

THE DILEMMA OF IRISH ECONOMIC DEVELOPMENT

Perspectives on the Evolution of Ireland's Public Finances and
Economy from the early-1960s to the mid 1980's

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(Read before the Society, 21 May 1987)

1 INTRODUCTION

- 1 1 In this paper we take a broad retrospective look at aspects of the evolution of the Irish public finances and the economy over the last 25 years or so. In particular, we attempt to rationalise that evolution in terms of the underlying dilemma of the Irish economy as set out by Dr Whitaker in his seminal paper entitled "Capital Formation, Saving and Economic Progress" to this Society on the 25th of May 1956 – what he termed the "Dilemma of poorer countries"

"Less developed countries, being at the disadvantage of starting from a lower standard of living, find it more difficult to set aside even the same fraction of income for capital building as the more highly developed countries. Yet, unless they make more rapid strides in other means of raising output, it is precisely those countries which must set aside a relatively greater fraction if they are ever to catch up in living standards"

- 1 2 This paper is essentially about the budget, meaning the financial activities of public authorities, at an aggregate level, in the macro-economic context. It does not set out to examine, except where this is unavoidable or necessary to set the scene, the detail of public expenditure or taxation which has been exhaustively examined in other fora and publications in recent years. Neither does it look at the specific policies which the budget plays a major part in implementing, but the reader will, we hope, be tempted to ask whether the overall thrust of budgetary policy in the period reviewed was compatible with the objectives which these 'micro' policies were seeking to achieve. The views expressed are, of course, personal views

Structure of Paper

1 3 The paper is structured as follows

- Part 2 outlines a framework for looking at economic and budgetary policy in a country such as Ireland,
- Part 3 makes a summary comparison of the level and structure of the budgetary aggregates and balances in 1960 and 1984,
- Part 4 contrasts budgetary developments in the 1960 to 1973 period with 1974 to 1984 period,
- Part 5 examines the Irish budgetary experience in the context of budgetary developments in European and OECD countries over similar periods,
- Part 6 considers some aspects of savings, investment and the external balance,
- Part 7 considers the possible relationship between the budget and the economy in the long run,
- Part 8 attempts an overview of budgetary and economic developments for the period as a whole

Finally in Part 9 some broad conclusions are drawn

2 FRAMEWORK

The Environment for Irish Policy and Aspirations

2 1 Before turning to the central theme of our paper, it would perhaps be useful to indicate where we see Ireland as located in economic time and space. In our view, it would be meaningless to assess developments here without reference to the environment in which the Irish economy exists, and to the technical and cultural influences emanating from that. Because of its size and location, it functions in many ways like a region of a larger economy comprising, broadly speaking, North America and Western Europe (and now, arguably, Japan). The Irish economy is 'open' with regard to the rest of this grouping in terms of trade, investment and financial flows, to a degree which is possibly not matched by any other country in the group and maybe not even by regions of some of the larger member-countries. There is an openness also, though more restricted in its scope, with regard to population movements and in regard to ideas.

- 2 2 This openness in its various aspects has done much to shape both the policies we have adopted and the aspirations at which these are directed, although, in fairness, it must be said that we have been innovative on both counts
- 2 3 In regard to policies, the pre-eminence of budgetary policy in our arsenal is a feature shared with most of the smaller countries in this group, but nowhere perhaps has it been more central than here Unlike many similar countries, we have, with rare exceptions, been firmly in the Anglo-American tradition in regard to incomes policies Exchange rate policy, which in some of the smaller countries of OECD has been actively deployed, was disavowed totally under the Sterling parity which obtained until 1979, when it gave way to the EMS arrangement involving only marginally less stability Monetary policy has, in turn, been geared to exchange rate considerations
- 2 4 As regards aspirations, these, until our accession to the European Community, emanated mainly from and related largely to conditions in the UK The influence from Continental Europe, which was beginning to be felt in the late 1960's has since grown in importance to the point where it is now arguably the most important Our legislation shows ample evidence of this, though our institutions are still recognisably of an earlier era Dr Whitaker in his paper of 1956 referred almost exclusively to the influence of the UK If writing today, he would surely feel it obligatory to broaden the basis of his comparison

Aim of Economic Policy

- 2 5 The implicit aim of economic policy in Ireland is to bring per capita incomes here ever closer to, and eventually into line with, incomes in the wider economic region to which Ireland belongs On the conceptual level, greater convergence of per capita incomes among neighbouring regions could, in principle, be achieved via alternative routes
- (a) the progressive movement of the factors of production towards the regions where returns are highest, probably implying falling population in the less-favoured regions,
 - (b) higher relative levels of productivity growth and investment in peripheral regions, against a background of population stability or growth

The focus of Irish political aspirations, implicitly at least, is to achieve convergence towards the perceived 'norm' primarily via the second route but with the support of transfers effected within an integrated European economy

- 2 6 In the Irish situation, the requirements of economic policy are in a sense twofold
- firstly, to adapt at the same pace as other countries to new developments affecting economic growth in all regions, and
 - secondly, to bring about the large increase in capital stock and technical progress required to close the gap in per capita incomes
- 2 7 Higher relative investment and productivity growth in an economy like Ireland requires higher rates of return to capital and enterprise (or quasi-rents)¹ and either higher levels of domestic savings or higher relative levels of foreign dissaving. Either of these courses runs up against powerful constraints. Both quasi-rents and higher levels of domestic savings imply lower levels of disposable income and consumption than otherwise. Given the natural pressure of improving individual welfare (whether from primary incomes or transfer incomes or public consumption), this can create a tendency for the shifting of the onus of financing investment to external borrowing. This creates its own difficulties as a significant increment of the output resulting from such investment (direct investment from abroad will probably require a particularly high level of quasi-rent) will have to be transferred abroad. Thus, while relative output (GDP) per capita may be increasing faster than elsewhere, income (GNP) per capita may not, so that the underlying objective may not be achieved. The key distinction made by Dr. Whitaker in this regard was between the implications of domestic capital formation and increases in national capital and, in particular, to the fact that "realisation of external capital does not of itself add to national capital. It entails merely a geographical redistribution of existing national capital."
- 2 8 An objective shortage of resources is not the major constraint on the higher investment needed to achieve stated national objectives. There are wider issues. Do investment opportunities exist on a sufficient scale? Are we dealing effectively with the constraints on investment? Assuming that the macro-economic environment is right, that markets are working well, that incentives are strictly limited to projects which will generate the required return and that real income (in the social sense) is at the minimum acceptable, the level of investment emerging at any point in time in the exposed sectors of the economy may not be sufficient to meet immediate aspirations. In that event, the system generates enormous short-term pressure to pursue contradictory objectives.

2 9 In looking at the phases of Irish economic development, one cannot help gaining the impression that perceptions of the nature of the Irish economy have tended to swing between two deterministic poles. At times, it has been regarded as doomed to inevitable decline as a peripheral region and at other times it has appeared to be viewed as a new frontier economy whose "take-off" is imminent. Acceptance of either view as a basis for policy would most likely lead to less than optimum outcomes. The first would lead to a too rigid risk-averting approach which would hamstring the economy, while the second, because it would promote a cavalier attitude to risk taking on the budgetary and external accounts, could be largely counter-productive. The challenge to policy makers is to find the right mix between these perspectives and to recognise, given the underlying dilemma of Irish economic development, that the requirements for sustained progress are onerous. Like Sisyphus of old, the dilemma of the Irish policymaker may well be to have to roll this particular stone continually to the top of the hill, only to continually repeat the process as the dilemma of Irish economic development repeatedly requires to be confronted.

Application of Framework

2 10 It would go far beyond the scope of a paper such as this to attempt to apply the above framework in a comprehensive and systematic way to developments in Ireland over the last 25 years. Instead, we will look separately at various aspects of Irish budgetary and economic developments in a largely descriptive way and then towards the end of the paper offer some reflections, and raise some questions, by reference to that framework. In particular, we will consider the extent to which policies/developments suggest continuity or change as between the 1960/73 period and the 1974/84 period.

3 PUBLIC FINANCES IN 1960 AND 1984

The development of the public finances over a long period will reflect the objectives and results of the incremental policy choices made over that period and should say a lot about how policy makers faced up to the choices which arose in confronting the dilemma of Irish economic development. We first look at snapshots of the position of the public finances in 1960 and 1984.

Key Budgetary Aggregates

3 1 The detailed figures for the key budgetary aggregates are set out in Table 1. The main features of, and some comments on, those figures are

- (a) expenditure by public authorities increased from 30% of GNP in 1960 to almost 64% in 1984 against a background of a volume increase in GNP of some 117%,
- (b) the overall revenue of public authorities increased from 26% of GNP in 1960 to 52% in 1984 while taxation increased from 22% to just over 43%. The structure of revenue as between taxation and other receipts remained broadly unchanged,
- (c) the cumulative percentage increases in real expenditure outlays and real taxation receipts over the period as a whole were 358% and 339% respectively. The corresponding average annual growth rates were 6.54% and 6.36% respectively,
- (d) the public authority borrowing requirement increased from 3.8% of GNP in 1960 to 11.8% in 1984. This increase was, however, wholly due to interest on public debt: the non-interest public authority borrowing requirement was similar in both years at about 1% of GNP. The average annual non-interest public authority borrowing requirement for the period 1960/84 as a whole however was 2.7% of GNP, reflecting the higher levels of underlying deficit in the intervening years. It is worth noting that the more commonly used concept, the Exchequer borrowing requirement, indicates a lesser shift over the period – from 6.1% to 12.6% of GNP – while the Non-Interest Exchequer Borrowing Requirement (NIEBR) actually fell from 3.7% of GNP in 1960 to 1.8% in 1984. The differences in trend as between the two borrowing concepts probably relate more to changes in those concepts (particularly the EBR) rather than any real fundamental differences,
- (e) the debt/GNP ratio increased from 60.3% in 1960 to 121.8% in 1984. The ratio of external debt to GNP increased from some 6% in 1960 to almost 55% by end-1984. Interest payments quadrupled as a proportion of GNP.

