compounded if, as has been claimed, the appropriate institutions for the firm to diversify this risk, and its equity, do not exist.

Some initiatives have been put in place in the form of low cost venture capital funds and guarantees. These have been particularly targeted

towards start-ups and smaller firms. While the uptake has been reasonably successful, it is generally accepted that intervention in this manner does not fully address the problem.

The Council is particularly concerned about under-investment in the Irish economy. It recommends that priority should be given to identifying the causes of this problem and the needs of firms. It recommends a focus on the working, and perhaps weaknesses, of financial institutions and the extent to which they are meeting the needs of Irish business.

(ii) Investment in Intangibles

The changes in the global economy and the enhanced need to ensure competitiveness mean that a much greater emphasis must be placed on investment in intangibles in the future. Major improvements have been made in marketing by Irish companies, although brand recognition often remains low in European markets. The vital area of skills and human resource development through investment in training is dealt with in Chapter 7. However, the importance of investment in intangibles is not restricted to training alone. Irish firms must be capable of employing recent developments in new industries and actively undertaking research. In other industries where the basic product technology is well understood, the standardisation of global production means that the need for constant innovation in product differentiation is enhanced. Again, the ability to compete successfully on this level requires considerable investment. For example, information technology has an increasingly important role to play in the design of even fairly basic products. This raises a number of parallel points, such as the manner in which such investment is to be measured, the way in which depreciation can be accounted for and what alterations to the tax or other systems are required to enhance competitiveness.

Innovation

The importance of technological innovation has received considerable attention in recent years and has been the subject of a number of reports, among the most notable being the STIAC report. Previous work by the Council has also emphasised the need to overcome weaknesses in the Irish National System of Innovation, if firms located in Ireland and, in particular, Irish indigenous firms, are to engage in product development and in the up-take of new technology (see NESC, 1992).

This involves flexibility, creativity and a constant willingness to change; it is particularly about the continuous search for new and better products and services to sell on the world market. Technology, as well as

management, is a key factor in such innovation, whether it be via research and development, in the increased use of information technology and communications to provide up-to-the-minute market data, or in the exploitation of new knowledge and expertise through the acquisition of product or process innovations.

Such innovations are just as important in traditional industries as they are in high technology ones, perhaps more so as the competition from lower-cost countries tends to be more severe for these sectors. The failure of indigenous industry to thrive since the advent of free trade has been attributed in previous NESC reports partly on the weakness of the national system of innovation in Ireland. Knowledge and learning are key to an innovative economy and a major failure in the past has been a lack of interaction between two important elements of the national system of innovation – the business sector, where industrial innovation takes place, and the higher education sector, which is an important source of knowledge and expertise in industrial technologies. Efforts must continue to strengthen links and interaction between these two sectors of the economy, as well as the continuing development of in-house capabilities and skills.

Innovation goes beyond the development of technology. Competitiveness requires that innovations are also put in place in firms operating processes and in the organisational capacities of firms. International experience shows that firms which have adopted systems of team-working, flexible specialisation among the labour force and which implement benchmarking standards for the processes adopted, have developed competitive advantages in their industries. In addition, modern firms increasingly adopt flatter structures to aid the freer flow of information between the various levels of management. The Council wishes to reiterate the importance it has previously attached to strengthening Ireland's National System of Innovation, and believes the ability of Irish firms to engage in active research and to innovate will be key determinants of future competitiveness.

6. TRANSPORT AND LOGISTICS

As a peripheral island transport infrastructure, services and systems logistics capability are crucial elements in Ireland achieving a high level of international competitiveness. The importance of transport and logistics arises also from our high trade dependence and, increasingly, because of world-wide business trends in a number of areas.

Increasingly, global competition is forcing producers to reduce operating costs and improve service quality. In terms of the transport/logistics function, this trend is manifesting itself in manufacturers demanding that their suppliers reduce lead times and in their specifying, in even greater detail, precisely what, when and how those goods and services should be delivered to them. To meet such demands, suppliers have to seek ways to improve speed and flexibility while continuously driving down distribution costs.

Systems logistics can be defined as the strategic process of managing efficiently and economically the flow and storage and of the materials and information necessary to meet customer needs. This is rapidly growing in importance and is being boosted by the ability of advanced telecommunications and IT technology to achieve greater efficiency.

Significant progress has been achieved in a number of areas, in improving Ireland's transport system, in recent years. However, the Forfás report *World Class to Serve the World* (Forfás, 1996c) highlighted the importance for Ireland of achieving a world class transport and logistics capability if we are to maintain and indeed substantially enhance our international competitiveness in the future. For Ireland this means continued improvement in:

- transport infrastructure;
- greater availability, competition, and efficiency in transport services;
- rapid achievement on the part of both the industrial and transport sectors of world class capability in the area of systems logistics.

The Council believes it is essential that competitiveness is promoted by enabling Irish companies to meet the requirements of international customers. The Council supports the Forfás report which makes a number of recommendations aimed at achieving the required progress in each of these areas over short to medium-term.

7. ENVIRONMENTAL ISSUES

(i) Sustainable Development

As concern over the impact of human activity on the environment has grown in recent years, so has the need to develop concepts to aid the pursuit of the twin objectives of increasing economic welfare while protecting the environment. Over the past decade, the concept of sustainable development has gained widespread acceptance. While many definitions have been put forward, the most widely used is that developed

by the report of the 1987 World Commission on Environment and Development, which defined sustainable development as development which proceeded in such a manner as 'to ensure the needs of the present without compromising the ability of future generations to meet their own needs'. It is important to recognise that the flexibility inherent in the concept of sustainable development is essential to balance the pursuit of environmental concerns with the control of the costs this may entail.

How Sustainable is Irish Economic Development?

One problem with attempting to ensure development takes place in a sustainable manner, and with incorporating sustainability criteria into evaluations, is that, even where the relevant criteria are identified, quantification is not always possible. Thus, the acceptance by policy-makers that sustainable development is desirable does not mean that actually operationalising the concept will be easy. However, the objective has been encapsulated into the Treaty on European Union and into the current programme for government.

Few countries have managed to develop a comprehensive series of indicators, but it would appear that Ireland has been particularly slow to develop along these lines. In general, Ireland has an image of having developed economically without excessive environmental damage, while conserving a high quality of life. McCoy (1992) surveys a range of data from the World Bank, the OECD and the European Commission in an attempt to identify the extent to which Ireland has been developing on a sustainable path. He finds that, in general, while the indicators appear quite good for a range of factors affecting the quality of life in Ireland, its performance on indicators of environmental impact is actually quite poor.

The creation of the Environmental Protection Agency (EPA) and measures to improve the provision of information on the environment are welcome developments in recent years. These institutions should continue to develop their role. It is important that the State take a pro-active role in ensuring that environmental considerations are included in its development strategy and that, in as far as possible, quantification of environmental impact indicators is included in any evaluations of expenditure of public funds.

(ii) Indicators of Sustainability

The measures of economic well-being and economic development currently employed take little account of changes in the natural and social environment. First, there are considerable deficiencies in the knowledge of what is happening and how economic activity impacts adversely on

the environment. Second, the benefits of environmental preservation are spread both within the current, and to future, generations. As a result, there may not be sufficient incentive for economic actors to take full account of the impact of their actions. A third problem arises due to the non-ownership of environmental resources. Economic theory would suggest that this could lead to over utilisation of these resources. Fourth, even where full information exists on the impact on the environment and where measures have been put in place to minimise this impact, a problem of control may still exist due to the diversity of economic activity. Fifth, as identified above, major difficulties exist in attempting to evaluate monetarily the impact of economic activity on the environment and the cost of overcoming these impacts.

The existence of simple condensed indicators of economic activity – for example, GNP, national income and growth rates – have led to a desire to identify similarly constructed indicators of the impact of economic activity on the environment. Considerable research has been undertaken on this topic in recent years. (See Scott, Nolan and Fahey (1996) for a review this work)

The Council recognises the importance of incorporating estimates for environmental damage in any estimates of economic growth and any evaluation of public investment undertaken. It strongly favours the emphasis which has been placed on following a sustainable development path, but also recognises that over adherence to strict criteria could impose unacceptable costs. The key to finding a balance between conflicting objectives is the provision of detailed and relevant information and methods for incorporating such information into evaluation of projects. Part of the EPA's job is indeed to collect relevant data and the Council emphasises the need to ensure that this work is adequately resourced and undertaken in close collaboration with the CSO.

The Social and Built Environment

It is a recurrent theme in the Council's recommendations that action must be immediately implemented to foster social inclusion. In many cases, problems arise from the sub-optimal distribution of wealth and income in the economy and many of the recommendations are concerned with the implementation of measures, or with bringing about structural changes, to improve this distribution while not impeding overall growth rates. However, non-economic aspects of social life are also of vital importance in the creation of a more desirable social environment. The problem is that these may often be difficult to measure.

Some data are available on these non-economic aspects but there are many deficiencies. The OECD have recently undertaken work designed to aid in the construction of a set of indicators to measure progress in these non-economic aspects. These indicators would cover areas such as health, education, employment, the quality of working life, the quality of free time, leisure, the distribution of income, housing, the physical environment, the social environment and personal safety. All these aspects of social life should be taken into account when judging whether or not welfare has improved.

The Council believes that efforts should be made to overcome the difficulties which exist in measuring these variables in Ireland and the priority should be afforded to the construction of indicators to determine the impact of economic and other policies on the social environment. The importance of achieving this in relation to the physical environment has been generally accepted by policy-makers and recognised in development plans. It is just as important that the importance of the social environment in relation to sustainable development is also recognised. The Council is of the opinion that having constructed the indicators that they should be employed in the formulation, evaluation and implementation of economic policy.

(iii) The Treatment of Waste

Waste materials are created by both domestic consumers and by commercial enterprises, the latter often in the form of contaminated water. The problems associated with the disposal and treatment of waste have become particularly acute in recent years for a number of reasons. First, there has been a very rapid growth in the volume of waste generated. In addition, there has been a substantial increase in the variety of products and in many cases the toxicity and non-degradability of the products produced as waste. Second, there has been a rapid rise in the costs of disposal of waste materials. This is related to the nature of the materials produced but is also related to the ability of current disposal methods to absorb the rapid rise in volume which has occurred. Third, there is increased resistance to the siting of land-fill operations, which are the major form of disposal currently employed. While most people recognise the need for such operations, few are willing to accept them in their locality.

These problems raise two questions. First, what alternatives to further land-fill or waste disposal may be available? Second, what can be done to reduce the volume, and the rate of growth in the volume, of waste? Barrett and Lawlor (1995) find that land-fill remains the most cost effective method for the disposal of solid waste in most cases. Schemes

such as the new IBEC 'REPAK' initiative to encourage the re-use of materials may be appropriate in the case of commercial enterprises, but are costly to implement for domestic waste. While recycling at any cost might be optimal from a purely environmental point of view, it could lead to a misallocation of resources if implemented in a mandatory manner. Instead, an incentive package should be devised to increase the amount of recycling and reduce the amount of waste.

This market-led approach is also evident in the work of Scott and Lawlor (1994), who examine the problem of water pollution and the disposal of contaminated water in Ireland. They suggest that the prices charged for treatment should be set at a level which will alter the behaviour of the polluter, as well as covering costs. In this way, economic factors will dictate that the most efficient method for the treatment of waste water to avoid pollution is used. The majority of liquid waste is produced by commercial interests. Enterprises should have the option not to use publicly provided facilities for which they are charged but, at the same time, would have to meet standards for disposal.

Unlike experience abroad practice in Ireland has been for charges to be set by a multitude of local authorities at a level which is usually too low for the treatment involved, the operation being subsidised either from other local sources, or by means of covering the capital costs involved from central funds.

In Ireland, the farming sector is also a major producer of liquid wastes. The responsibility for ensuring this does not lead to pollution is taken by individual farmers. In general, investment in on-farm storage facilities and the recycling of waste as organic fertiliser has meant that only a very small proportion of the waste produced on farms leads to pollution or imposes costs on public authorities. The principle role for public policy in this case is to monitor events and provide information on best practice.

A much greater role exists for the public authorities in the case of households who are also major producers of waste. This is particularly important given the substantial volume of public authority housing in Ireland. However, there have been many instances where the inadequate provision of sewage treatment facilities in public housing schemes, or failure to fully comply with planning requirements in the case of private residential developments, have resulted in problems.