3.2 The striking features of the changes in the public finances over this period are thus the enormous increases in expenditure and revenue, the explosion in debt, particularly external debt, and debt service costs, and the fact that at the end of the period borrowing for non-interest purposes was at or below that shown at the outset.

Trends in Expenditure 1960 to 1984

3.3 Details of the changes in individual components of expenditure are contained in Table 2. The main points of note are

- (1) all categories of expenditure increased as a proportion of GNP. As the volume of GNP grew by 117% over this period, this increase

reflected substantial increases in the real level of outlays for all categories,

- (2) the largest relative increases as a proportion of GNP were in respect of unemployment payments and interest payments. Expenditure on transfers (excluding unemployment) and goods and services expenditure also increased substantially. The lowest relative increases were recorded by capital expenditure and subsidies,
- (3) of the total increase in expenditure as a percentage of GNP in this period, almost 33% was due to unemployment and interest payments, 28% to transfer payments, 31% to goods and services expenditure and the balance of 9% due to subsidies and capital expenditure.

3.4 Changes in the structure of expenditure as between 1960 and 1984 can be seen from Table 3. Following the pattern outlined in the preceding paragraph this suggests

- (1) a possible "squeezing out" in some sense of goods and services, capital formation and subsidies by expenditure on unemployment, transfers and interest payments, and,
- (2) leaving aside the "semi-autonomous" unemployment and interest expenditure items, the displacement of subsidies and capital expenditure by transfers, goods and services expenditure holding its own.

Whether, and the extent to which, this displacement of one area by another actually took place is difficult to judge. The growth in total expenditure was undoubtedly heavily influenced by unemployment and interest payments. In the absence of such pressures, the level of total expenditure would probably have been lower but probably by not as much as the amount of the increase in the unemployment and interest provisions.

Trends in Taxation 1960 to 1984

3.5 Details of the change in individual categories of taxation are set out in Table 4. The main features are

- (1) all tax categories with the notable exceptions of rates and taxes on capital increased as a proportion of GNP. (The overall level of total taxation doubled as a proportion of GNP). These increases imply substantially increased tax rates,
- (2) the largest relative increase was in social insurance contributions followed by taxes on income other than social insurance contributions. The contribution of rates and taxes on capital both fell significantly,

- (3) of the total increase in taxation as a proportion of GNP, 74% is accounted for by the increased yield from total taxes on income, 37% by taxes on expenditure (including EEC taxes but excluding rates) and -11% and -1% respectively by rates and taxes on capital

3.6 Changes in the structure of taxation as between 1960 and 1984 can be seen from Table 5. This shows

- (1) a substantial increase from 28% to 51.5% in the proportion of taxation accounted for by the total taxes on income category, and,
- (2) a substantial fall in the total taxes on expenditure category accounted for by falls in the shares taken by both rates and other taxes on expenditure

Over the period as a whole, therefore, a very substantial change took place in the structure of taxation towards taxes on income and away from taxes on expenditure (including rates). This change took place, however, in the context of a substantial increase in the overall burden of taxation.

4 VARIATIONS IN DEVELOPMENT OF PUBLIC FINANCES AS BETWEEN 1960-1973 AND 1974-1984

4.1 The analysis of development in the public finances as between 1960 and 1984 showed very significant trends and changes in structure. In this part of the Paper we examine if there are any significant differences in pattern as between the 1960 to 1973 and the 1974 to 1984 periods.

Key Budgetary Aggregates

4.2 As regards the key budgetary aggregates (see Table 6) the main conclusions are

- (a) while expenditure increased substantially faster relative to GNP in the second period, this was largely due to the slower pace of GNP growth rather than to a stronger trend increase in real expenditure. Expenditure did, it is true, increase slightly faster in the post-1973 period but this related to interest and unemployment costs, leaving aside these "semi-autonomous" expenditure elements, the real increase in outlays was slightly lower in the second period,
- (b) similarly taxation increased substantially faster in relation to GNP in the second period. Although the trend of real taxation receipts moderated somewhat as compared with the 1960/73 period the overall tax rate, given lower GNP growth, increased considerably,
- (c) the bulk of the deterioration in the underlying budgetary imbalances occurred in the post-1973 period. The average non-interest public

authority borrowing requirement was 4.9% of GNP in the 1974/84 period compared with a modest 1% of GNP in the first period,

- (d) whereas the scale of public indebtedness, as measured by the debt/GNP ratio, had actually declined in the earlier period, reflecting relatively strong growth in GNP and a real interest rate of virtually zero, it more than doubled over the following ten years through a combination of slower growth, positive real interest rates and, of course, the higher level of basic deficits

Trends in Expenditure

- 4.3 Details of the trends in expenditure over the two periods and the 1960/84 period as a whole are set out in Tables 7 and 8. In the 1960/73 period developments were reasonably well balanced with no great change in the composition of expenditure. The shares accounted for by interest and unemployment payments were virtually unchanged. The major change in share was in respect of transfers (excluding unemployment) which was counter-balanced by minor falls in the shares accounted for by subsidies, goods and services and capital outlays.
- 4.4 The explosion in the share of outlays taken up by unemployment payments and interest payments took place in the 1973/84 period. Excluding these payments, the share of transfers continued to increase significantly in the second period with corresponding falls in the shares held by subsidies and capital expenditure.
- 4.5 Looking at the period as a whole, the major increase in the share taken by unemployment and interest payments is accounted for by developments in the second period. Leaving aside these payments, outlays on transfers showed equally significant growth in share in both periods.

Trends in Taxation

- 4.6 It is clear from Table 9 that the trend in the structure of taxation towards taxes on income, and away from rates and taxes on expenditure generally (apart from the reduced share of capital taxes in the 1974/84 period), was fairly well established in the 1960 to 1973 period. This trend was sustained in the 1974 to 1984 period, but its nature was different. The decline in relative importance of the latter emanated principally from the reduction in property taxes while income taxes perhaps because of the effects of inflation, increased relatively faster than in the early period.

Analysis of Stability in Tax Expenditure and Tax Policies

- 4 7 An indication of the stability or otherwise of expenditure and taxation policies can be obtained by looking at the coefficients of variation for various headings over different periods. The data are set out in Table 10. Of particular note are the following points
- (i) the close similarity between the stability of total expenditure 'real' growth and real GNP growth over the period as a whole,
 - (ii) the high level of instability in the 1974/84 period compared with the earlier period,
 - (iii) the high variability of capital expenditure,
 - (iv) the higher stability of 'real' tax receipts than 'real' expenditure outlays, implying greater continuity in tax policies than in expenditure policies

While the direction of causation is not one-way, there is a suggestion that instability in GNP growth in the second period was a factor in introducing instability in budgetary management. It probably comes as no surprise that capital expenditure, given its role in counter-cyclical policies, its inherent lumpiness and the degree to which it is 'induced' by private sector activity, was both more variable and increased in variability between the two periods.

5 DEVELOPMENTS IN THE IRISH PUBLIC FINANCES 1960 TO 1984 IN A EUROPEAN AND OECD CONTEXT

- 5 1 While the foregoing developments in the Irish public finances seen in isolation would seem extraordinary, to say the least, it is only by putting these developments in the context of the trends in other economies that any judgement about the Irish position can be made. In this part of the paper, we, therefore, compare developments in the public finances in Ireland in the period 1960 to 1984 with developments in Europe and the OECD.

Expenditure

- 5 2 Comparative figures on the evolution of total outlays of Government as a percentage of GDP in 1960 and 1984 are set out in Table 11. It could be argued that the absolute growth of expenditure rather than the increase relative to GDP is the more appropriate basis of comparison, but over long periods one could expect that the pace of economic growth would be a major influence on the aspirations of the community for public services, income maintenance, etc. and the ability of the Government to meet them. The main points of note are

- (i) in 1960 outlays in Ireland were significantly below the relative level in the UK and the EEC countries. They were, however, in line with the average for all OECD countries and were above those for smaller European countries,
- (ii) the level of outlays (as a proportion of GDP) increases substantially in all groupings over the period concerned,
- (iii) the rate of increase in outlays relative to GDP over the period in Ireland was substantially faster than for the other countries and groupings shown, so that by the end of the period the level of outlays in Ireland (56% GDP) was significantly above the UK (48%), EEC countries (51.3%) and the OECD as a whole (44.9%)
- (iv) outlays as a proportion of GDP in Ireland doubled, increasing by 28 percentage points. This compared with 17 percentage points of GDP for the OECD – Total grouping. Indeed, in Ireland's case, GNP is a more appropriate denominator than GDP in this connection and, on this basis, the increase in the share of national resources allocated through the Government sector was even more pronounced, rising by 35 percentage points

5.3 Differentiating between the sub-periods 1960 to 1973 and 1974 to 1984 shows some interesting patterns

Country/Grouping	Growth in outlays as % of GDP		
	1960 to 1973	1973 to 1984	1960 to 1984
Ireland	+11.0	+17.0	+28.0
UK	+8.3	+7.3	+15.6
Smaller European Countries	+10.0	+13.3	+23.3
EEC	+6.7	+12.4	+19.1
OECD Total	+5.0	+11.7	+16.7

Perhaps the most striking feature is that in the more recent period Ireland conformed fairly closely with the general European pattern, even though this entailed a very marked divergence from the trend in the UK. Could this be indicative of the waning influence of conditions in our nearest neighbours? The table also shows that, in terms of our divergence from the EEC and OECD 'norms' there was no marked shift

between the two sub-periods. Clearly, Irish public expenditure has had a particularly marked propensity to outpace economic growth. While the example of other countries may have had a bearing on the trend here, it does not, in any meaningful way, explain why expenditure should have grown as rapidly as it did.