The Council agrees with the general principle that the producer of waste must pay for its treatment and elimination. In addition, where large capital investments by public authorities to treat waste are required, these costs should be recouped from the producers of the waste. In as far as possible, charges should be related to the volume and type of waste produced.

While aiming to cover costs, however, the charging system must also aim to ensure the optimal behaviour of waste producers. They must also be applied in a fair manner and must be designed and applied in a simple and consistent way. By doing so, producers will have an incentive to alter their behaviour and, in this manner, the market will dictate the optimal level of recycling.

The Council believes that rather than waiting until a situation emerges whereby Ireland is forced to act to implement EU directives, it must approach this problem in a planned strategic manner. In addition, the Council believes that any reform of local financing, administration and democracy – following the Devolution Commission – should include a review of the planning process. The Council recommends that adequate research should be undertaken to determine the extent of the requirements for the disposal of waste and the correct charging procedures to bring about the optimal behaviour by producers. Current approaches appear inadequate to bring about this conclusion.

CHAPTER 7

ENTERPRISE PARTNERSHIP AND TRAINING

1. INTRODUCTION

The analysis in Chapter 3, which was further developed in Chapter 6, concluded that, as a result of a range of factors, a number of changes must take place in the economy, if it is to remain competitive. These will include changes in the system of production, the system of relationships between – and within – companies, management systems and the role of the public sector. This chapter argues that, in this environment, training and improving the skills of the workforce must be given a high priority. Thus, to achieve competitiveness, the economy must ensure an efficient and effective training system.

Section 2 develops this analysis and identifies the need for new forms of organisation within firms and the importance of training for competitiveness. Section 3 argues that extension of the partnership approach to the enterprise level would facilitate these new forms of organisational structures and would be a key element in enhancing Ireland's training system. Section 4 sets out the Council's recommendation towards achieving this outcome.

2. THE PROCESS OF PRODUCTION

(i) The Changing Environment

A number of new developments within which the driving force of change can be identified were discussed in Chapter 3. Among the most important are:

- (i) The increasing internationalisation of markets and globalisation of trade and production;
- (ii) The emergence of new technologies which have created new industries in themselves and radically altered the production processes in other industries;
- (iii) The need for *specialisation* within firms, to handle the high technologies, and produce and use knowledge which is the key production resource. This must be allied to a high degree of *flexibility* in abilities, relationships and organisational structures among both management and workers;

- (iv) Cultural, social and demographic changes which influence the make-up of the workforce and consequently the type of labour relationships which are most appropriate;
- (v) A new emphasis on quality, reliability and innovation as the basis for competitiveness.

The huge differential in unit labour costs between western Europe and the new production centres in Asia and, in the future, in Central and Eastern Europe, means that the EU, to ensure the competitiveness of its industry, must ensure a high level of productivity in knowledge intensive products which meet the demands for quality. Bennett and McCoshan (1993) identify the following requirements to meet these new challenges.

- (i) A need for a new emphasis on design and marketing of the products produced in EU countries;
- (ii) Concentration on the production of high value-added products which intensively utilise knowledge as the chief resource;
- (iii) The assurance of high quality standards and reliability in all products;
- (iv) Development of an ability among management, workers and the public service to adapt rapidly to change;
- (v) A need for changes in the industrial organisation of economies, both within and between firms, to facilitate new forms of relationships and positive negotiation;
- (vi) The development of closer collaboration between firms and related industries to ensure the rapid and efficient transfer of knowledge and avail of externalities in the production of knowledge. In addition, some opportunities for availing of economies of scale in R&D and marketing could be developed;
- (vii) The development and implementation of effective and adaptable management systems which take account of the change in circumstances and can accommodate new requirements, as detailed in this chapter;
- (viii) An improved technological and innovation capacity based on strengthening the elements of the national system of innovation and, if necessary, escape from a sub-optimal, historically driven, path;

- (ix) An altered scope and rationale for government intervention which takes full account of changed circumstances and the new, priority aims and objectives;

It is argued that the vital common point running through these requirements is a need for the improvement of labour skills, in management and the workforce, and the development of the institutional arrangements to bring this about.

(ii) The Dynamics of Production and Growth

The Process of Production

During the period of the long expansion following World War II, economics viewed production and the process of economic growth as a linear relationship between technology and growth. In essence, new technologies could be applied to stable and known forms of work organisation to develop standardised products. The major impact of new technology, apart from the occasional opportunity for the development of new products, was to develop cost savings which would result in larger profits and/or greater market share. The principal gain was the ability of new technologies to generate increasing returns to scale. To handle any opportunities for the application of new technologies and to obtain these scale economies, a high degree of specialisation among workers was deemed necessary. However, a by-product of this process was that the skills of production workers were gradually down-graded. As long as growth remained strong, and the appearance of cost reduction stimulating growth could be maintained, this model appeared a viable representation of the optimal production structure.

The termination of the long period of growth led to a questioning of this approach. This development was given an impetus by the success of economies which appeared to employ alternative models, in particular, the German and Japanese economies. It soon became clear that the conventional model was extremely rigid and non-adaptable, and resulted in poor quality and a lack of innovation due to the down-grading, rather than development, of the workforce skills. An alternative 'interactive model', within which cost reduction and quality improvements are compatible, is demand driven, in that it formally internalises response to market forces. This approach places a high priority on the availability and development of skills within the workforce and an industrial organisation which is compatible with the development of these skills and the effective marketing of the product. Technological and organisational innovations need no longer be merely the result of external forces randomly driven,

out may be created from forces within the firm which are organised to induce innovation.

The integrated and interactive nature of this model gives it the ability to generate, process and disseminate information within the firm. In addition, the firm's relationships with its external suppliers become more flexible and adaptable. As a result of these developments, greater production flexibility is now compatible with the reduction of costs and quality improvements. While new objectives may have become clear, the ability of firms to change is a lot less certain. For managers and workers to learn new skills and develop the versatility to respond to new situations, training is required. However, the organic development of training systems requires the simultaneous development of new work arrangements

The Process of Growth

The conventional model assumed that trade and economic growth resulted from the utilisation by firms in a particular economy of a predetermined stock of capital, labour and natural resources. Occasional, externally determined, technological advances could affect the efficiency of the usage of these factors, while public policy had a role in optimising the external conditions and environment within which firms could operate. On the basis of its allocation of these resources, and the availability of developed and organised production units, an economy developed advantages in certain goods which eventually led to international trade. This model thus predicts that a country will specialise according to its basic factor endowment. All economies can benefit from engaging in international trade and the model further predicts an eventual equalisation of returns across all economies.

New models of economic growth imply a primary role for the development of knowledge within the firm. This allows the firm to produce new products or processes which enable it to capture or develop new markets. In turn, its ability to develop these new products and markets enhances its ability to undertake the search for new forms of knowledge. In this model, rather than advantages deriving from predetermined resources, the firm, operating in an environment which can be enhanced by state policy, searches for dynamic and competitive advantages. Thus, the advantages which accrue are internally developed. The model further suggests the possibility that the benefits from trade will be distributed unequally, leading to a possibility of divergence between countries. In addition, and most importantly, path dependency may mean that an economy becomes stuck on a low level equilibrium.

The Importance of Knowledge

Knowledge is a basic resource for production and economic growth. Technical progress is of utmost importance and training to develop and use new technology, rather than being treated as a given factor, must be developed. Those countries which develop effective training practices can move to a higher growth path. Skilled labour is the scarcest resource and growth will be largely the result of the extension of skills, as a result of education or on the job training. In this, public policy has a major role to play. However, it is vitally important that initiatives to stimulate and increase the skill levels of the workforce must be undertaken simultaneously, and fully co-ordinated, with the actions of firms as they attempt to enhance the process of innovation and monitor and create new markets, while ensuring overall quality and cost competitiveness. This approach takes the emphasis off training as a short-term solution to the unemployment problem.

(iii) Organisational Innovation and Training

The importance of adopting organisational innovations in the firm simultaneously with appropriate training policy, must be emphasised. Innovation in a number of institutions must be co-ordinated. These include the organisation of industry, firms and the work process; the industrial relations system; financial markets; the state and political structure, as well as the operation of the training system. The problem is that changes in one or two of these factors, without corresponding alterations in the other institutional variables, may have disappointing results. For example, if individual firms undertake human resource development without changing organisational structures it may fail to avail of the potential benefits. Similarly, a national training policy which does not take account of the structure of industry within the economy will be ineffective. To illustrate this point, Boyer (1995) surveys the industrial and training systems within three relatively successful economies – Japan, Germany and Sweden. He finds substantial differences in the way training is organised and the effects it has on labour markets and the economic process. However, he concludes that the organic development of these systems, along with timely recognition and appropriate policies on the part of the state, resulted in successful outcomes. He contrasts this with the situation in the UK and France, where attempts to implement Japanese organisational styles in the UK, and German apprenticeship systems in France, in the absence of many complementary factors which exist in the original countries, were relatively unsuccessful.

The importance of implementing a number of changes simultaneously with the introduction of a national training policy is highlighted in the Forfás report, *Shaping Our Future*.

The ability of firms to compete will increasingly depend on the capability of the workforce to continually adapt to change and be flexible. This will require not just new organisational structures but also new consultative arrangements between managers and workers and their representatives. (p.153).

The stylised models in Figure 7.1 indicate what is meant by incorporating an appropriate training model within a complementary management and industrial organisation system. The old style 'Fordist' model was one which combined rigid job classification with minimal training and a relatively rigid wage structure. The new model fully integrates human resources into the production and development of the company thereby encouraging workers to undertake continuous on-the-job training. The result is multi-skilled workers on whom the firm is dependent. The company involves the workers in the production process in return for flexibility, in terms of wages and occupations within the firm, while enabling the workers some element of mobility within the particular industry.

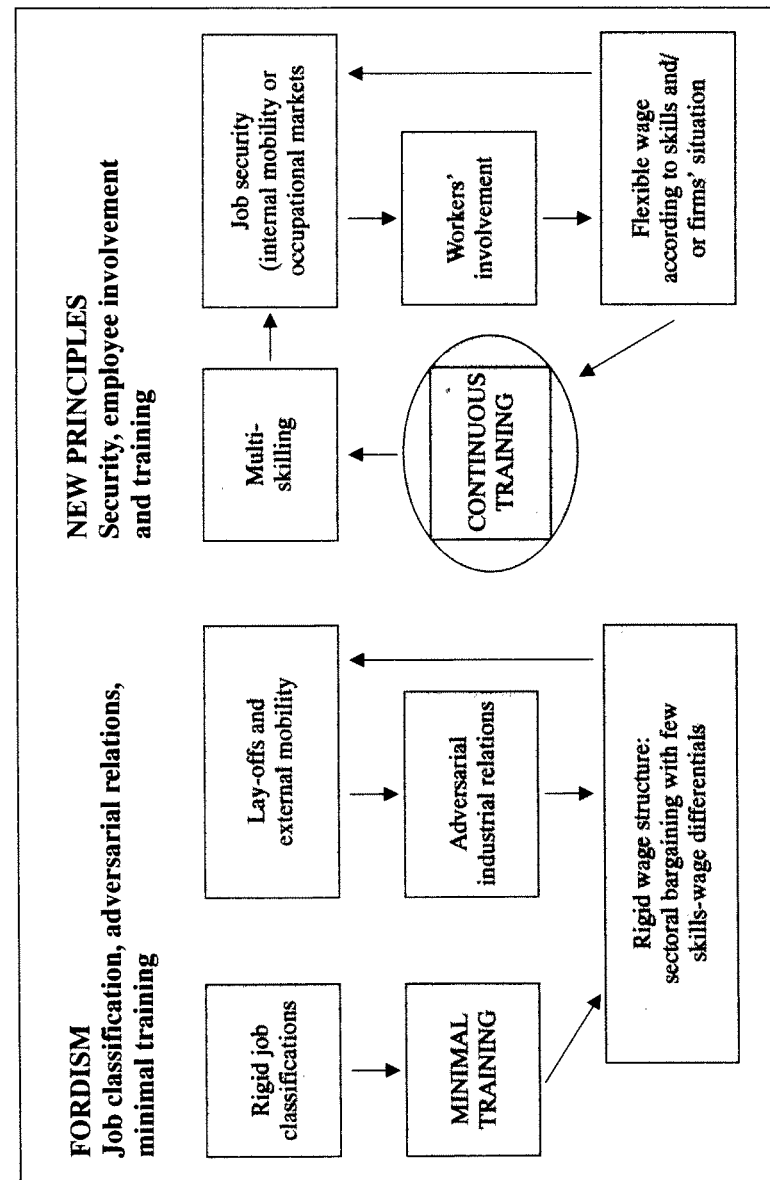
This model alters the set of relationships from one of adversarial industrial relations to one of worker involvement in the production process and in the training process. This fact leads to the conclusion, that the appropriate approach to these developments involves partnership arrangements and consensus building to be transferred from the level of the national economy to the level of the firm.

A role for the public sector exists due to the need to overcome deficiencies in the education and enterprise systems simultaneously with those in training. Bennett and McCoshan identify five key elements of the training process to which the government can respond. These are:

- (i) the need to prevent free riding and allow the internalisation of any benefits arising from investment in training;
- (ii) the provision of agencies to enable the pooling of resources and enhance the ability to pay, especially, for small firms;
- (iii) the provision of start-up funds and a long-term commitment to allow the sufficient time period for benefits to accrue;
- (iv) institutions to bring together the necessary numbers of producers and clients and ensure compliance and;
- (v) the provision of information on what is most needed in the provision of training.

FIGURE 7.1

Interaction of Organisational Structure and Training



Source: Adapted from Boyer (1995)

Three major points come out of the preceding sections. First, because the optimal form of industrial organisation has changed, existing firm structures and institutional arrangements are not necessarily those which will maximise competitiveness and employment. Second, training policy must be seen as much more than a short-term solution to the unemployment problem and must be undertaken in the context of a range of reforms and innovations within the economy. Third, these points suggest that social partnership may be a particularly appropriate institution to promote the upgrading of the national training system.

3. ENTERPRISE PARTNERSHIP

(i) Competitiveness and the Partnership Approach

Core elements of Ireland's economic challenge, and the social partnership approach to addressing it, have been outlined in Chapters 3, 4 and 5. These involve:

- (i) Recognition that the competitiveness of the Irish economy is a pre-condition for the pursuit of all other economic and social goals, in particular that of employment;
- (ii) Widespread support for a macroeconomic approach which guarantees low inflation, a steady growth of aggregate demand and a falling debt/GDP ratio;
- (iii) A social partnership programme which produces rates of pay increase and reductions in non-wage labour costs which enhance national competitiveness;
- (iv) Supply-side policies – in areas such as training, regulation and innovation – which produce positive flexibility;
- (v) Sufficient social cohesion and co-operation to make these supply-side measures effective.

Significant progress has been made in achieving requirements (i), (ii) and (iii). However, in common with other European Union countries, Ireland now faces a global economy where there are major differences in costs of production, and where EMU will involve a clear focus on the requirements of a fixed exchange rate. Growth and development of Irish firms, and the maintenance of employment, in these conditions demands continuous innovation, flexible working methods, high-skilled workers and life-long learning in all work roles.

These are vital because the pace of adaptation to change can be a key competitive advantage. Achieving this involves a focused combination

of action by employers, employees, trade unions and government. Consequently, the Council believes that the partnership approach should now be further developed at enterprise level, such that key issues can be discussed there, enhancing the competitiveness of firms, the quality of the work environment and the access of employees to life-long learning.

(ii) Partnership at Enterprise Level

The International and Irish Context

In devising an approach to developing partnership at enterprise level, the Council notes that the building by the social partners of national level relationships over a period of nearly a decade provides them with a potentially powerful means for accelerating innovation at enterprise and work-place levels. The Council also notes that, internationally, there has been an increased emphasis on the enterprise as the level at which competitiveness is determined and at which human resource and industrial relations patterns are shaped. Almost all countries have witnessed an increased focus on education and skills as competitive factors. However, internationally, there is no evidence that any one structural or institutional model or approach systematically out-performs others, nor that an effort to import a model from one country to another is an effective approach. The Council also notes that information and consultation obligations are developing at EU level, including the enactment of the recent European Works Council Directive. The past decade has also seen significant enterprise and work-place innovations in Irish industrial relations. These include management-employee partnerships in unionised companies, the human resource management systems adopted by many companies of US origin and experimental innovation in a wide range of companies and sectors.

International evidence indicates that work-place innovations designed to increase employee participation, work organisation, the distribution of work and working hours, positive flexibility and teamwork, communications and gain-sharing have a substantial positive impact on economic performance, employment, quality and productivity (Ichniowski *et al*, 1996). These international and Irish trends define the context within which an enterprise-level component of the partnership approach can be developed.

The Challenge for Ireland

In the Council's view, the challenge is to encourage firms, employees and unions to advance from experiment to comprehensive innovation. In addition, the development of the new models discussed above must be

encouraged. It is important, however, to recognise the different starting points of different enterprises and employees.

The key to providing this encouragement lies in understanding that successful work-place innovation occurs:

- (i) In ways which support competitive strategy in an ever-changing market environment;
- (ii) At natural opportunities for change – such as training, new investment and crisis adjustment.

Principles for a National Framework

On this basis, the Council recommend that a National Framework – that ‘runs with the grain’ of work-place innovation as it occurs in Ireland and abroad, and encourages change – should be agreed, based on the following principles:

- (i) That national partnership be continued, including national programmes which enhance competitiveness;
- (ii) That the next stage in the national partnership be to further extend partnership at the enterprise level of the economy. This should be done not by imposing any single structure or model, but in ways that recognise the need to tailor the partnership approach to fit different employment settings and take account of existing arrangements;
- (iii) That the objectives of enterprise partnerships are:
 - to enhance the prosperity and success of the enterprise;
 - to create the basis for discussion of major decisions affecting the organisation’s future, including future economic security;
 - to engage all stakeholders’ ideas, abilities and commitment;
 - to enhance the quality of the work environment;
- (iv) That appropriate arrangements and institutions be put in place at national, sectoral or regional levels to jointly monitor, study and learn from experience with enterprise partnerships and promote best practice among Irish enterprises;
- (v) That similar work-place innovations be implemented in both the public sector and commercial state enterprises.

The Council emphasises the close link between this national framework for enterprise-level partnership and a national programme which guarantees continued wage moderation and competitiveness.

(iii) Action to Implement Enterprise-Level Partnership

The Council recommends that, following agreement on these principles, an implementation process be considered for agreement to include the following elements:

- Arrangements for discussion at enterprise, network or sectoral level, as appropriate, of company performance, training, working methods, the work environment and other relevant issues;
- Arrangements at national level – considering the possible role of the Irish Productivity Centre (IPC), the Labour Relations Commission (LRC) and the Central Review Committee (CRC) – to monitor and promote best practice in enterprise partnerships;
- Arrangements on the part of the relevant state agencies stemming from the application of the principles, including in relation to project development.

The continuation of national partnership, and its extension to the level of the enterprise as part of national competitive strategy, will pose major challenges to business associations and trade unions. This calls for a programme of suitable training, including leadership training, supported by the state, to assist these organisations in discovering new policies, structures and roles.

4. PARTNERSHIP AND TRAINING

(i) Training in the Irish Economy

Current Performance

The Forfás report, *Shaping Our Future*, found that Ireland’s performance in terms of education and training is, in fact, comparable with many competitors. However, this is not the criterion against which performance must be assessed since, in many cases, it falls far short of the best practice against which it must be measured. The report identified no persistent shortages of specific skills, although certain occasional shortages did occur. It estimated, however, that these shortages are likely to get worse in the future, rather than better, if action is not taken. A further pressing problem also arises since many of those now working – the report estimates up to 80 per cent – will still be working in the year 2010, but will be required to operate in a very much changed environment. Without

training in the coming years these workers will be unprepared for this situation and, as a result, will be uncompetitive and relatively unproductive.

The task faced if competitiveness is to be further strengthened is summed up by Bennett and McCoshan (1993).

Global competition means that 'doing better than before' is not enough: long-term success will require being as good as the best and as fast as the fastest', (p.25).

Expenditure on Training

Recent estimates of the level of expenditure on training have varied according to the source consulted. Work undertaken by FÁS in 1995 showed companies spend approximately 1.5 per cent of labour costs on training within the industry. It is estimated that this would amount to expenditure of about £110 million per annum by employers. Comparison with earlier work shows that this has risen in recent years from less than 1 per cent in the early 1990s.

O'Connell and Lyons (1995) concluded that Ireland has a low level of training and skills compared to its EU partners, in particular, those countries with the highest living standards. Examination of the 1993 Labour Force Survey shows that 6.5 per cent of those at work had participated in training in the four weeks prior to the survey. Comparison with the 1988 Labour Force Survey shows only a very small increase in this percentage during this period. The percentages vary greatly according to the sector involved with only 1 per cent in agriculture having received training, 6.5 per cent in manufacturing and 7.5 per cent in services.

Forfás (1996) estimated that training by employers in Ireland accounted for approximately 1.2 per cent of the payroll in the mid-1990s. Many other European countries have rates of 3 per cent and above and Forfás found that leading firms often have expenditure on training as high as 5 per cent of payroll. In the OECD, the average was about 2 per cent. Forfás recommends that expenditure on training by firms should exceed 3 per cent of payroll.

There are some other weaknesses in Ireland also, for example, participation in full-time education by younger age groups in the post-primary stages is somewhat below the OECD average and well below the average for participation in further education. The problems this causes tend to be concentrated within families and communities experiencing long-term unemployment, where younger generations leave education at earlier ages and consequently experience further

unemployment. This results in social problems with concentrations of long-term unemployment and low educational attainment. In addition, the instances of low expenditure on training also tend to be concentrated, with small and medium sized firms' expenditure well below that of larger firms.

The Forfás report concludes, from this analysis of Ireland's performance, that 'radical change will be required', (p.154). Two challenges must be faced by policy if it is to overcome these problems. First, policy must aim to maximise the numbers of young people remaining in full-time education beyond the end of second level. Second, policy must aim to maximise the number of apprenticeships for those leaving education and going straight into work without undertaking third level.

(ii) Action on Training

Competitiveness and Training

The analysis above leads to the conclusion that if the economy is to remain competitive in the face of global competition several changes are required. Specifically, changes are required in systems of production employed by firms, the system of relationships between, and within firms, management systems and the role of public policy. The importance of information as the key resource means a high degree of specialisation must be allied to a high degree of flexibility in abilities, relationships and organisational structures among both management and workers. This greatly enhances the need for constant improvements in skills, in both management and the workforce, and the development of the institutional arrangements to bring this about. Only by doing so can firms achieve the dynamic and competitive advantages required for economic success.

The actions of public policy must be co-ordinated with firm strategies to ensure a national training policy is successful. Workers should be encouraged to undertake training and become involved in the production process, in return for multi-dimensional flexibility and adaptability. Training is an area in which enterprise-level partnership has particular advantages. Consequently, the Council believes that a more effective training system can be achieved through the extension of the consensus approach, which has been developed at national level, to the enterprise level.

Training Policy

The Council is convinced of the vital importance of implementing a strategy to upgrade the Irish national training system. It also believes that the partnership process lays the foundation upon which this can be

undertaken successfully. The Council is concerned that expenditure on training within industry, at only 1.2 per cent of payroll (as measured by Forfás) is wholly inadequate. It is also concerned that current institutional arrangements appear inadequate to achieve the target of 3 per cent of payroll, as laid down by Forfás.

The Council recognises that it is important that the institutional arrangements devised to implement a national training policy must encompass training for the unemployed, training for those in work and training for those entering, or re-entering, the labour force, and must play an important role in facilitating the return to gainful employment of unemployed people. Some separation, at the level of implementation may be required in the provision of training services to these different groups of people. The Council recommends that action be taken as a matter of urgency, and that the institutional arrangements be decided in the light of the forthcoming White Paper on training.

The Council suggests that, in the framework of any new training system, mechanisms need to be developed to ensure an employer-led process in the development and implementation of policy, aimed at upgrading skill levels in business. Such processes must also accommodate employee representatives. The Council also suggests that in the context of any new institutional arrangement, priority be given to the following principles.