Taxation

5.4 Data on comparative taxation developments are set out in Table 12. The main features are

- (i) in 1960 the tax level as a proportion of GDP in Ireland was substantially below the UK level and the average for OECD countries,
- (ii) the tax level as a proportion of GDP increased substantially for the countries/groupings shown over the period 1960 to 1984,
- (iii) again, however, the scale of increase in Ireland was substantially higher bringing the level of taxation in Ireland by 1984 above the UK level and the OECD grouping shown. Nevertheless, the level of taxation in Ireland as a proportion of GDP remained below the general level of the EEC countries in 1984.

Looked at in terms of GNP, the scale of increase of the taxation level in Ireland at 22.6% (as against 17.5% as a proportion of GDP) is an extremely high figure.

5.5 Analysis of the periods 1960 to 1973 and 1973 to 1984 shows the following pattern

Country/Grouping	Growth in Taxation as % of GDP		
	1960 to 1973	1973 to 1984	1960 to 1984
Ireland	+ 8.9	+ 8.6	+17.5
UK*	+ 4.9	+ 5.1	+10.0
OECD**	+ 6.5	+ 5.2	+11.7
OECD Europe	n a	+ 6.6	n a
EEC	n a	+ 8.1	n a

* Average of 1972 to 1974 figures used for UK

** Excluding France, Greece and Luxembourg - unweighted average

As with the expenditure pattern, the figures suggest that the divergence of Ireland from the tax growth pattern in the broader OECD grouping was broadly similar in both periods

Tax Structure

5 6 The data available from OECD revenue statistics allow some comparison to be made of developments in tax structure in Ireland vis-à-vis the UK and OECD countries. The details are set out in Tables 13 and 14. The main points of note are

- (i) in 1960, in Ireland, taxes on income, profits and payroll, and social security were substantially below the other groupings, while taxes on property and goods and services etc. were substantially higher (although there was broad similarity on property taxes with the UK),
- (ii) over the period 1960 to 1984, the shares accounted for by taxes on income, profits and payroll, and social security increased for the groupings shown while the shares taken by property and goods and services taxes fell,
- (iii) by 1984 Irish taxes had begun to conform more closely to the OECD norm, insofar as the broad balance between income (profits, payroll and social security) and commodities (goods, services and property) was concerned. Nevertheless, major divergences in taxes on goods, services etc. and social security still remained, with social security particularly low and goods and services taxes exceptionally high by EEC standards. As regards the UK, this pattern was largely repeated but with the major exception of taxes on property. There the Irish and UK experience totally diverged, the share of property taxes in the UK remaining exceptionally high in a European context.

Budgetary Deficits/Debt Levels

5 7 Data for the net lending/net borrowing of general government, and for general Government debt for various periods, are set out in Tables 15, 16 and 17

5 8 The key points to emerge from these tables are

- (i) the level of debt in Ireland in 1970 was already very high,
- (ii) the average level of budget deficit (as measured by net lending) in Ireland in the 1961/70 period was the highest for the countries shown and substantially above the average,
- (iii) the average level of budget deficit in the group of countries increased significantly (by the equivalent of 4 percentage points of GDP) in the period 1974/84 (as compared with the 1961/70)

(iv) the greatest increase in budgetary imbalances in the second period occurred for those countries which were in greatest imbalance in the first period. Generally speaking also (though with some notable exceptions), the greatest increase in levels of debt took place in those countries which were most heavily indebted at the outset.

5.9 As regards drawing general conclusions on the development of the public finances and the light that those developments may throw on our general theme, we will leave these until the final section of the Paper.

6 SAVINGS, INVESTMENT AND EXTERNAL BALANCE

6.1 We now turn to look at trends in savings and investment in Ireland and at the level and composition of the balance of payments deficit on current account.

Trends in Investment and Savings

6.2 The broad investment and savings picture for Ireland can be summarised as follows.

	Investment	Financing of Investment	
		Foreign	Domestic*
	% GNP	% GNP	% GNP
Annual Average			
1963-1973	23.2	2.7	20.5
1974-1984	28.4	8.3	20.1
Change	+ 5.2	+ 5.6	- 0.4

* Including net capital transfers from abroad

The investment ratio jumped sharply in the 1974 to 1984 period while domestic savings remained broadly static. The balance of payments deficit trebled, thus financing virtually all the increase in investment.

6.3 Figures for the shares of balance of payments financing and of domestic savings as between the Exchequer and the rest of the economy are summarised below.

	Balance of Payments Financing			Domestic Savings*		
	Exchequer % GNP	Other % GNP	Total % GNP	Exchequer % GNP	Other % GNP	Total % GNP
Annual						
Average						
1963 to 1973	0.7	2.0	2.7	0.7	19.8	20.5
1974 to 1984	6.0	2.3	8.3	-6.2	26.3	20.1
Change	+5.3	+0.3	+5.6	-6.9	+6.5	-0.4

* including net capital transfers from abroad

One interpretation of these figures is that virtually all the increase in investment was, in effect, financed by the Exchequer through its increased recourse to foreign financing in the 1974/84 period. Private sector savings increased to match the increase in public sector dissavings.

Non-Trading and Investment BOP

6.4 The foregoing analysis of the 1963/73 and 1974/84 periods suggests a stark contrast. However, looked at from a different perspective, the picture which emerges suggests, at least, greater continuity. The following table divides the cumulative balance of payments on current account into its net investment income and other components.

Cumulative (as % GNP)	Current Account	Trading and Investment Income	Non-Factor Balance	Memo International Transfers
1963 to 1973	-29.8	+19.8	-49.1	24.3
1974 to 1984	-92.0	-47.6	-45.8	59.0

The level of trading and investment income basically reflects the interaction of the economy's net external asset position and rates of interest/return. The table shows that a significant surplus on trading and investment was available in the first period partly to finance a considerable underlying BOP deficit. However, this surplus was being gradually eroded so that it had evaporated by 1974/75. This presumably

indicated that the Irish economy had progressively run down its external assets in the previous eleven years and was about to become a debtor nation. There is some difficulty in interpreting the figures in the second period, notably in its latter stages, because remittances of profits by multi-national enterprises may not reflect solely returns on investment. They, nevertheless, seem to indicate that broadly speaking, and notwithstanding the two oil price shocks, the BOP deficit on non-trading and investment account may not have been appreciably worse than in the earlier period. What had changed, however, was that the surplus on trading and investment account which had existed in the first period had been converted into a considerable deficit. However, the substantial increase in the level of international transfers makes it difficult to directly compare the two periods.

- 6 5 This analysis suggests that the period as a whole shows considerable continuity in that foreign assets were initially run down and later foreign liabilities accumulated to finance growing levels of investment. It also raises questions about the wisdom both of such high investment levels and of relying so heavily on foreign financing.

International Perspective

- 6 6 A broader perspective can be put on Ireland's performance by comparing it with that of smaller European countries and the UK.

	Average Annual Gross Fixed Capital Formation	Average Annual Gross Saving	Cumulative Current Account Deficit	Cumulative GDP Growth
	% GDP	% GDP	% GDP	%
(i) Smaller European Countries				
1966 to 1973	24.1	25.6	0.4	47.3
1974 to 1984	22.1	21.8	12.2	25.6
1966 to 1984	22.9	23.4	12.6	85.0
(ii) United Kingdom				
1966 to 1973	19.1	20.1	-	27.7
1974 to 1984	18.2	17.9	2.7	13.1
1966 to 1984	18.6	18.8	2.7	44.4
(iii) Ireland				
1966 to 1973	22.4	21.0	19.8	45.0
1974 to 1984	25.8	18.7	92.5	45.0
1966 to 1984	24.4	19.7	112.3	110.2

- 6 7 Investment in Ireland in the first period was lower by 1½% of GDP per annum than in the Smaller European Countries (SEC) but savings were lower by some 4½% GDP, so that, while the SEC were in broad balance

on external account, Ireland ran up a considerable cumulative balance of payments deficit. Cumulative GDP growth, however, was broadly similar over the 1966/73 period.