- The services provided must be responsive to the needs of firms and national competitiveness;
- Due recognition must be given to the wishes of employees and their representatives;
- Human resource development policy should be closely integrated with overall development policy;
- Services would be provided by either public bodies or private firms following a tendering process;
- Where appropriate, decisions regarding the contracting of services be taken on a sectoral basis;
- Local development bodies have a role to play in the implementation of this strategy.

The Council believes that adopting this structure will result in a training system which is responsive to the needs of industry and is integrated with overall development strategy. The Council would welcome and support initiatives to re-educate both companies and workers in the new ways of production and highlight the important role which training plays in the

successful implementation of new production methods essential for the achievement of competitiveness.

Individual firm actions will be a lot less effective if undertaken on an individual basis than if undertaken by a number of firms in related industries. The Council believes the development of networks between firms could make a positive contribution to training. This is particularly so in the case of small firms which may be unable to undertake training programmes individually but which could participate in training schemes. The Council also believes that to encourage management and workers to undertake training it is essential that objective means to assess qualifications must be available. The creation of TEASTAS as a national certification authority is a potentially important move in this direction.

The major role in the development of training should be taken by the social partners. The developments which have occurred in Irish institutions over the past decade are highly compatible with the development of the training process, by having altered the character of labour relations at the national level. The Council believes it is now time to extend this development to the enterprise level to facilitate the commitment to training required from both firms and employees.

CHAPTER 8

ACTION ON UNEMPLOYMENT AND SOCIAL EXCLUSION

1. INTRODUCTION

The purpose of this chapter is to draw together a number of conclusions in relation to promoting social inclusion and countering marginalisation and poverty. The chapter identifies unemployment as the single most important problem and source of social exclusion today. It calls for a further reorientation of policy on several fronts towards cutting unemployment, and emphasises the need for a continued shift in emphasis from income maintenance to active employment measures. Section 2 acknowledges the many forms and meanings of social exclusion highlighting its dynamic and societal nature, and stressing the key importance of unemployment in driving exclusion and the need to focus policies on this. Section 3 sets out a number of principles which we believe should guide action to promote social inclusion, while Section 4 presents an overview of the areas which require to be tackled in an integrated programme to combat social exclusion. This section covers: long-term measures dealing with deprivation and inequality; income support and related measures; employment incentives and poverty traps; active labour market measures; the problem of control, fraud and conditionality, and a consideration of new measures via the social economy.

2. DEFINING AND TACKLING SOCIAL EXCLUSION

Precise definitions of social exclusion are hard to agree upon. But the common thread is that it involves a condition or process whereby a person is cut-off from access to the normal expectations or standards considered acceptable in a society. Social exclusion takes many forms and connotes different things for different social groups such as disabled people, the long-term unemployed, Travellers, or other welfare dependent categories such as lone parents. Firstly, exclusion implies significant deprivation of resources, including income and other material assets (wealth), or less tangible resources such as educational attainment. Secondly, exclusion can arise directly as a result of economic, social, cultural, legal barriers, attitudes and discrimination. These factors usually set the conditions for participation in the normal life of the community (Townsend, 1988) or determine the capacity of people to function as citizens and members of

society (Sen, 1993). The National Anti Poverty Strategy Summary of Submissions (1996) reveals a relative consensus on this broad approach while highlighting the dynamic and societal aspects of the problem of social exclusion.

The particular focus on exclusion and inclusion today reflects the profound effect of large-scale and, for many, long-term unemployment. Twenty-five years ago, in Ireland, unemployment was a considerably lesser problem for policy – and was usually a shorter-lived experience for those affected – than is the case now. In the late 1960s, the main concern was about the poverty and housing conditions of groups such as the elderly. The obvious policies were to improve cash income, housing stock, health and social services. Since then the focus, and, more importantly, the characteristics of poverty and exclusion have changed dramatically, with a greater role played by paid work in determining inclusion. The focus on policies to counter social exclusion today, therefore, must go beyond the provision of basic cash income and housing and social services to employment. Without policies for the most vigorous promotion of employment and reduction of unemployment, such measures only deal with the symptoms of exclusion and may even reinforce it. The dawning of this realisation – not just in Ireland but throughout the EU and the developed world – has been painfully gradual and, up to recently, the response has been uneven.

This new situation requires a very definite re-orientation of economic and social policy geared to more employment intensive economic growth and more investment in the development of the relevant skills of the population of working age. In the specific area of social policy too it requires policies to facilitate the transition to employment by ensuring that employment is always the more attractive option than unemployment from an income perspective, by addressing non-economic barriers to the offer and take-up of employment, and by direct interventions to train, prepare and give work experience to the unemployed in order to facilitate a transition to employment.

3. PRINCIPLES GUIDING ACTION TO PROMOTE INCLUSION

Policies for social inclusion are an intrinsic part of any strategy for economic and social progress, and the degree of inequality or exclusion in a society typically testifies to the success or failure of past policies in either addressing existing sources, or anticipating new sources, of inequality and exclusion. The present *Strategy* aims to keep issues of social inclusion at the forefront of policy. The Council believes that action on social inclusion should be guided by the following principles.

(i) Inclusion and Participation are Desirable in Themselves

The Council believes that the widest participation in social life, economic activity and policy making are inseparable and fundamental requirements for the well-being of Irish society. The inclusiveness and quality of relationships in social life, communities, economic life and public governance are goals in themselves. These are desirable, quite apart from the fact that inclusive and co-operative participation is productive – economically, socially and in public policy terms. The value of inclusion is more often evident from the costs of exclusion. The exclusion of the unemployed and their dependants from the direct and indirect benefits of paid work denies them the benefits of personal development and well-being. Apart from these, it creates enormous demands on the exchequer and those at work. Cumulative social exclusion leads to poor physical and psychological health, contributes to alienation, and the attendant problems of alcohol and drug abuse, crime and violence.

(ii) Inclusion Requires Resources

While inclusion and participation are desirable in themselves, they are impossible without adequate resources. Adequate resources – emotional, financial and educational – are fundamental requirements for inclusion and participation. Consequently, the principles of inclusion and participation require a concrete expression of solidarity in both public provision and redistribution. Such principles cover a wide range of resources, in cash terms or in the form of services such as health care, housing, social services, education and employment.

Most obviously, resources need to be so distributed as to provide adequately for those who by virtue of age, disability, labour market or social conditions require support. Apart from the key role of unemployment, income poverty is also much more prevalent in households whose head is ill, disabled or confined to home duties (which includes many lone parents and people depending on non-contributory old age pensions). Such deprivation cannot adequately be accounted for by comparisons of income level. The issue of duration and persistence of low income over long periods is crucial in determining overall levels of deprivation. It is acknowledged, however, that there are important economic and fiscal constraints on available resources, which must be carefully targeted.

(iii) Active Inclusion Measures: Access to Employment

Inclusion and participation can take many forms, including many valued social roles outside of the labour force. Nevertheless, the reality of the

modern economy and society is such that paid employment is a major aspect of participation and lack of access to work is a major source and form of exclusion. Consequently, while widespread distribution of resources is necessary, special attention must be paid to policies which promote employment and the distribution of jobs to those who are unemployed.

Social exclusion is not merely a static condition but a dynamic and, often, cumulative process. Loss of one resource can trigger the loss of others. Employment is a key resource, therefore, providing the basis for family formation, purchasing household goods, providing adequate support for children and providing for old age. Conversely, the cumulative effect of long-term unemployment is to deplete such resources and, in time, undermine the family and social relations that depend on them.

The focus on active inclusion must also seek to counter the institutionalisation of unemployment and/or welfare dependency – a very definite danger where long-term unemployment is concerned. Therefore, we take the view that, in the context of policies providing genuine, reasonable and viable alternatives to welfare payments, there is also an onus on unemployed people or first time job seekers to make themselves available or to seek out these alternatives. Not all poverty, as noted already however, is a function of unemployment, and specific additional measures other than labour market solutions will be required for certain groups (e.g. the ill, lone parents, non-contributory pension dependent).

While the Council rejects the attitude of penalising unemployed people or their dependants for being unemployed, we believe that it is both necessary and fair that, in addition to providing a range of measures to create pathways to employment, such as the new Local Employment Service, the provision of unemployment payments should be subject to reasonable conditions being met by claimants, to ensure that it is only paid to those genuinely seeking employment.

(iv) Integrated Action Against Unemployment and Exclusion

The fourth guiding principle is the need for a multi-faceted and integrated response to exclusion. This arises because of the multi-dimensional nature of the problem, encompassing poor housing, poor educational attainment, low income or lack of employment, varying family circumstances, or lack of local infrastructure, services or community associations. But, the principle dynamic behind this multi-faceted process of exclusion today is the level and enduring experience of unemployment. This exclusion must be tackled by policies which are integrated, and consistent with maximising the return to paid work and minimising the

reliance on passive income support. The Council believes that two key elements of the Action Programme – income support and active labour market policies – need to be designed together. This is necessary: (i) to avoid the dependency which characterises traditional welfare approaches; and (ii) to ensure that active measures are successful in achieving real progression back to employment.

(v) Both Short and Long-Term Measures

Fifth, the Council advocates a balanced combination of short and long-term measures to tackle social exclusion. While short-term policies – such as providing adequate income maintenance, incentivising the take up of available work or subsidising and directly creating employment – are vital, they should be complemented by a range of long-term measures aimed at upgrading ‘human capital’ through advanced education policies and improving the quality of life through better planning and prioritising of policies in relation to housing, the local environment, transport, social and recreational amenities and education and training services aimed at reducing disadvantage from an early age, etc.

(vi) Partnership

The sixth principle which should guide action to promote social inclusion is partnership. Partnership involves engaging the agreement of those most affected by policy. In many instances, this involves government and public agencies collaborating closely with employers and trade union representatives and with other groups, through various mechanisms and institutional arrangements. Frequently, this will require area-based approaches to the design and implementation of policy. In all cases, partnership is characterised by a problem solving approach designed to produce consensus, in which various interest groups address joint problems.

(vii) Monitoring and Benchmarking

Seventh, integrated action to promote social inclusion requires an effective system of ongoing monitoring and benchmarking. While some progress has been made in this regard, systems of monitoring, benchmarking and policy adaptation are far from adequate. Recent years have witnessed the growth of area-based policies and an evolving range of targeted policies on employment, training and enterprise development. It is necessary to make systematic reviews of these interventions, particularly to assess their future feasibility and effectiveness with respect to targeting, scale and delivery. A recent OECD report on the Area

Development Partnership's, LEADER and the CEBs (Sabel, 1996) highlighted the critical importance of 'learning by monitoring' to the further success of local area development through partnership, but noted as yet the absence of obvious mechanisms for so doing.

(viii) Support for Self-Generating Social Inclusion

Finally, policy should aim to support self-generating social inclusion by defending and disseminating the idea of social solidarity and harnessing Ireland's energetic business associations and trade unions, high levels of community involvement, extensive voluntary associations and relative absence of deep social divisions.

4. MEASURES IN AN ACTION PROGRAMME

The Council believes that an integrated action programme to promote social inclusion must be implemented. An integrated response to unemployment and exclusion has the following characteristics:

- A *logical* integration of a range of policy measures including education, income maintenance, secondary benefits, pay, taxation and social insurance and active labour market measures that is consistent with the key goal of reducing unemployment. These policies must be designed together in order to counter the dangers of reinforcing dependency and to generate progression to employment;
- A nationally integrated policy approach to the problem of unemployment and exclusion cutting across traditional Departmental lines through teams of civil servants tackling Strategic Result Areas (SRAs). The Strategic Management Initiative has set out a blueprint for the working of such teams, and identifies Unemployment and Social Exclusion as an SRA (1996, p.16);
- Because of the geographically concentrated nature of much unemployment – particularly long-term unemployment – there must continue to be a locally integrated approach drawing on all available local resources and seeking to match local unemployed people with locally generated opportunities. Some of the Area Development Partnerships have piloted radically new ways of working with the long-term unemployed. The evaluation of these and other locally and area-based approaches, such as LEADER, must be carefully built upon (Sabel, 1996);

- Because of the very different circumstances of each person who is unemployed there must be a method of providing an integrated package of measures geared to individual circumstances. We would highlight the potential of the new Local Employment Service (LES) in achieving this and view the development of the LES into a nationwide service as critical.