- 6.8 In the 1974/84 period, however, performance diverged sharply. Savings fell in both Ireland and the SEC, but investment increased in Ireland whereas it fell in the SEC grouping. Thus, while a small cumulative BOP deficit emerged in the latter, a massive cumulative deficit of over 90% of GDP was run up for the Irish economy. Although GDP growth in Ireland at 45% over the period was almost twice the SEC level, this growth was achieved at the cost of building up considerable external debt.
- 6.9 As compared with the UK, Ireland had a significantly higher level of investment in both periods and the divergence widened in the second period to 7.6 percentage points of GDP. Savings in Ireland were marginally higher than in the UK over both periods. The growth performance of the Irish economy in terms of GDP ran substantially ahead of the UK in both periods.
- 6.10 Given the low level of BOP deficit for the SEC grouping as a whole it seems reasonable to postulate, without recourse to figures, that there was no great divergence in its case as between GDP and GNP growth. In Ireland's case the divergence has been considerable.

Increments to GDP, Factor Incomes and GNP (1980 Constant Prices)

	A	B	C
	GDP £m	Net Factor Income £m	GNP £m
1965	4866.7	123.2	4990
1984	10026.0	- 1091.0	8935
Increment	+ 5159.3	- 1214.2 (23½% of A)	+ 3945
Increment (%)	+106%		+ 79.1%

These results suggest that GNP growth over the period was probably not greatly different as between Ireland and the SEC grouping.

- 6.11 While a great many factors bear on the relationship between investment and growth, there seems to be a tentative conclusion that the high levels of investment, financed through running high and persistent

balance of payments deficits, which then drew on the trading and investment account, did less than expected to enhance the economy's welfare on a lasting basis. It is ironic, in a sense, looking back at the concerns expressed by Dr Whitaker in his 1956 paper about the relatively low level of investment in the early 1950's and the limitations this imposed on growth, that the problem which emerged in the 1970's was perhaps one of excessive (or poorly-directed) investment. If we had been more mindful of the key distinction he made between domestic and national investment, then some of the implications of policy stance of the 1970's might have become clearer at an earlier point in time, and the problems we have had since might have been less acute.

Composition of Investment and Savings

6 12 While the level of investment was substantially higher in the 1974/84 period than in the 1963/73 period, what is critical from a growth perspective is the composition of that investment. An indication of how the composition of investment changed as between the two periods can be obtained by distinguishing from total gross physical capital formation, investment in dwellings, capital spending by public authorities and the element needed to cover depreciation. For public authorities we have taken their total capital spending (excluding the Post Office and dwellings) as a measure of their financing of total investment. There is, of course, some overlap between the depreciation and the dwellings and public authority capital spending categories but its degree would seem unlikely to overturn the broad conclusions reached. Lumping public authority capital expenditure with dwellings is justified on the basis that it largely relates either to the non-market sector of the economy and/or to social investment. The figures are

	(i) Gross Physical Capital Formation	(ii) Deprec- iation	(iii) Dwellings	(iv) Public Authority Capital Expenditure	Balance (i) less (ii) - (iv)
Cumulative	% GNP	% GNP	% GNP	% GNP	% GNP
1963/1973	235.1	86.7	44.9	63.3	40.2
1974/1984	297.1	108.4	66.0	79.8	42.9
Change	+ 65.0	+ 21.7	+ 21.1	+ 16.5	+ 2.7

6 13 While any conclusions drawn from the above figures must be highly qualified, they nevertheless suggest that the increment to capital formation in the 1974/84 period, apart from replacement investment,

was dominated by sheltered sector activity whose contribution to sustainable growth would probably be, at best, long-term in nature. The figures also imply that it was this increment which was financed via the increase in the external deficit and foreign borrowing by the Exchequer referred to earlier.

- 6.14 A somewhat similar perspective is of course provided by looking at the level of net national savings less dwellings, which fell considerably as between the two periods.

	Net National Savings	Dwellings	Net National Savings less Dwellings
Cumulative (as % GNP)			
1963/1973	141.8	44.9	96.9
1974/1984	106.9	66.0	40.9
Change	- 34.9	+ 21.1	- 56.0

While gross physical capital formation increased by the equivalent of 62% of GNP (of by just over one quarter) in the 1974/84 period as compared with the 1963/1973 period, net national savings less dwellings fell by 56% of GNP (or by over one half) over the same period. Thus the basis for sustained growth in GNP on foot of a high level of investment was significantly undermined in the second period, leading to the inevitable divergence as between GDP and GNP growth which could come under extreme pressure if real international interest rates should increase.

7 THE BUDGET AND THE ECONOMY IN THE LONG-RUN

- 7.1 Until quite recently, mainstream economics has focused on fiscal policy mainly from the perspective of short-term economic management. The emphasis has, therefore, been on its immediate impact on growth rather than its bearing on the development process. The former dimension can be found to dominate, even to the point of exclusiveness, policy statements not only in Ireland but worldwide, until the past few years. Indeed it is possibly only because of the conspicuous deterioration in global economic and employment performance – which perhaps began in the mid-1970's but was recognised as such only in the early 1980's – that the structural aspects of budgetary policy began to be more closely examined. Empirical work

in this long neglected area is still relatively undeveloped but tentative conclusions are beginning to emerge which would appear to have a particular relevance to an assessment of the link between economic performance and budgetary trends in Ireland over the long period. We will take up only two aspects: the growth in public debt, due to recurring fiscal deficits, and the issue of how the increase in the size of the government sector per se might, in a complete economy model with certain behavioural features, have had a negative impact on growth in output and employment over the long-run.

- 7.2 As we have seen in part 5, the increased fiscal deficits, and the consequent explosion in public debt, were by no means unique to Ireland, being a general phenomenon among OECD countries and indeed also a feature of developing and socialist countries. We can, therefore, put developments here in a global context.
- 7.3 The factors which brought this growth in debt are complex. In 1984 the then Managing Director of the IMF summarised some of the key factors as follows:

“For a variety of reasons, the traditional stigma attaching to fiscal deficits and growing public debt gave way to a certain nonchalance on the part of policy makers. Fiscal deficits no longer required justification even when they occurred during non-recessionary periods. Some economists even came to see them as virtuous”

“The prevailing mood of the time created high expectations of the role that Government should play with respect to income maintenance, job creation and income distribution. The frontier of what was considered as justified public sector intervention was progressively pushed forward. However, while the electorate pushed for higher spending, it was far less supportive of the tax increases that would have been needed to finance that spending”

“Traditional principles, that had held that no deficit was justified if associated with unproductive investments, current expenditure was insidiously abandoned in favour of fiscal activism that made full employment and the expansion of welfare programmes predominant objectives of economic policy. Fiscal deficits became a means or a consequence of achieving those objectives. Such fiscal activism went beyond the acceptance of cyclical deficits. Rather, it came to justify deficits even in periods of normal economic activity”

- 7.4 He also highlighted the point that until the 1980's

“ discussions about the role of fiscal policy in the economic performance of countries had focused on fiscal deficits rather than the accumulation of liabilities on the part of the Government. Deficits were judged on the basis of their alleged impact on current economic activity, on the rate of inflation and on the balance of payments. The implicit assumption was that this impact was temporary, so that this year's deficit affected the current performance of the economy but had no implication for its future performance. The cumulative effect of a chain of fiscal deficits was too often ignored”

- 7 5 The foregoing comments made from a world perspective would seem to describe particularly well developments in Ireland. In many respects they mirror the comments specific to Ireland made by Dr. Whitaker in his analysis entitled “Financial Turning Points” and by Bradley et al in the ESRI publication “Medium-Term Analysis of Fiscal Policy in Ireland: A Macro-economic Study of the period 1967-1980”. Some of the main conclusions of the ESRI study relevant to this paper are

“ the overall impression is of a fiscal policy which has succeeded in attaining short-run benefits to either demand, the balance of payments or inflation with no beneficial long-term consequences”

“ our estimates of the cumulative affects of fiscal policy suggest that by 1980 its effects on GDP and living standards were small. Ironically it appears to us that the long-term effect of aggregate fiscal policy for 1967 to 1980 has simply been to provide a constraint in the form of huge debt which must be repaid in future periods rather than create an environment for growth”

- 7 6 The balance between expenditure and revenue is not, however, the only way in which the evolution of the budget can impact on economic performance over the long-run (even if we leave aside the micro-economic/resource-allocation aspect). There is a growing body of opinion internationally that even if the budget is balanced, the level at which this balance is struck is of relevance to growth and employment. There seems to be emerging a broad agreement about the negative impact of high tax levels on labour supply and capital formation, although the research results to back this up are as yet limited and qualified. While the immediate focus is on the rate of tax, we must bear in mind that, in this framework, taxes and expenditure are by definition equal and so a negative judgement on the effects of an increase in taxes implies the same judgement on increases in expenditure generally, since taxes must eventually rise in tandem with public expenditure

7 7 Recent work on structural models of labour markets and on the supply-side of the economy forms the empirical basis for the belief that growth in public expenditure, financed by higher taxation (immediately or after an interlude of borrowing), is inimical per se to employment, most acutely in open economies. Studies by Hughes (1985), Geary and Murphy (1985) and Bradley and Prendergast (1986) add Irish evidence to that from abroad in relation to the tax 'wedge', between labour costs to the employer and the consumption wage, exerting a negative influence on employment. The conclusion drawn in Bradley's contribution to the Louvain Symposium on 'Unemployment in Europe' is particularly significant:

"The supply side of small open economies, such as Ireland, which are closely integrated into the wider OECD economy and the movement of investment, and the choice of location where output prospers, is a further important channel for transmitting international shocks. A consequence of these findings is that the role of the domestic wage equation in determining Irish international competitiveness is of much greater importance than <closed economy> type labour demand studies would seem to imply. For example, the use of gross own-price elasticities in the range -0.2 to -0.5, typical of <stand-alone> labour demand studies, would seem to be low by a factor of up to four for any realistic policy analysis."

Taking these results together, the weight of evidence seems to be tipping steadily against the Keynesian view of balancing the budget at a higher level (or of deficit budgeting) for employment purposes in an Irish context. As Bradley notes in the same paper, the implication is that "an increase in public spending financed by raising taxes will have a low 'balanced budget' multiplier, which could even be negative". This is a far cry from the perceptions which underlay the formulation of Irish economic policy for much of the past 25 years.

7 8 We would, however, stop short of concurring with Bradley's comment on the basis of fiscal policy over the period 1967-1980:

"there appears to have been a fundamental misunderstanding of the structure of the Irish economy, most particularly the relationship between fiscal expansion, taxation and competitiveness", even if sharing his view that it resulted in a "a major shift of resources from the exposed industrial sector to the public sector."

We dissent not as to whether or not the mechanism of the economy was misunderstood, but rather insofar as the policy stances reflected the prevailing much more limited view of the impact of taxation on the real

economy The adverse effects of taxation on economic performance have until recently been considered as a side-issue by the academic world

- 7 9 In fairness to the policy-makers of the past, it must be said that they had to develop and implement policies within the confines of 'economic science' as it then existed We cannot judge them by the additional and major insights into the functioning of the economy which are now at our disposal Policy-advisers were at the mercy of the established economic theories and models then available Models or theories which were not proven in some sense, can hardly be counted for this purpose

8 OVERVIEW OF DEVELOPMENTS

- 8 1 Having surveyed various aspects of economic and budgetary developments over the last 25 years, or so, we now return to consider in a general way how well this country coped with the permanent dilemma it faces on the one hand achieving higher levels of relative investment than other countries so as to narrow the gap in per capita incomes, while at the same time generating the national savings to finance that investment

Convergence

- 8 2 When Dr Whitaker was writing his paper in 1956 he highlighted the fact that investment levels in Ireland were below the levels in other countries and substantially below the levels required to bridge the per capita income gap with those other countries or to cope with the prospective growth in population As we have seen, however, the relative level of investment in Ireland by the 1966/73 period was higher than in the UK and not far below the level for smaller European countries In the 1974/84 period, when the investment ratio fell in most countries, it increased in Ireland Figures for relative per capita incomes, as compared with the UK and the EC12 countries, would seem to bear out the expectation that this would lead to a convergence in per capita *output*

GDP per capita in purchasing power standards

	1960	1970	1975	1980	1985
Ireland (as % of average for EC12)	67.3	66.7	68.5	70.4	70.7
Ireland (as % of UK level)	53.5	63.0	66.1	71.3	69.3
Memo					
UK (as % of average for EC12)	125.8	105.9	103.5	98.7	102.0

- 8.3 However, looked at from an *income* perspective, we have to take into account the GDP/GNP divergence in Ireland, particularly in more recent years

Average Annual Growth Rates			
	1961–1973	1973–1980	1980–1985
Ireland			
GDP	4.5	4.0	1.8
GNP	4.3	3.3	-0.1

- 8.4 The period 1960 to the mid-1970's was characterised by an enormous rise in per capita output and incomes in Ireland and in the EC 12 as a whole, although Ireland's relative position did not change greatly. As the UK's relative position deteriorated sharply vis-à-vis the EC 12 average, the Irish position relative to the UK improved dramatically over that period. Developments since the mid-1970's are characterised by a sharp fall off in growth rates in all countries and the emergence of a significant divergence between GDP growth and GNP growth in Ireland. Allowing for the trend in GNP growth in Ireland, it seems that Ireland's underlying relative per capita income position did not improve much, if at all, from the mid-1970's to the mid-1980's and that a significant deterioration took place in the post-1980 period. There is also a striking contrast in the relative performance of the Irish and UK economies in the post-1980 period reversing the previous trend in Ireland's favour.

- 8 5 The impact of the trend in relative per capita income, vis-a-vis the UK in particular, seems to be reflected in the trends in migration and population viz

Population Total, Natural Increase and Net Migration, 1951-1986

Census Year	Population Total	Changes	Natural Increases	Net Migration
	(000)	(000)	(000)	(000)
1951	2,960	-	-	-
1961	2,818	- 142 3	266 5	- 408 8 (1951-61)
1971	2,978	+ 160 0	294 5	- 134 5 (1961-71)
1981	3,443	+ 465 0	361 0	+ 104 0 (1971-81)
1986	3,537	+ 94 0	169 0	- 75 0 (1981-86)

While there were many exceptional factors affecting the 1970's, it is likely that the increase in population was stimulated in part by growth in relative per capita income. Dr Whitaker had asked in 1956 "if we do not keep pace with other countries in material progress, who can confidently predict that emigration will not continue virtually unabated?" Few would have then predicted that running ahead in the rate of increase of relative per capita income would have led to substantial inward migration. Unfortunately, this was achieved on the basis of unsustainable budgetary, investment and balance of payments positions. In many respects the migration experience of the 1980's may have been an inevitable and direct consequence of the developments of the 1970's and, in particular, the deterioration in the budgetary and external balances. This outcome is all the more disappointing in that in the post-1973 period Ireland had the benefit of a substantial increase in international transfers via EEC membership, although the implications of the adjustment associated with that, and of the freeing of trade generally, should not be overlooked.

- 8 6 Looking back at the investment levels and associated policies of the post-1973 period, the roots of which may well have been laid in the 1960's, it is difficult to avoid the conclusion that the level of investment, per se, was accorded an undue weight in policy-making and there was less than adequate regard to its composition, its justification at a micro level, its financing or to the ability to properly manage the direct costs of

the projects involved. It appears that increasingly sight was lost of the particular investment requirements for long-term growth, namely the conditions needed to sustain adequate autonomous investment in the exposed sectors of the economy. In particular, the fundamental proposition that investment which would not remunerate itself over the longer term would diminish rather than improve the economy's capacity to deliver both income and jobs was too often overlooked.

Budgetary Developments

- 8.7 Looked at from a European/OECD perspective budgetary developments in Ireland over the last 25 years do not look particularly exceptional. While expenditure and taxation levels in Ireland, having started at lower levels, increased faster as a proportion of GDP than many other countries, the increase in virtually all countries was substantial. Ireland, however, started out with a significantly higher level of annual borrowing and public debt than other countries, and in line with many countries in a similar position, experienced the greatest deterioration over the period as a whole. Thus Ireland's position in terms of annual borrowing and level of total debt was extreme in a European context both at the beginning and end of the period. It is, however, Ireland's level of external debt, reflecting excessive levels of investment and low levels of savings, leading to the persistent high balance of payments deficits incurred over the last decade or so, which makes its current position particularly difficult.
- 8.8 Why did Irish budgetary performance deteriorate in the post-1973 period? It may be far too simplistic a view to attribute this simply to, say, the abandonment of the balanced current budget convention. A case could be made to the effect that the budgetary problems of the post-1973 period were predictable given the experience of the 1960's – the expectation of inevitable progress engendered, the perception (both by itself and the public at large) of the role of the State in promoting development, and the dynamics of population – and that the dramatic change in the objective environment which took place in the 1974/84 period merely compounded the latent problems here, as elsewhere.
- 8.9 It can be argued that Ireland was already running a somewhat lax fiscal policy in the 1960's through a period of exceptional upturn and favourable interest rates and that the State already possessed at that time a substantial level of debt. Public expenditure was increasing at a pace which, at least with hindsight, we can recognise as unsustainable. There were important developments in policies and in the external environment which enabled Ireland to fully participate in the strong growth taking place in the international economy. Yet, there may have been some confusion of cause and effect – was state expenditure pulling

the economy up or was it simply reflecting the distribution of the proceeds of growth? State capital expenditure had, perhaps because of its association with the improvement in economic performance, come to be less than rigorously appraised. We may have lost sight of the reality that capital spending, if it does not generate growth in the tax-base, has ultimately to be financed by higher tax-rates. Because of the fashion for "demand management", the connection between the justification for projects at a micro level and overall long-term macro-economic requirements was weakened. In particular, there seems to have been an undue focus on the costs/inputs (e.g. employment) to public capital projects rather than on the long-term output or opportunity cost.

- 8 10 A balanced budget implies a discipline. However, the discipline that requires to be exercised to maintain a balanced budget when unemployment is low, real interest rates are favourable, and very high and stable growth is taking place is of a qualitatively different nature than needed when those conditions are sharply reversed. To have maintained in the post-1973 era a balanced current budget, while representing a formal continuity in the fiscal rule, would in effect have required a dramatic reversal of previous tax and expenditure policies, given the deterioration in growth prospects, the increased instability and, later on, on the steep rise of real interest rates. Moreover, it would have represented a considerable departure from the European trend in the 1974/84 period. There is little in the experience of the pre-1973 period, or in the perception of the role of the State that seems to have developed, to suggest that such a departure was ever a likely possibility.
- 8 11 Both objective factors, and the perceptions which were already firmly established, heavily influenced budgetary trends in the post-1973 period. The weight of the objective factors should not be underestimated. One way of looking at this is to consider some of the key determinants of the debt/GNP ratio and the factors which influenced it over the 1960 to 1984 period. It should be pointed out that there is not an entirely satisfactory methodology for examining the interaction of debt, basic borrowing, interest rates and GNP growth. The data on the following table are, therefore, indicative of the orders of magnitude involved rather than definitive estimates.