An integrated action programme will involve action of five different kinds, which are logically connected, including:

- (i) Long-term measures to promote inclusion;
- (ii) Income support;
- (iii) Action on private sector employment incentives and poverty traps;
- (iv) Active labour market policies and related issues of conditionality and control;
- (v) Exploration of the possibilities of the social economy.

The Council's comments and recommendations under each of these headings are set out below.

(i) Long-Term Measures to Promote Inclusion

While immediate measures are necessary and feasible, a realistic view suggests that an integrated programme for social inclusion requires long-term action on a number of fronts. This is so for two reasons. First, social exclusion, disadvantage and inequality cannot be adequately reversed very quickly. Second, they are shaped by long-term structural characteristics of the economy, society and public infrastructure. Consequently, a long-term strategy for social inclusion requires that several areas of public policy – education, housing, transport, local government, health and social services and the legal framework – be consciously oriented in such a way as to promote a reallocation of resources to those in greatest need. In this regard, the Council notes the key role of the National Anti-Poverty Strategy (NAPS) which aims to ensure that the issue of poverty and social exclusion is on the agenda of all government departments and agencies with appropriate co-ordination across departments on policy in this area (December, 1995).

Education and Related Issues

Education and training policies play a major role in promoting employment and countering social exclusion. Increasingly, the divide

between the employed and unemployed is defined by educational attainment, while traditional criteria, such as gender, are less decisive in relation to labour force participation. As greater proportions of the population reach third level education and the majority complete second level, the residual, but substantial minority who do not complete second level education stand out as a high risk category. Low levels of educational attainment in the past could be ascribed to an overall lack of educational opportunities. This is no longer the case. The funding of the education system has grown, and this has, with a decline in the total number of primary level school-going children, allowed a significant increase in the resources needed to address educational disadvantage in recent years, notably, to counter and minimise non-completion of education.

The Council, therefore, welcomes these developments and the supporting statements in the White Paper on Education concerning the allocation of resources to those in greatest need, including the commitment to the earliest feasible intervention to support children at risk of educational failure – in particular through greater pre-school intervention and other measures targeting resources at the earlier years – and develop specific measures to continue special supports for such children throughout their education (1995, p.7).

Priorities for education must, therefore, include:

- Evaluation of the pilot pre-school intervention Early Start programme in disadvantaged areas;
- Development of the Home-School Community Liaison initiative at first and second level and provision of deeper collaborative support for parents whose children are at a disadvantage;
- Assessment of the impact of the redeployment of educational resources, investment and personnel to schools in disadvantaged areas, and the strengthened remedial, guidance and other supportive services to counter drop out problems;
- Further progress towards the policy aim of 90 per cent completing the second level senior cycle and expansion of VTOS type initiatives, literacy programmes and second chance education;
- Development of partnership between parent and school representatives in educational matters.

Local Poverty and Disadvantage

Education has obvious long-term consequences. Just as deep-seated, though, are the less obvious consequences for social integration of poor

housing, cramped conditions, the scarcity or absence of local facilities for recreation and leisure, and of services including shops, transport and community supports. Such conditions not only reflect private poverty but a failure of public policy and a lack of far-sightedness and thoughtfulness in designing the built environment and planning local services and in fostering – through statutory, voluntary and commercial initiative – the kind of public spirit that is the cornerstone of any community and of personal esteem and identity.

Integrated policy action at *national* level is required to underpin co-ordinated *local* development. Centralisation based on functional divisions between departments and between statutory and non-statutory bodies has a tendency to *produce* fragmentation at the local level. This is a key failure that must now be addressed on a number of fronts, including:

- Local devolution of statutory functions on a cost-efficient basis and greater co-ordination of state agencies at local level;
- Increased focus on statutory/voluntary liaison in disadvantaged areas in relation to housing matters and environmental issues;
- Co-ordinated action to address the physical environment, transport, recreational and social service difficulties;
- Promotion of participative management structures in local authority/voluntary or co-operative or other types of social housing schemes;
- Policies to foster local organisation of voluntary and representative associations as a basis for building community life, particularly in the face of the threat of crime, drug abuse and attendant health and psychological problems.

Considerable investment by the EU and several initiatives for local development, including the Area Based Partnerships, County Enterprise Boards, Leader Programme, have been provided in recent years. These should be monitored and evaluated in terms of their impact on the local environment and living conditions and to avoid duplication and waste of resources. The issue of local area development is returned to below in the context of tackling unemployment.

(ii) **Income Support and Related Measures**

Income supports are a key element of an action programme to promote social inclusion. Since the publication of the Report of the Commission on Social Welfare (1986), income maintenance levels for those who depend on social welfare have been benchmarked against the

TABLE 8.1
Main Social Welfare Rates as a Per Cent of the Minimum Band Recommended by the
Commission on Social Welfare*

| Scheme | Main £50 rate | | Main £55 rate | | Main £60 rate | |
|---|---------------|------|---------------|------|---------------|------|
| | 1985 | 1996 | 1985 | 1996 | 1985 | 1996 |
| Injury Benefit/Interim Disability Benefit | 109% | 95% | 99% | 86% | 91% | 79% |
| Old Age Contributory Pension | 103% | 110% | 93% | 100% | 86% | 92% |
| Retirement Pension | 103% | 110% | 93% | 100% | 86% | 92% |
| Survivor's Contributory Pension | 93% | 100% | 84% | 91% | 77% | 83% |
| Deserted Wife's Benefit | 93% | 100% | 84% | 91% | 77% | 83% |
| Invalidity Pension | 91% | 97% | 82% | 88% | 76% | 81% |
| Old Age Non-Contributory Pension | 88% | 95% | 80% | 86% | 73% | 79% |
| Widow's Non-Contributory Pension | 86% | 95% | 78% | 86% | 72% | 79% |
| Deserted Wife's Allowance | 86% | 95% | 78% | 86% | 72% | 79% |
| Prisoner's Wife's Allowance | 86% | 95% | 78% | 86% | 72% | 79% |
| Lone Parent's Allowance | 86% | 95% | 78% | 86% | 72% | 79% |

TABLE 8.1 continued

| Scheme | Main £50 rate | | Main £55 rate | | Main £60 rate | |
|--|---------------|------|---------------|------|---------------|------|
| | 1985 | 1996 | 1985 | 1996 | 1985 | 1996 |
| Disability Benefit | 79% | 95% | 72% | 86% | 66% | 79% |
| Unemployment Benefit | 79% | 95% | 72% | 86% | 66% | 79% |
| Long-Term Unemployment Assistance | 70% | 95% | 64% | 86% | 58% | 79% |
| Small-Holder's Unemployment Assistance | 70% | 95% | 64% | 86% | 58% | 79% |
| Pre-Retirement Allowance | 70% | 95% | 64% | 86% | 58% | 79% |
| Short-Term Unemployment Allowance | 66% | 92% | 60% | 83% | 55% | 76% |
| Supplementary Welfare Allowance | 64% | 92% | 58% | 83% | 53% | 76% |
| Carer's Allowance | - | 99% | - | 90% | - | 83% |

* In 1996, the equivalent main rates were £68.10, £74.90 and £81.70.

Source: Department of Social Welfare.

recommended and interim priority rates which it put forward. Progress in attaining these rates has been arduous and remains incomplete. By 1994, the priority of increasing the lowest social welfare rates to a minimum of £45 (in 1985 terms) was achieved. Now the focus is on reaching the rates recommended by the Commission. Although, in practice, more attention is now paid to the minimum £50 threshold, it should be noted that the Commission set out a minimum band of £50-£60 and further recommended that a 10 per cent differential be kept between insurance and assistance payments in order to support the contributory principle. This minimum band (which in 1996 ranges from £68.10 to £81.70) was arrived at by the Commission by applying several internationally accepted methods of computing an adequate income. All the outcomes were in the £50-£60 range. The Commission also pointed out the necessarily pragmatic nature of its definition of the minimum payment and recommended five-yearly reviews of the adequacy of rates in the light of changing economic circumstances. Finally, once the minimum rates of payment are achieved, the Commission recommended annual reviews either based on the CPI and backed by legislation or based on government decision taking account of prices and other considerations.

Table 8.1 sets out the main rates under each of the social welfare schemes. It compares the payment under each scheme as a percentage of the Commission on Social Welfare recommended main rate. In this table, for illustrative purposes, the lower, middle and upper points of the band are selected.

- Two contributory benefits – old age and retirement pensions – exceed the lower point by 10 per cent, are level with the middle point and are at 92 per cent of the upper point;
- Two contributory benefits – survivor's benefit and deserted wife's benefit – are at the lower point, are at 91 per cent of the midpoint and 83 per cent of the upper point;
- The carer's allowance, a non-contributory payment, stands at 99 per cent of the lower point, 90 per cent of the mid-point and 83 per cent of the upper;
- Invalidity pension stands at 97 per cent of the lower point, 88 per cent of the mid point and 81 per cent of the upper;
- Short-term unemployment assistance and supplementary welfare allowance stand at 92 per cent of the lower point, 83 per cent of the mid-point and 76 per cent of the upper point;
- The remaining payments stand at 95 per cent of the lower point, 86 per cent of the middle point and 79 per cent of the upper point.

Under the PCW, the social partners set the objective of achieving further progress towards the Commission's recommended rates. As Table 8.1 shows, there has been progress, but as yet not all rates reached the lower end of the recommended band.

Currently, the ESRI is undertaking a study of income and deprivation with a view to redefining the basis on which social welfare payments should be benchmarked. In light of the ESRI study, a new basis should be outlined for future improvements in social welfare, to take us beyond the year 2000. In considering any recommendations which ensue from the ESRI study, careful attention should be given to the relationship between in work incomes and unemployment-related welfare payments. Pending agreement on a re-definition of income adequacy, the Council now recommends that the outstanding gap between actual and recommended rates be addressed in the course of any subsequent programme. While acknowledging that some believe that the target should be somewhat higher, the Council holds that all payments remaining below it should at least be brought up the lower point of the recommended band. Such a phased improvement has to take account of overall demands on the exchequer, the implications for taxation, and the need to avoid unemployment traps and disincentive effects. This would cost in the region of £113m on a full year basis, if agreed.

Current income level, as a share of average disposable income, is not a sufficient guide to the level of poverty and deprivation in a society. In addition to income, therefore, account must be taken of other forms of basic material deprivation and other forms of deprivation, including housing deprivation (Nolan and Whelan, forthcoming). Also, the measurement of poverty must take into account variations in need arising from such factors as age, health, physical or psychological dependency and the need for care and other services, and contingent variations in need. These should, as stated previously by the Council, be addressed through targeted measures and appropriate provision, rather than through a variety of rates of cash payment under the Social Welfare Code. The Council looks forward to the forthcoming *Living in Ireland* study by the ESRI which will provide an update, at 1994, of income poverty and basic deprivation, particularly as compared with 1987.

(iii) Employment Incentive Measures and Poverty Traps

Since most individuals will experience changes in income over time, what matters most is the cumulative impact on resources of long-term income deprivation. Therefore, the significance of income level must be understood in conjunction with some appreciation of other factors influencing deprivation. The key issue here is employment. For most

people, employment provides not just current resources but the basis for future well-being such as retirement and other contingencies. Long duration unemployment erodes this capacity to provide for the present and the future. It is necessary, therefore, to design policies for income maintenance and employment together.

Some definition of income adequacy sets the floor for income maintenance. However, subject to maintaining such a floor, policy must address the relationship between income when unemployed and net employment incomes, on the one hand, and between gross and net earnings from employment, on the other. Without this the risk of unemployment and poverty traps arises. This has rightly become a central focus of policy and the key emphasis on reducing unemployment by incentivising the take-up of jobs and return to work. Several measures have already been introduced covering tax and PRSI contributions, FIS, Child Benefit, Back to Work Allowances, and retention of secondary benefits for some categories. Some of these will have varying levels of take-up which could be improved by providing an effective information service to target groups.

Although much of this reform has been of an incremental nature, the changes are welcomed. The Report of the Expert Group on the Integration of the Tax and Social Welfare (1996) sought to present a coherent approach to tackling unemployment and poverty traps in the period ahead. The Expert Group made a number of recommendations which provide the basis for a more integrated and enduring approach to some of the key tax and welfare issues, but short of complete integration. Here, three important aspects of policy are identified where action is required. These are child income support, tax exemption and marginal relief tax rates, and supplements for housing, rent or mortgages.

Child Income Support

There are well known disincentive effects in current arrangements for child income support. Currently, there are four types of child support comprising:

- Family Income Supplement (FIS), paid to low paid employees, with children, who work at least 20 hours per week;
- Child additions (CAs) to the tax exemption limits;
- Child Dependant Allowances (CDAs) for children of social welfare claimants;
- Child Benefit (CB) for all children regardless of the income or employment circumstances of a parent.

A reform of child income support has been recommended previously by the Council in view of the particularly high replacement ratios facing families with children. In *A Strategy for the Nineties*, the Council noted many difficulties (not least expense) in achieving its recommendation of a fully Integrated Child Benefit, which it nonetheless viewed as a benchmark against which incremental changes in the tax and benefit system should be evaluated. The Council was concerned (a) to target family poverty associated with low pay and (b) to remove traps connected with the transition to work arising from rising CDAs and poverty traps connected with the withdrawal of FIS. These goals should be kept to the forefront at every step of the process of reforming child income support. Because this objective requires considerable resources, it can only be reached in a phased way if planned over a definite time period. The Council, here, notes the improvements to Child Benefit introduced in recent years, particularly in 1995, which have made a worthwhile contribution to countering child poverty.

What is not evident, though, is a commitment to a planned move towards an integrated and taxed benefit. The Government of Renewal Programme (1994) included proposals for a means-tested, Child Benefit Supplement as top up to Child Benefit for low income families whether or not they have employment income. Meanwhile, the Expert Group on the Integration of the Tax and Social Welfare Systems, established in 1993, considered the full range of options in some detail.

The Group considered, but rejected, a proposal for a basic income for children (a variant of basic income consisting of a universal, untaxed payment in respect of all children). It did so on the grounds that the outcome would be mixed in relation to the poverty trap and incentive to work, it would be costly (some £400m per year), with a considerable proportion of the gains going to families on higher and middle incomes, and that if funded by a revenue neutral tax increase, the numbers of losers would be twice the numbers of gainers.

The Group gave more positive approval to three further options involving a more selective approach to child income support. These were:

An *In-Work Benefit* (IWB), payable through extending and enhancing the current FIS principally by assessing entitlement on a net income basis. Take-up problems need to be solved if the IWB is to meet its objectives though it could improve take-up from the present low rate of 40 per cent. However, it is the least costly of the three options estimated to cost £17.4m net (if tax exemption-linked child additions were to be phased out at the same time).

Child Benefit Supplement (CBS), a means tested payment, in addition to CB, to families with children, whether unemployed or in work. This option has the same problem as ICB (below) with respect to FIS. Also, take-up problems and major administration problems arise. On one set of assumptions, the net cost of CBS would be £114m.

Integrated Child Benefit (ICB), that is a basic income for children that would be subject to tax. But, for some, this would mean loss of FIS for which insufficient compensation would be provided. In turn, this would entail a residual form of FIS. Also, the Group stated that legal issues arise regarding the taxation of ICB. A high net cost (estimated at £200m) is entailed by this option. As a universal benefit, subject only to withdrawal through the tax system, this cannot be fully withdrawn from those families with highest incomes.

In view of the problems associated with each of these options, the Expert Group, while convinced that child income support should be part of a package of tax/welfare reform measures (including the phasing out of tax exemptions and marginal relief), did not reach agreement on a preference for one approach over another. All of the options considered worthy of implementation by the Expert Group could be viewed as having more or less far reaching implications for the integration of tax and social welfare. However, the Expert Group stated that these were discrete options rather than stages towards a *single* solution and, therefore, by adopting some of the intermediate approaches outlined by the Expert Group it may become more difficult to proceed further. There is an issue of choice to be resolved here. The main choice problem is between CBS and ICB. Opting for a means-tested child benefit to top up the lower universal benefit would clearly rule out a phased increase in the universal payment or taxation of it. Conversely, the Integrated Child Benefit approach would involve decisions, in principle, to increase and tax the universal benefit without the introduction of a new means test. The Council does not rule out either option though it is conscious of the limitations associated with means-tested schemes in this area. In addition to the problem of incomplete take-up to be expected under a Child Benefit Supplement, there would be complex and costly administrative implications to be dealt with before the scheme could be introduced. For this reason, and given the opportunities afforded by the current rapid growth in employment to target jobs at the unemployed, the Council tends to view Integrated Child Benefit as a more solid proposition.

An interim reform of FIS along the lines of IWB would improve the poverty trap associated with the interaction of FIS and the tax system for

a relatively modest cost. Also IWB could ease the take-up problem with FIS since the scheme would be based on net income. In the UK, take-up of Family Credit – which is on a net earnings basis – has increased from 50 to 80 per cent between 1988 and 1994 suggesting that take-up can, in principle, be improved. The Expert Group, in addition, suggested other ways to improve take up of FIS. However, as pointed out by the Expert Group (p. 137) if the long-term objective is ICB or CBS, then improving FIS in the short-term will have the effect of increasing the need for, and role of, residual FIS in the new structure. This would increase the complexity of the reformed structure. Nevertheless, reforms to FIS designed to improve take-up do not rule out phased implementation of Integrated Child Benefit.

The Council views Integrated Child Benefit as the relevant benchmark against which changes should be evaluated. Indeed, in general, the Council emphasises the advantages of using the tax system to target support for low income families and households. It recognises the substantial cost involved in a fully Integrated Child Benefit system. In consequence, the Council believes that this desirable system can only be achieved, if planned over several years and introduced incrementally, subject to available resources. Bearing in mind the time-scale involved in achieving a complete integration of child income support, and the merits of a reformed FIS aimed at increasing take-up, as outlined by the Expert Group, the Council includes the latter among the measures which could be implemented on an interim basis.

Tax Exemption, Marginal Relief and Incentives

Elsewhere this report examines the findings of the Expert Group on Integration of Tax and Social Welfare and supports the phasing out of tax exemptions and marginal relief. It puts forward options which include standard-rating of basic allowances or replacement of tax free allowances by tax credits. One advantage of standard rating of allowances or tax credits is that any increase in allowances or credits would ensure that high income earners would gain no more proportionally than other earners.

The elimination of the tax exemption thresholds in either of these ways would make the tax structure more progressive and simplify it. Poverty traps could be reduced over those income bands in which marginal relief tax is paid, without redistributing advantages disproportionately to higher rate tax-payers. This should have beneficial effects on employment by allowing for improving net take home pay through increasing the value of credits or allowances. The Council recommends, therefore, that in the interests of achieving these goals in an equitable and employment-friendly manner, the Expert Group's proposal for an early examination

of the administrative implications of tax credits be undertaken immediately as a possible basis from which to replace tax exemption and marginal relief. Alternatively, the Council recommends the standard rating of personal allowances as a close substitute for tax credits.

Supplementary Welfare Housing Supplements and Differential Rent

The Review Group on the role of Supplementary Welfare Allowance in relation to Housing (1995) has concluded that the SWA rent and mortgage supplements constitute a severe unemployment trap because they are withdrawn in full once a person works for 30 hours per week or more, and fall on a pound for pound basis on earnings below 30 hours. It recommended that consideration be given to cost-effective ways of ameliorating these traps within overall budgetary constraints. Various concrete examples have been suggested as to how this might be done. One solution is to introduce a means-tested payment without the employment/unemployment cut-offs. The other, more pragmatic measure, which the Council equally recommends, is to extend the taper by introducing a lower, for example, 50p per £1, withdrawal rate.

On Differential Rent, the Council welcomes the comments of the Expert Group on tax and social welfare integration which underscore the need for a nationally uniform scheme in all local authorities, free of the poverty traps in some schemes.

The extension of these subsidies for a period of time after unemployed people obtain work, as recommended by the Expert Group, needs to be considered in the light of the effects on the unemployment traps of the measures taken to rationalise the different schemes.

(iv) Active Labour Market Policies (ALMPs)

The Need for ALMPs

In conjunction with the above components of a strategy, policies are also required which directly tackle unemployment, for example through training, education, community employment and employment services concentrated on the unemployed. The justification for special active labour market policies in Ireland is not difficult to find. In *A Strategy for Competitiveness, Growth and Employment* (1993), the Council acknowledged the particular difficulties of the long-term unemployed, who are unlikely to gain significantly from any general improvement in labour market conditions resulting from structural reforms or the emergence of a more positive external environment. The probability of 'escape' from unemployment decreases sharply with unemployment

duration. Therefore, policies specifically targeted at the long-term unemployed – and those at risk of becoming long-term unemployed – are necessary.

There are limits to how far and how fast such policies can be expanded given the constraint of achieving economic stability and increasing the growth in productivity. However, these active labour market policies (ALMPs) are increasingly necessary in order to target problems such as the growth of long-term unemployment and youth unemployment and the influx of women into the labour force. Given the scale and persistence of long-term unemployment in Ireland, great care and attention is needed in designing and implementing such policies to get the most from them.

There have been several significant contributions to policy development in this area over the past two or three years, in particular the NESF Report on Long Term Unemployment, the Task Force on Long-Term Unemployment and the recent strategy paper, *Growing and Sharing Our Employment* (Department of Enterprise and Employment, 1996). Currently, there is an Inter-Departmental sub-group to oversee strategy on unemployment. These contributions should be seen against a similar concern throughout Europe and the developed world, with high levels of unemployment and lingering long-term unemployment. Contributions from the OECD, the EU, and the example of other countries, have informed debate in Ireland. The EU's "Essen Process", for example, has involved the prioritisation of policies to cut unemployment in the EU. General agreement has emerged on the need for a wide range of policy approaches on the tax and social welfare front and through ALMPs with the overall objective of shifting the emphasis of policy from passive, income maintenance to active labour market policies.

Evidence from research by the OECD testifies to the fact that Active Labour Market Policies (ALMPs) are now widespread, and play a significant part in tackling unemployment, particularly long-term unemployment. Through ALMPs, individuals benefit through participation itself, as well as post programme earnings and employment. At a wider level, evaluation focuses on possible negative outcomes such as dead-weight, displacement and substitution, and some account is taken of possible externalities. Different groups benefit from different approaches and, therefore, a key issue is to devise programmes which are properly refined and targeted. The EU, since the Commission's White Paper on Employment (1994), has also stressed the need for targeted measures for different categories and circumstances.

An important aspect of ALMPs is to ensure that income maintenance policies do not operate so as to institutionalise unemployment and this has meant a renewed emphasis internationally on the issues of

qualification conditions and proper controls on entitlements. This is dealt with, separately, in the Irish context under (v) below.

Types of ALMP

Active Labour Market Policies includes training, employment services and direct employment measures. Each of these is commented on below in the Irish context.

Training

Training can be sub-divided into formal classroom training and on the job training. Although training is crucial to overall labour market performance, training in the ALMP context is expensive with potentially low or negative returns unless carefully targeted so as to provide relevant skills for specific *niches*. The Council has previously (1990) cautioned against taking too sanguine a view of the potential of training as a remedy for unemployment, particularly long-term unemployment. The success of training depends critically on some mismatch between labour demand and available skills. The benefit of training comes when skills are created or adapted to meet existing demand. Therefore, in Ireland, as elsewhere, emphasis must be placed on linking training and other policies, particularly guidance, counselling and placement measures. The Council has previously argued that training linked closely with guidance – while it has been used very successfully in Sweden, where it served to *prevent* the growth of unemployment – would be totally insufficient in the Irish context where unemployment is high and entrenched. Training – if targeted – may be most effective in boosting the chances of a return to work for those who have recently become unemployed, or have left the education system or for those who have qualifications but wish to re-enter the labour force, such as married women. Such training should, in principle, be part of a package including counselling and information with a view to placement in the labour market and should include some work experience elements.

A case can be made for targeted training for the long-term unemployed, geared towards equipping them with work-related skills at the most basic level. A key option for the long-term unemployed, however, would be direct employment, which reproduces some of the routines and requirements of regular employment, and thus may prove more likely than training to address the problem of hysteresis or ‘stickiness’. Also, it is known that employers value recent work experience in job applicants. In this context, however, the development of the training content of such

employment should not be overlooked. By providing work opportunities *with* training, employment chances can be improved.