Determinants of Growth in Debt

Determinant etc	Period		
	1961/73	1974/84	1961/84
(1) Average non-Interest Borrowing of Public Authorities (NIBPA) (% GNP)	1 7*	5 9*	3 7*
(2) Average Annual Real GNP Growth (%)	4 4	2 0	3 2
(3) Average Annual Nominal GNP Growth (%)	11 7	16 4	13 8
(4) Implicit Interest Rate** (%)	7 0	17 0	12 5
(5) Implicit* Real Interest Rate (%)	-	2 5	2 1
(6) Variation between Nominal GNP Growth Rate and Interest Rate [(3) - (4)]	4 7	- 0 6	1 3
(7) Debt at beginning of period (% GNP)	60 3	52 1	121 8
(8) Increase in Debt over period	- 8 2	+ 69 1	61 5
(9) Average Non-Interest Borrowing required to keep debt ratio at level at beginning of period (% GNP)	2 5	- 0 3	0 7

* Including Post Office receipts and expenditure and local authority loans and therefore not comparable with the non-Interest borrowing requirement of public authorities in Table I

** This is a derived figure. It is the interest rate which, given the growth and NIBPA figures leads to the debt outcome.

The considerable slowdown in growth and the substantial rise in interest rates, or rather the combination thereof, transformed the framework for budgetary policy in the 1974/84 period as compared with the 1961/73 period

- 8 12 Given the current focus on the debt/GNP ratio as an objective/constraint of budgetary policy, it is interesting to note how the stance of policy required for stability in the ratio varied, and how, with the benefit of hindsight, we deviated from the requirements. One notes immediately that non-interest borrowing in the 1961/73 period was 1 percentage point of GNP above the level that, for the parameters of the long period, would have been required to keep the debt/GNP ratio at its initial level. Allowing for differences in growth rates (and allowing also for the operation of automatic stabilisers) it would appear that the "target" level of non-interest borrowing for long-term debt stability should have been significantly lower in the first period than the "required" average (i.e. well below 0.7% of GNP). Thus in retrospect one could reach a tentative conclusion that budgetary policy in the 1961/73 period was too strongly pro-cyclical. The conclusion that the rate of basic borrowing in the second period was incompatible with debt stability is not affected.
- 8 13 It is worth mentioning, however, that the budgetary problem which now faces us is of a different nature to that of the 1970's and early 1980's. The current imbalance reflects essentially the interest associated with previous borrowings. The non-interest account is around the level where, with modest growth and "normal" real interest rates, there would be a good prospect of getting the debt/GNP ratio on a downward trend. However, with extremely high real interest rates, both at home and abroad, and low levels of growth, a significant surplus on non-interest account is required merely to stabilise the debt/GNP ratio. Incidentally, the present global configuration of the determinants of the debt/GNP ratio means that, in the absence of budgetary retrenchment, indebtedness will be on an explosive path in most economies.
- 8 14 Concluding on budgetary issues, we return to the theme of the dilemma of Irish economic development to find the political and psychological rationalisation of the experience of the post-1973 period. The system did not cope with the changes in the objective environment that took place. Departure from budgetary discipline could be supported on classic cyclical grounds and/or implicitly rationalised on the basis that high risks were justified given that Ireland was in effect a frontier economy on the verge of take off. While sight was not entirely lost of the dilemma of Irish economic development and of the onerous requirements that needed to be met if higher long-term growth was to be achieved - i.e. increased national savings and thus postponed consumption, the weight of this view among the public at large, the

political system, the public service and, indeed, the economics profession was considerably diminished. It was considerably easier in the short term to postpone the adjustment rather than confront the basic reality that the State could not, as it was mistakenly perceived to have done in the 1960's, simultaneously deliver growing levels of current consumption and high levels of national investment, and continue to do so in the context of a low growth scenario. Thus the system was pressurised to pursue both objectives at the same time by resorting to foreign savings, through incurring large balance of payments deficits. The consequences of such a policy had been well signalled by Dr Whitaker who, in his 1956 paper, had noted the dangers of maintaining an inflated standard of living by incurring balance of payments deficits. He commented that "the illusion is not that living standards can be raised more than productivity warrants but rather that this can go on for long". What is remarkable about the post-1973 period is how long in fact the process was sustained.

9 CONCLUSIONS

- 9 1 Any assessment of the evolution of the public finances, and of the balance struck between the economic objectives pursued through the budget, over a period of twenty five years must of necessity be partial and impressionistic. Perhaps the overriding impression is that we asked too much of the budget! The resolution of too many of our problems was in terms of financial injections of various kinds. Too little attention was paid to where that money must ultimately come from, and to how it might, from a long-term economic welfare perspective, be best spent and even more fundamentally, perhaps not enough thought was given to 'solutions' which did not involve the budget.
- 9 2 The keynote in regard to the 1960's is possibly that one can never look too far ahead in assessing the consequences of policy decisions. A secondary conclusion is that the way in which policies and affairs are progressing should be continually reviewed by reference to the initial intent. Directions which were taken at the beginning of the 1960's, and which were in themselves sound, broadened in scope over the decade and beyond, to become, in the less-favourable climate of the 1970's and 1980's, unsupportable and even detrimental, through their wider consequences, to economic and social progress. The primary lesson from the 1970's is probably that the pursuit of growth is a complex process and one about which we are continually learning. Governments should, therefore, be slow to accept exclusive responsibility for bringing it about, lest their well intentioned efforts are, in fact, counterproductive over the long-term. In common with a great many other countries, our response to the various "shocks" of the post-1973 period was

dominated by short-term considerations. The policy effort focused on offsetting their effects, rather than on the requirement, from a long-term perspective, to assist markets and economic agents in adapting to them. By deferring necessary adjustments, we made these more difficult and more costly.

- 9.3 A still more basic question that must be asked, especially in the light of the experience of the 1960's and 1970's, is whether the long-term consequences of accepting as natural and correct – because it mirrored what was happening abroad – the fiscal trends of that period were fully appreciated. Did we take adequate account of the differences between our situation and that of our neighbours? We were a country with a persistent labour surplus (whether reflected in unemployment or migration) and an income level well below that which we thought attainable. These problems would only be resolved by increased levels of investment, requiring inter alia, a super-competitive cost-structure. Were we justified in seeking to match the rates of growth of public expenditure of countries at much higher stages of development, given that growth in public expenditure in excess of national output involves some diversion of real resources away from private consumption and productive investment? Unless these public interventions were very selective, and particularly effective in terms of enhancing productive potential and the tax base, these costs to the Exchequer were likely to precipitate an increase in tax pressure, inflating the general cost level in the economy.
- 9.4 Looking to the future, Ireland undoubtedly has a high potential rate of growth, given the prospective natural increase in the labour force and the scope for bridging the technological gap with the rest of the Community. One of the lessons we should learn from the last 25 years is that the realisation of this potential will require both patience and care. We must realise that if we rush to consume what we have yet to produce, we may well undermine the very basis of increases in production in the future. Where resources are scarce, we must in our policies give the highest priority to ensuring that they are allocated in accordance with the precepts of efficiency.
- 9.5 The requirements for realising this potential are demanding and in the short term may seem to give results contrary to long-term objectives. Given the inevitable conflict of interest between various groups in society, and between the welfare of some and the greater good, the process will continually give rise to its own tensions and difficulties. The dilemma of Irish economic development will thus require to be continually confronted.

FOOTNOTE

- 1 The view would be widely held among economists that the earning of super-normal rates of return (in Dr Whitaker's terms "a liberal attitude towards profits") would be necessary to ensure that the higher levels of investment to bridge the gap in capital stock between Ireland and more advanced countries would be achieved in practice

Table 1 Adjusted* Public Authority Expenditure, Taxation, etc and Borrowing, 1960 and 1984

	1960 % GNP	1984 % GNP
1 Expenditure	30.1	63.7
2 Revenue	26.3	51.9
- Taxation	22.0	43.2
- Other Receipts	4.3	7.7
- Transfers from the rest of the World	-	1.0
3 Adjusted Public Authority Borrowing [(1) - (2)]	3.8	11.8
4 Interest	2.7	10.7
5 Non-Interest Borrowing [(3)-(4)]	1.1	1.1
6 Exchequer Borrowing Requirement	6.1	12.6
7 NIEBR	3.7	1.8
8 Debt/GNP Ratio (excl capitalised liabilities)	60.3	121.8
9 External Debt/GNP Ratio	6 (approx)	55 (approx)

* Excluding Post Office receipts and expenditure and Local Authority loans to persons. The inclusion of these items because of the setting up of An Post and Bord Telecom and the Housing Finance Agency in the 1980s would distort comparisons between 1960 and 1984. Redemption of securities and loan repayments also excluded.

Source: Department of Finance databank

Table 2 Trends in Expenditure as a percentage of GNP in the period 1960 to 1984

Expenditure Category	(1)	(2)	(3)	(4)	(5)
	1960 % GNP	Increase 1960/84 % GNP	1984 % GNP	Ratio of (3) to (1)	Contribution to total increase over period (%)
1 Subsidies	3.0	0.8	3.8	1.27	2.4
2 Interest	2.7	8.0	10.7	3.96	23.9
3 Unemployment	0.6	3.0	3.6	6.00	9.0
4 Transfers (excluding Unemployment)	5.6	9.2	14.8	2.64	27.5
5 Goods and Services (Gross)	12.7	10.4	23.1	1.82	31.0
6 Total Current	24.6	31.4	56.0	2.28	93.7
7 Capital	5.5	2.2	7.7	1.40	6.6
8 Total Expenditure	30.1	33.6	63.7	2.10	100.0

Source Department of Finance databank

Table 3 Shares of Expenditure

Expenditure Category	1960 %	(Excl 2 & 3)	1984 %	(Excl 2 & 3)
1 Subsidies	10.0	(11.2)	6.0	(7.7)
2 Interest	9.1		16.8	
3 Unemployment	2.0		5.6	
4 Transfers (excluding Unemployment)	18.6	(20.9)	23.2	(29.9)
5 Goods and Services (Gross)	42.2	(47.4)	36.3	(46.6)
6 Total Current	81.7	(78.5)	87.9	(84.4)
7 Capital	18.3	(20.5)	12.1	(15.6)
8 Total Expenditure	100.0	(100.0)	100.0	(100.0)

Source Department of Finance databank

Table 4 Trends in Taxation as a percentage of GNP in the period 1960 to 1984

Tax Category	(1)	(2)	(3)	(4)	(5)
	1960 % GNP	Increase 1960/84 % GNP	1984 % GNP	Ratio of (3) to (1)	Contribution to total increase over period (%)
1 Taxes on Income and Wealth (excluding 2)	5.1	11.6	16.7	3.27	51.10
2 Social Insurance Contributions	1.1	5.3	6.4	5.82	23.30
3 Total Taxes on Income and Wealth (1 + 2)	6.2	16.9	23.1	3.73	74.40
4 Rates	3.5	-2.4	1.1	0.31	-10.60
5 Taxes on Expenditure (excluding Rates and EEC Taxes)	12.0	6.8	18.8	1.56	30.00
6 EEC Taxes	-	1.7	1.7	-	7.50
7 Total Taxes on Expenditure (Including EEC Taxes) (4 + 5 + 6)	15.5	6.1	21.6	1.39	26.90
8 Taxes on Capital	0.5	-0.3	0.2	0.40	-1.31
9 Total Taxation	22.2	22.7	44.9	2.02	100.00
10 Total Taxation (excluding EEC Taxes)	22.2	21.0	43.2	1.95	

Source Department of Finance databank

Table 5 Structure of Taxation 1960 to 1984

Tax Category	1960 %	1984 %
1 Taxes on Income and Wealth (excluding 2)	22.9	37.2
2 Social Insurance Contributions	5.0	14.3
3 Total Taxes on Income and Wealth	27.9	51.5
4 Rates	15.7	2.4
5 Taxes on Expenditure (excluding 4 & 6)	54.1	41.9
6 EEC Taxes	-	3.8
7 Total Taxes on Expenditure (4 + 5 + 6)	69.8	48.1
8 Taxes on Capital	2.3	0.4
9 Total Taxation	100.0	100.0

Source Department of Finance databank

Table 6 Trends in Budgetary Aggregates

Item	1960 to 1973	1974 to 1984	1960 to 1984
1 Expenditure (% GNP)	30 10 (1960)	38 20 (1973)	63 70 (1984)
(a) Average Annual Increase as % of GNP	0 62	2 32	1 40
(b) Average Annual Real *Increase (%)	6 30	6 90	6 50
2 Non-Interest/Non-Unemployment Expenditure			
(a) Average Annual Increase as % of GNP	0 55	1 43	0 90
(b) Average Annual Real *Increase (%)	6 20	5 60	5 90
3 Taxation** (% GNP)	22 20 (1960)	29 70 (1973)	44 90 (1984)
(a) Average Annual Increase as % of GNP	0 58	1 38	0 95
(b) Average Annual Real *Increase (%)	6 70	5 90	6 40
	1960 (% GNP)	1973 (% GNP)	1984 (% GNP)
4 Public Authority Borrowing Requirement	3 8	4 6	11 8
5 Interest	2 7	3 5	10 7
6 Non-Interest Borrowing	1 1	1 1	1 1
7 Exchequer Borrowing Requirement	6 1	7 1	12 6
8 NIEBR	3 7	3 9	1 8
9 Debt/GNP Ratio	60 3	52 1	121 8
10 External Debt/GNP Ratio	5 0	5 5	55 0
11 Average Annual Growth in GNP	4 3 (1960/ 1973)	2 0 (1974/ 1984)	3 3 (1960/ 1984)

* Deflator used is the GNP Deflator

** Including EEC Taxes

Source Department of Finance databank

Table 7 Ratio of Expenditure as percentage of GNP at end of period to beginning of period

Expenditure Category	1973/1960	1984/1973	1984/1960
1 Subsidies	0 97	1 31	1 27
2 Interest	1 30	3 06	4 00
3 Unemployment	1 50	4 00	6 00
4 Transfers (excluding Unemployment)	1 54	1 72	2 64
5 Goods and Services	1 22	1 49	1 82
6 Total Current	1 28	1 78	2 28
7 Capital	1 22	1 15	1 40
8 Total Expenditure	1 26	1 67	2 12

Source Department of Finance databank

Table 8 Shares of Expenditure

Expenditure Category	1960 %	(Excl 2 & 3)	1973 %	(Excl 2 & 3)	1984 %	(Excl 2 & 3)
1 Subsidies	10 0	(11 2)	7 6	(8 6)	6 0	(7 7)
2 Interest	8 9		9 2		16 8	
3 Unemployment	2 0		2 4		5 6	
4 Transfers (excluding Unemployment)	18 6	(20 9)	22 5	(25 5)	23 2	(29 9)
5 Goods and Services	42 2	(47 4)	40 6	(46 0)	36 3	(46 8)
6 Total Current	81 7	(79 5)	82 5	(80 1)	87 9	(84 4)
7 Capital	18 3	(20 5)	17 5	(19 8)	12 1	(15 6)
8 Total Expenditure	100 0	100 0	100 0	100 0	100 0	100 0

Source Department of Finance databank

Table 9 Structure of Taxation 1960, 1973 and 1984

Tax Category	1960 %	1973 %	1984 %
1 Taxes on Income and Wealth (excluding 2)	22.9	30.3	37.2
2 Social Insurance Contributions	6.1	9.4	14.3
3 Total Taxes on Income and Wealth	27.9	39.7	51.5
4 Rates	15.7	9.1	2.4
5 Taxes on Expenditure (excluding 4 & 6)	54.1	48.5	41.9
6 EEC Taxes	-	0.7	3.8
7 Total Taxes on Expenditure (4 + 5 + 6)	69.8	58.3	48.1
8 Taxes on Capital	2.3	1.7	0.4
9 Total Taxation	100.0	100.0	100.0

Source Department of Finance databank

Table 10 Co-efficient of variation of real rates of growth

Expenditure Category	1973/1960	1984/1973	1984/1960
Current Expenditure	0.31	0.64	0.52
Capital Expenditure	1.52	4.10	2.73
Non-Interest and Non-Unemployment Expenditure	0.46	1.43	0.98
Total Expenditure	0.42	1.06	0.81
Taxation	0.28	0.73	0.50
GNP	0.46	1.39	0.80

Source Department of Finance databank

Table 11 Comparative Trends in the Level of Total Outlays of Government as a percentage of GDP

Country/Grouping	(1) 1960 % GDP	(2) Change 1960 to 1984 % GDP	(3) 1984 % GDP	(4) Ratio of (3) to (1)
Ireland	28.0	+ 28.0	56.0*	2.0
United Kingdom	32.4	+ 15.6	48.0	1.5
Total Smaller European Countries	26.1	+ 23.2	49.3**	1.9
EEC	32.2	+ 19.1	51.3	1.6
OECD - Europe	30.9	+ 19.7	50.6	1.6
OECD - Total	28.2	+ 16.7	44.9	1.6
Memorandum Item				
Ireland				
- Total as % of GNP	27.3	+ 35.1	62.4	2.3

* 1983

** Incomplete Data

Source OECD

Table 12 Comparative Trends in the Level of Total Taxation 1960 to 1984

Country/Grouping	(1) 1960 % GDP	(2) Change 1960 to 1984 % GDP	(3) 1984 % GDP	(4) Ratio of (3) to (1)
Ireland	21 94	+ 17 54	39 48	1 80
United Kingdom	28 50	+ 10 01	38 51	1 35
Unweighted Average				
EEC			41 93	
OECD Europe			38 95	
OECD Total			37 11	
OECD Countries *	24 87	+ 11 69	36 56	1 47
Memorandum Item				
Ireland				
Total Taxation as % of GNP	21 4	+ 22 6	44 0	2 06

* OECD Countries (Excluding France Luxembourg and Greece)