Special Employment Measures

These may take three broad forms:

- *Subsidies to employment* in existing or new enterprises: Subsidies to employment in the private sector seem to have most potential in relation to the long-term unemployed, and if carefully targeted particularly at those who find it hardest to get into paid jobs. Subsidies may require controls, such as extending the employment period beyond the subsidy period, or by targeting participants to occupations where there is an excess demand, or to sectors with an expanding demand for output, deciding whether subsidies should be directed to the employee or the employer or both and, relatedly, whether subsidies can be linked with on-the-job training. There has been extensive activity on this front including the Back to Work Allowance (BTWA), the extension of secondary benefits and direct subsidies to employers (Jobstart), introduced in 1996. It is important to undertake regular independent evaluations and to review these measures in an ongoing way to ensure that they constitute part of a coherent package without duplication or avoidable gaps.
- *Direct job creation* or social employment (e.g. Community Employment) has greatest potential in relation to the most disadvantaged unemployed, particularly the long-term unemployed. On the negative side, direct job creation has limited long-term benefit potential. Direct job creation has the potential both to provide some on-going employment for the very hard-to-place and improve the ‘employment-readiness’ of the long-term unemployed and can potentially be linked to other measures aimed at achieving progression to more mainstream employment.
- *Subsidies to New Enterprises* set up by unemployed people: Aids to unemployed people starting enterprises have tended to be identified with a small subset, pre-dominantly male, educated and under 40 years of age, and the short-term unemployed. However, we should not overlook the potential role of such subsidies as the BTWA in stimulating the establishment as sole traders of other categories, including the long-term unemployed. Motivation is a key factor and mentors and counselling are recommended. Also, removing any barriers and providing appropriate training and

childcare support to the establishment of enterprises by women wishing to return to work would provide an additional stimulus to new enterprise development.

Ireland now has over 20 years of experimentation in direct job creation and employment subsidy programmes. Prior to the PCW, there were a number of specific programmes. These programmes were unified under the Community Employment (CE) programme, with the aim of building on the strengths and addressing the weaknesses of its predecessors and creating 40,000 places by the end of 1994. When launched in 1994, CE had wide criteria for eligibility. These have been redefined with clearer differentiation between different categories, not just the long-term unemployed, but also sub-groups of the long-term unemployed (out of work for three or more, or five or more years).

The Task Force on Long Term Unemployment (1995) set out a basis for refocusing employment options as one of a range of strategies for tackling long-term unemployment. The Task Force set out its recommendations in relation to the likely options for various categories of unemployed people who are long-term unemployed already or at risk of so becoming (i.e. those out of work over 6 months). These were estimated at 184,000 of those on the Live Register. The options fall into three broad categories:

- Options designed to provide genuine opportunities for progression and *integration* into the open labour market for those for whom this is a realistic possibility. These options will, in general, apply more to most young unemployed, or short-term unemployed, and some long-term unemployed, an estimated 73,000 people;
- A longer duration *part-time* job options for those older and longer unemployed who are less likely to get jobs in the open labour market in the short-term at least. These were estimated to number 111,000 by the Task Force;
- A pilot programme providing a limited number of longer duration *whole-time* contract jobs for those most disengaged from the labour market by virtue of their duration of unemployment, age and the area in which they live.

The Council welcomes the Task Force's approach to targeting of schemes in this way. In the context of such rigorous targeting, the scale of unemployment and long-term unemployment also requires review, and can be viewed more realistically. The NESF has called for the elimination of long-term unemployment. The possibility of a major expansion of CE and targeted progression slots to pursue this objective must be considered. The Council, therefore, recommends that close consideration be given to

the expansion of *targeted* measures (as defined by the Task Force) in the light of experience and subject to overall resource limitations.¹ The present problem of long-term unemployment requires both "curative" and "preventative" measures. We must not lose sight of the objective of gradually shifting the emphasis to preventative measures. For the foreseeable future, and certainly during the course of the period up to 2000, it is evident that the need for a substantial commitment to special employment and progression measures is unavoidable.

Local Employment Services

Employment services includes individual counselling, employment placement services and matching of vacancies with job seekers. This is the least costly of all ALMPs and is usually closely integrated with the public employment service. Public employment services are also more effective if they are the gateway to all other active measures and employment for the unemployed. In Ireland, such services have largely been the responsibility of FÁS. Increasingly, centralised employment services are recognised as less effective than locally dispersed ones. This is now a key issue in the Irish context.

The NESF proposal for a Local Employment Service (LES) was adopted by the Task Force on Long-Term Unemployment. The Task Force set out a blueprint for the establishment of a nationwide service in Area-Based Partnership areas and other areas. In a limited number of areas, the LES is now in its early stages of operation. The aim is to have a nationwide service established over the next few years.

The Council views the concept of the LES as a potentially vital development in our public employment services as a whole. In the past, over-centralisation and a pre-occupation with training has tended to undermine the role of FÁS in employment services. The LES, with a focus on local co-operation and service delivery, and a priority on the more 'hard-to-place' categories of unemployed people, has – if properly implemented, resourced and given backing by all the key departments and statutory agencies – considerable potential to overcome past failures in our employment services in a cost-effective manner.

The Second Report on the Strategic Management Initiative, launched in May 1996, provides an impetus for bringing about the necessary changes,

¹ The idea of a job guarantee has been proposed in this context by representatives of the unemployed aimed at offering an option of *indefinite*, subsidised or direct employment to the very long-term unemployed over 35 years of age. This could be examined further in the light of the pilot programme on longer term jobs listed above.

especially since "Unemployment and Social Exclusion" is now a *Strategic Result Area* for cross departmental team action. The LES is a litmus test of the SMI in tailoring employment services effectively to the needs of the 'customer'. It is critical that the LES is given every opportunity to realise its potential through secondment of staff and systematic collaboration, information generation, and sharing, across agencies and sectors. The key is to bring about the institutional climate required for successful local collaborative action. The definition of mechanisms for organisation of the LES in the Task Force report and subsequently in the plans drawn up by the Department of Enterprise and Employment need to be scrutinised closely, kept under review, and implemented in the spirit of the original proposals.

The success of the LES hinges on several factors including having an adequate range of placement options locally and a capacity to give *individually* tailored direction to job seekers. To be successful it needs to have sufficient staff and to liaise professionally with local employers, unemployed people and a variety of statutory agencies.

The Council would like to stress the goal set out for the LES of becoming the gateway to a full range of progression, integration and employment options for the unemployed. The LES is not an add-on, nor should it become open to the criticism of duplication of existing services. It is a new way of working which offers an integrated employment service based on principles of partnership and co-operation across agencies at a level close to the target population. It is up to the existing departmental, statutory and other key stakeholders to ensure that the service becomes a properly functioning part of a vigorous drive to cut unemployment – and that responsibility, budgetary resources and data must be devolved to the LES.

Area-Based Partnerships

An innovative, area-based approach to long-term unemployment was launched in the early 1990s as part of the PESP, following a Council recommendation. The area-based approach involved initially 12, and subsequently under the PCW, 35 areas, in which the strategy was to bring about a co-ordinated range of policy measures against unemployment tailored to local circumstances. The success of many of these partnerships was built upon precursor parallel Community Development Programmes supported by the Department of Social Welfare.

A recent evaluation which examines these partnership models, the LEADER model and CEBs (Sabel, 1996), highlights the enormous potential that such local partnerships unleash, notably by cutting across traditional, functional divides between different departments and

statutory agencies, and drawing together representatives of the private commercial, voluntary and community sector in an effort to generate economic development locally and create employment. The study further characterised these developments as living experiments in local participation and combating exclusion. It also noted the centrality of creating a mechanism whereby the best achievements and learnings of these locally-based projects could be absorbed and transferred to other areas. Indeed, the study argued that some of the local partnership projects had, by their own efforts, discovered many of the principles which underlie working practices in the most modern firms. That is, the partnership model for local development, by drawing together a diverse set of experts and partners, created a problem-solving team approach to local needs.

The Council recommends that the lessons of this evaluation, and indeed other evaluations of locally-based development, such as LEADER and the County Enterprise Boards should provide the platform for further development of local initiative. The decision to situate the LES initially in the original 12 partnership areas reflects, in our view, the obvious advantages of the local partnership model.

The experience of the local partnership, as described in the OECD evaluation, poses fundamental questions about the capacity of the Irish state and its institutions to facilitate on a permanent basis the kind of authority and autonomy granted through the partnership model over the last few years. The Strategic Management Initiative provides an example of the kind of response that this evaluation appears to wish to elicit. This is so because the SMI seeks not only to bring about, in the specific area of unemployment, greater cross agency collaboration at local level, but also to put forward a problem-solving, team-based approach to the workings of government itself.

(v) Control, Fraud, Conditionality and Unemployment

In view of the scale and importance of welfare spending and active labour market measures in relation to unemployment it is vital that resources are carefully allocated and subject to the kinds of controls that will minimise fraud and maximise the return to work. Below, the Council sets out its perspective on the subject of fraud in relation to unemployment payments and the concept of conditionality in relation to measures to support the unemployed and to promote the transition to employment.

The Control of Fraud

The publication of a special CSO study of the differences between Live Register and the Labour Force Survey measures of unemployment, based

on a sample of claimants, has given rise to a renewed concern with the problem of 'dole' fraud. So far, the precise details of the survey are limited to a statistical release of the 18th of September 1996. This release omits, for example, data on the age or gender of claimants. The key table from this statistical release is reproduced here (Table 8.2). It contains the reweighted data from the study, and we have inserted the percentages in the row and column totals. These row and column percentages show, respectively, the International Labour Organisation (ILO) classification of claimants surveyed, and the Principal Economic Status (PES) classification.

TABLE 8.2

Labour Force Survey (LFS) Responses (Weighted#) by a Sample of Persons on the Live Register, April 1996

| ILO Economic Activity Status* | Principal Economic Status* | | | Total | Per Cent Total |
|---|----------------------------|------------|---------------------|-------|----------------|
| | At Work | Unemployed | Not in Labour Force | | |
| Employed: full time | 166 | 1 | – | 167 | 11.4 |
| Employed: part time | 99 | 3 | 5 | 107 | 7.3 |
| - Not under-employed | 35 | 3 | 1 | 39 | 2.6 |
| - Under-employed | | | | | |
| Unemployed | 2 | 665 | 57 | 724 | 49.5 |
| Marginally attached to the labour force | 1 | 52 | 13 | 66 | 4.5 |
| Others not economically active | 2 | 98 | 259 | 359 | 24.5 |
| Total | 305 | 822 | 335 | 1462* | |
| Per Cent Total | 20.9% | 56.2% | 22.9% | | 100.0 |

Weighted to reflect the overall distribution of the Live Register between long-term and short-term claimants and also adjusted for an estimated small level (34) of outflows from the Live Register between 19 April 1996 and reference period of the LFS.

* Sample of 1,496 less the estimated small level (34) of outflows from the Live Register between 19 April 1996 and reference period of the LFS.

Source: CSO Statistical Release, 18 September 1996.

Table 8.2 shows that about half or slightly over half of claimants (49.5 per cent on a PES basis or 56.2 per cent on a ILO basis) fitted into one or other of the Labour Force Survey definitions of unemployment. However, by no means were all of the remainder at work. On the ILO basis, 21.3 per cent of claimants were in employment, compared to 20.8 per cent on a PES basis. Furthermore, only the ILO classification system includes a sub-categorisation of employment into full and part-time employees. On this basis, therefore, 11.4 per cent were deemed to be in full-time work, 7.3 per cent in part-time work and not under-employed and 2.6 per cent in part-time work but under-employed. It should be pointed out that many part-time workers are entitled to sign the Live Register, and indeed it may be the case that some of those defined as full-time workers in the Labour Force Survey, also qualify. Beyond that, we have no information as yet on the nature or quality of pay or employment conditions of those at work but signing on.

In addition to those signing on and in work, this study recorded 23 per cent (on a PES basis) and 29 per cent (on an ILO basis) of claimants who are deemed to be outside the labour force. Once again, the ILO grouping may be sub-divided into those who are deemed marginally attached to the labour force (4.5 per cent) and those who are otherwise not economically active (24.5 per cent). Of this 24.5 per cent figure, just over 27 per cent were classified as unemployed on a PES basis, and according to the CSO, further analysis on an ILO basis reveals that approximately three quarters said that they were neither looking for work nor wanted work. While it is questionable that these should be on the Live Register since they are apparently not "available for and actively seeking work", one should again be careful regarding inferences as to fraud. Many people, due to lengthy spells out of work, for example, become discouraged to the point where they no longer actively seek employment. In addition to those classified as marginally attached, many of these will define themselves (on a PES basis) as outside of the labour force citing retirement, home duties or other statuses. However, we cannot – even in a majority of these instances – rule out the possibility that people would take up a suitable offer of work. On the other hand, there may be an unknown member who for reasons of poor health, physical, psychological or drug dependency, are not capable of working. Strictly, these should not be on the Register, but all of these would require income and other types of support from the State.

In addition to discouraged workers signing on are many – usually married women – who sign on for credited contributions, but receive no payments, usually with a view to later take-up of employment or maintaining continuity of a contribution record with a view to qualifying for a contributory old age pension. Many in this category are seeking

employment. In fact, the survey confirms that 17 per cent of those who defined themselves as outside of the labour force on a PES basis, were classified as unemployed on the basis of the ILO system. This means that they were actively seeking employment *in the survey period*.

There has been, in addition to concern about the data contained in the survey, a great deal of concern expressed about the labour force status of those sampled from the Live Register but not residing at the addresses recorded. The CSO has cautioned against drawing any specific conclusions in respect of this group. Nevertheless, it is a cause for concern, even if it may be explained, in large part, by records being somewhat out of date at the time of the survey.

Thus, on the basis of this survey, there is still a good deal of room for speculation as to the precise extent of unemployment fraud. It would certainly not be correct to infer that the 44 per cent not classified as unemployed on a PES basis are engaged in fraud. Moreover, it would be difficult to sustain a claim that even 21 per cent – those describing themselves as in some form of employment – were making fraudulent claims. Quite simply, we do not have a precise figure.

The only study of the absolute level of fraud and abuse was undertaken in 1987 by the Department of Social Welfare with the assistance of consultants. The study covered both disability benefit and unemployment payments. According to the Department, in relation to unemployment payments, the findings indicated that in Dublin, some 2 per cent of the number of unemployment payments were based on claims which contained some clear element of fraud. In monetary terms, this figure represented some 1.6 per cent of unemployment payments.

In addition, the review showed that 7 per cent of the sample of cases gave rise to suspicion on the ground that the facts of the case did not check out at the initial interview. Later investigation of these cases showed that two-thirds were found to be *bona fide*, a minimal number were clearly fraudulent and no definite conclusions could be drawn about the remainder. Based on this study, the Department reached the conclusion that at that time there was a baseline fraud level of around 5 per cent.

Control activity of the Department has been a continuing feature of its work and by its nature, it is targeted at the more suspect or higher risk categories of claimants. The total annual value of savings arising from the Department's control activities in 1995 is published at £125 million. Some £50 million or so of this relates to the unemployment payment schemes, which represents some 5 per cent of total expenditure. Insofar as control measures can never be totally effective, particularly in a situation where there are some 50,000 to 60,000 movements on and off

the Live Register each month, the overall level of abuse must be in excess of that figure.

We note the series of measures being taken by the Government in response to the CSO survey and, in particular, to the Dáil statement by the Minister for Social Welfare on 25 September in response to Dáil Questions where he stated that he proposes, as part of a fundamental examination of control and anti-abuse measures, that a better assessment will be made of the level of fraud and abuse. We welcome this and hope that it will provide a firm basis for deciding on whatever policy or other measures are required.

It is the Department of Social Welfare which is primarily responsible for tackling 'dole' fraud. However, there is no doubt that a co-ordinated effort between the relevant government departments and State agencies – in particular between the Revenue Commissioners, the Departments of Social Welfare and Enterprise and Employment and FÁS – is essential to tackling the problem of employment fraud more generally.

Supportive Conditionality

Apart from the specific issue of fraud, the shift in emphasis from 'passive' to 'active' measures in support of the unemployed poses the question of whether there should be special conditions, attached to unemployment payments or the take-up of ALMPs. This shift, on the one hand, can give rise to fears of a loss of social welfare rights and the introduction of a penal attitude into the treatment of the unemployed. On the other hand, there are concerns that unemployment can become institutionalised, taking on a quasi-permanent status for significant sections of the labour force, unless measures are introduced to bring people back into employment.

The Council takes the position that the resolution of these difficulties is only possible on the basis of adopting a range of approaches appropriate to different circumstances. Underlying such measures is the assumption that the continuation of high unemployment, and particularly long-term unemployment, is of no benefit to society and, more importantly, is a profound cost to the unemployed themselves and their families. We also take it that unemployed people themselves, for the most part, wish to be employed and will, with supportive policies, be willing and able to take up employment if it is available. This stance is consistent with a consideration of existing or new conditions to be attached to social welfare and particular ALMP policy measures.

The application of conditions exists already in relation to unemployment benefit and unemployment assistance payments. Eligibility depends on

being available for and seeking employment. Nevertheless, as distinct from reviews of eligibility by the Department of Social Welfare which are routinely used to police the Live Register, there is a case for introducing such conditions as might assist or encourage job seeking activity. There ought to be requirement of a review at 6 months of the options available to a person to avert the drift into long-term unemployment.

Another illustration of this approach is the way in which the Task Force on Long-Term Unemployment dealt with the supportive application of conditionality in its proposals for a progression package for those aged 19-20 years, separate from CE. This was followed up in the Youth Progression Programme (YPP) announced in the 1996 budget whereby after 6 months, continued eligibility for UA depends on registration for the YPP. The Task Force stressed its non-penal attitude, and drew attention to the huge potential waste and long-term loss involved in not acting to coax or redirect young people towards a transition to employment, in *their own* interests.

There is no reason why the same principle of supportive conditionality should not consciously inform a review of possible or existing rules on eligibility for unemployment benefit or assistance. Already, conditions are attached to all schemes for income support and ALMP participation. These should be carefully reviewed in an ongoing way in the context of aiming to support a return to employment whenever possible.

The targeting of schemes itself is closely allied to this form of conditionality, where, for example, it counteracts problems of deadweight, displacement and substitution or helps those finding it hardest to gain employment to do so. But targeting is an application of qualifying conditions to aggregates whereas supportive conditionality may require action by the individual. For example, targeted community employment measures may be over-subscribed but there would be no guarantee that all or most of the target group would apply to participate. Conditionality, on the other hand, would imply that each person in the target group had some obligation to be available for consideration for appropriately targeted measures. At the same time, it is acknowledged that many discouraged workers, particularly those out of work for a long time, require encouragement if they are ever to re-enter employment, and it may be counter-productive to attempt imposing conditions in individual situations without regard to their real potential.

The concept of supportive conditionality allied to targeted active labour market measures and tax/benefit reforms aimed at removing traps and disincentives has potentially broad application in different contexts. It is distinct from the need for measures to counter fraud – which are

absolutely essential and must be stepped up in that it is intended to assist people who are genuinely unemployed in regaining a foothold in employment. However, in many instances, measures introduced in this spirit can also have the positive externality of generating responses among some people, such as signing off the Live Register, regularising economic activity formerly undertaken in the black economy, or even taking up employment or further education in preference to participation in a programme.

Supportive conditionality – while it is distinct from targeting – can only be adequately fostered in a context where sufficient jobs or placements are available to absorb the target groups, particularly if the measures are a means to long-term employment at market rates. Thus, the scaling up of targeted measures provides the best opportunity for helping individuals through a tailored package aimed at integration or other job placement options. The potential of the Local Employment Service (LES) will depend, to a large extent, on the capacity of LES offices to provide a set of proper quality options to all comers. If sufficient gateways are made available through the LES, it will be correspondingly easier to apply supportive conditionality. However, even on the most optimistic assumptions, there will be a shortfall in available places over the next few years. Moreover, the LES, as noted above, has a vital *supportive and guidance* role to play in relation to the long-term unemployed, and this needs to be nurtured. In the final analysis, it is the agencies primarily involved in *providing* income maintenance, training or employment – and not the LES – who have the main responsibility in setting, and ensuring compliance with, conditions. What is required, in overall terms, is a professionally combined blend of support and control across the whole range of State support for the unemployed.

(vi) The Social Economy

The Council has considered the possibility of new measures to reduce unemployment, particularly long-term unemployment. Among the ideas considered is the concept of the social economy, which was given a clear endorsement in the EU white paper, *Growth, Competitiveness, Employment* (1994), and which has been the focus of much discussion and some experimentation throughout the EU in recent years.

The EU white paper sets out its ideas on the social economy in very brief, broad but relatively coherent, terms. In short, the EU identified the possibility of encouraging new types of social service provision and useful social employment along a 'continuum' between pure, commercial service provision, on the one hand, and pure statutory provision, on the other. The social economy could, for example, bridge certain market

failures or limitations on statutory provision, or play a role where people in need could only afford part of the cost of a useful social service. The social economy would provide mechanisms through which such provision could be subsidised, yet be provided through a *quasi* market. To this extent, it goes beyond most existing forms of Community Employment where the outcome is not in the form of a saleable commodity. However, the social economy could develop in part as an extension of CE, and by building on the experience of local area-based partnerships, LEADER initiatives and CEBs.

Several contributions have been made to the debate on the social economy, both at European and national level, since the publication of the EU White Paper. However, in an Irish context, no systematic review or study has been conducted into the possibilities of the social economy and, in particular, its potential for reducing unemployment, especially long-term unemployment. Moreover, even in the international context, there has been some incoherence in the discussion, due to conflicting definitions.

The Council proposes that a working group be established to make a systematic examination of the potential of the social economy. The group would formulate a workable and meaningful definition suitable to Irish needs. The group should study the potential range of activities as well as the pitfalls associated with extending the social economy, including the danger of misallocating public resources. It should identify mechanisms through which the demand for and supply of suitable services could be generated. For example, it should critically examine the potential and limitations of service vouchers and tax deductions which were mentioned by the EU as possible demand-side measures, in the light of experience elsewhere. Also, some examination of mechanisms to stimulate the supply-side, including assistance in developing skills for the new occupations or professions which may emerge, e.g. in social care services, to meet emerging needs.

The Working Group should comprise representation from relevant government departments, the social partners, the unemployed, people with disabilities, women, the Travelling Community and the voluntary/community sector. The working group should seek to provide a set of conclusions and recommendations on the social economy as a pre-requisite to developing suitable policy implementation measures.

5. CONCLUSIONS

Social exclusion is both a condition and dynamic process cutting people off from participating in the normal way of life of a society. Today, unemployment is the key factor involved in generating and perpetuating social exclusion, with consequences for the future as well as the present.

Policies to tackle low income and educational or social deprivation and policies to tackle unemployment must be designed together. Income maintenance should be guided by the targets set by the Commission on Social Welfare pending the study of income adequacy being conducted at the ESRI, which will provide the context for a review of current guidelines. While income maintenance policy sets the floor for protection against poverty, policy on tax and social welfare, housing subsidies and other areas must be linked to this floor to ensure that work is always the preferred option to unemployment.

Directly targeting sectors of the unemployed by providing active labour market policies is a key part of the programme to tackle exclusion. The Task Force on Long-Term Unemployment provides a solid basis on which to build and expand such measures. In addition, adequate information services are required to promote take-up of various employment subsidies now being provided.

The issue of unemployment fraud has to be tackled resolutely by the Department of Social Welfare and through inter-departmental, inter-agency co-operation and tighter controls. Apart from that, the concept of supportive conditionality should guide us in linking together income maintenance for the unemployed, active labour market policies and other policy measures against exclusion, to successfully bring about the progression to work.

The Strategic Management Initiative has important implications for unemployment and exclusion policy. In relation to the LES, for instance, a challenge is posed to the capacity of several departments and state agencies to work together. In relation to local area development too, the SMI brings into relief the need to combine at national level in order to provide the foundations for collaborative local action on unemployment. Here, the specific learnings of the area-based partnerships (Sabel, 1996) should provide the basis for a wider application of the principles involved. Finally, the proposed study of the social economy's potential too will likely pose questions that require a collaborative, inter-departmental response.

Action to counter social exclusion requires resources, particularly public resources, and has implications for public expenditure. This strategy elsewhere sets out a limit of 2 per cent in real terms for the growth of public expenditure over each of the next three years. To achieve the objectives set out in this action programme would require that savings in public spending be achieved in other areas.