Source OECD

Table 13 Main Headings of tax revenue as percentage of total taxation

Country/Grouping	Income & Profits & Payroll	Social Security	Property	Goods & Services & Others
1960				
Ireland	21 27	4 87	19 09	54 76
United Kingdom	37 51	12 57	15 16	34 76
Unweighted Average for OECD Countries for which 1960 data available*	37 61	15 13	8 65	38 74
1984				
Ireland	36 54	14 55	3 78	45 12
United Kingdom	39 17	18 12	12 23	30 47
Unweighted Average				
EEC	35 25	28 79	4 43	31 53
OECD - Europe	37 38	26 68	4 00	31 94
OECD - Total	40 40	23 99	5 08	30 53
OECD Countries for which 1960 data available*	42 28	22 37	5 19	30 12

* I.e. OECD Countries excluding France, Greece and Luxembourg

Source: OECD

Table 13(A) Percentage Points Deviation by Ireland from OECD* Taxation Structure, 1960 and 1984

Tax Category	1960	(Ratio of Irish Share to OECD Share)	(Ratio of Irish Share to UK Share)	1984	(Ratio of Irish Share to OECD Share)	(Ratio of Irish Share to UK Share)
Income Profits and Payroll	- 16 34	(0 57)	(0 57)	- 5 94	(0 86)	(0 93)
Social Security	- 10 26	(0 32)	(0 39)	- 7 82	(0 65)	(0 80)
Property	+ 10 44	(2 21)	(1 26)	- 1 41	(0 72)	(0 31)
Goods and Services and Others	+ 16 02	(1 41)	(1 58)	+15 00	(1 50)	(1 48)

Source OECD

Table 14 Percentage Points Change in Shares of Taxation Accounted for by Main Headings between 1960 and 1984

Tax Category	Ireland	United Kingdom	OECD*
Income Profits and Payroll	+ 15 27	+ 1 66	+ 4 87
Social Security	+ 9 68	+ 5 55	+ 7 24
Property	- 15 31	- 2 93	- 3 46
Goods and Services and Others	- 9 64	- 4 29	- 8 62

* Excluding France Luxembourg and Greece

Source OECD

Table 15 Net lending or net borrowing of general Government (% of GDP)

Country	A	B	C
	1961-70	1974-84	Increase in Deficit
Belgium	- 1 5	- 7 8	- 6 3
Denmark	1 3	- 2 9	- 4 2
Germany	0 4	- 2 9	- 3 3
France	0 4	- 1 4	- 1 8
Ireland	- 3 6	-10 8	- 7 2
Italy	- 2 3	-10 2	- 7 9
Netherlands	- 0 8	- 3 9	- 3 1
United Kingdom	- 0 6	- 3 7	- 3 1
Europe 8	- 0 4	- 4 4	- 4 0

Source EEC

Table 16 General Government Gross Debt (% GDP)

Country	(A)	(B)	(C)	(D)
	1970	Change 1970 to 1984 (% GDP)	1984	Ratio of (C) to (A)
Belgium	73 3	+ 48 9	122 2	1 67
Denmark	11 3	+ 53 9	65 2	5 77
Germany	18 4	+ 23 6	42 0	2 28
France	29 4	+ 2 4	31 8	1 08
Ireland	65 6	+ 54 3	119 9	1 83
Italy	44 4	+ 47 0	91 4	2 06
Netherlands	51 4	+ 12 8	64 2	1 25
United Kingdom	85 8	- 32 0	53 8 *	0 63
Europe 8 (Unweighted Average)	47 5	+ 26 3	73 8	1 55

* 1983

Source OECD

Table 17 General Government Gross Debt (% GDP) Smaller European Countries*

Country	(A) 1970	(B) Change 1970 to 1984 (% GDP)	(C) 1984	(D) Ratio of (C) to (A)
Austria	19.4	+ 26.4	45.8	2.36
Belgium	73.3	+ 48.9	122.2	1.67
Denmark	11.3	+ 53.9	65.2	5.77
Finland	15.2	+ 4.1	19.3	1.27
Greece	21.3	+ 26.0	47.3	2.22
Ireland	65.5	+ 54.3	119.9	1.83
Netherlands	51.4	+ 12.8	64.2	1.25
Spain	14.4	+ 20.7	35.1	2.44
Sweden	30.7	+ 37.1	67.8	2.21
Switzerland	37.5	+ 0.8	38.3**	1.02
Unweighted Average	34.0	+ 28.5	62.4	1.84

* Excluding Norway

** 1983

Source OECD

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DISCUSSION

John Fitzgerald To begin I would like to say how happy I am to second the vote of thanks to the authors for the stimulating paper which they have presented tonight. Too often when discussing Ireland's current economic problems observers find it difficult to stand back and look at them in a wider context of both time and space. The authors are to be congratulated for attempting such a task and in replying to the paper one is immediately forced to look anew at issues which too often are forgotten when considering day to day developments.

I find myself in agreement with many of the conclusions of this paper. The authors are obviously correct in stressing the need to plan policy in a longer term horizon than that of the annual budget. Their conclusion that too much has been asked of fiscal policy in the past is one with which most economists today would agree. As the authors say in par 8.6 "the level of investment, per se, was accorded an undue weight in policy making and there was less than adequate regard to its composition". This failure was clearly of great importance in explaining the poor performance of the economy in the late 1970's and early 1980's.

Where I disagree with the authors is over the framework in which they choose to examine Ireland's economic development. By concentrating on the level of investment as the key determinant of growth they are in tune with the vision of those who formed the economic policies pursued in the 1960's. However, as the authors themselves admit, the key to our problems in the 1970's and 1980's lay not with too little investment but rather with too much investment which provided a poor rate of return to the nation in general and to the Exchequer in particular. In considering the recent economic history of Ireland, I believe that it is important to use a different framework which explains the growth of the economy in terms of a wider range of variables than investment alone. As many economists have pointed out, while subsidising capital will increase the level of investment this might result in the employment of less labour rather than increasing the overall level of output. While I believe that this was probably not the case for much of Irish industry in the period under examination (see Bradley and Fitzgerald, 1987), it is still true that the process of growth and development is not just a question of increasing the capital stock. This is particularly true of the Public Capital Programme. It has been popular in the past to regard borrowing to fund capital projects as in some way more justified than borrowing for current purposes. As the authors point out, the appropriate criterion is not whether the spending is for capital purposes but rather what rate of return it is likely to yield. In this regard the analysis presented in par 6.11b of the paper is interesting. This shows that the big growth in investment in the period after 1973 occurred in the sheltered sector of the economy.

When considering the development, especially the industrial development, of the Irish economy in the last 10 years the cause of the low growth must be sought not so much in a lack of investment but rather in the factors which made expansion of output and capacity unattractive. Any such assessment must involve an examination of the costs, broadly defined, which face industry in Ireland. The fact that, as the authors indicate in their paper, these costs are themselves influenced by budgetary problems means that no one simple explanation can be found for this poor performance. Lack of wage cost or energy cost competitiveness was itself partially a function of a wider malaise in the economy.

I would disagree with the authors when they say in paragraph 2.3 that, like other countries, budgetary policy has been pre-eminent in our arsenal of policy weapons. What has made us very different from other similar countries has been our very active use of industrial policy. In looking for an explanation of why the Irish economy has performed so poorly in the 1974–1984 period one of the first factors which should be considered is the success or otherwise of that industrial policy. As the authors highlight, the economy which we are examining is a very complex one. Where in the 1950's and 1960's the question of industrial policy seemed a very simple one we now know that this is not the case. The budgetary stance has affected domestic costs which affected domestic output. In subsidising new industry, existing industry was affected through the effects of the new entry on domestic costs. As Honohan, 1986, points out, the shadow price of labour for the new firms was far from being zero. Because of the kinds of firms targeted, the profits have, of necessity, been large and have been repatriated.

In looking to the future it is important that we recognise the complex interdependencies which exist in the economy. As the authors indicate, fiscal policy does not have a direct role in promoting long term growth. We learned the hard way in the 1970's that it was not sufficient to give a fiscal stimulus to bring about growth in capacity (see Bradley et al 1985). The long term burdens which this policy imposed on the economy, and imposes even today, must be recognised. These burdens have more than undone any temporary benefit from the demand stimulus of the 1970's. For the future it is clear that fiscal policy should be formulated with a longer time horizon and that in such a time horizon the appropriate policy stance will be seen to be very different from that of the 1970's.

While the authors discuss in section 7 of the paper the complexities of the mechanisms driving the economy, their analysis in places comes across as rather mechanistic in nature and does not take account of the dynamic effects of policy changes. For example, in section 3 of the paper the authors comment on the major contribution to the growth in public expenditure of unemployment transfers and interest payments. Clearly these increases were to a large extent the effects rather than the cause of the lack of economic growth. Again in section 6.4 the attribution of a major role in the deterioration

in the balance of payments position post-1973 to the factor outflows is true on an accounting basis. However, these outflows are part of a wider picture and reflect the low net contribution to growth from the industrial sector which, in turn, has wider causes.

In paragraph 8.7 the authors suggest that the high level of external debt makes the current position of the country particularly difficult. However, as the current balance of payment deficit is, by historic standards, very small, the net flows on capital account must also be small. This in turn means that, in contrast to the last ten years, the growth rate in the immediate future should not be greatly reduced by interest payments abroad. As I have suggested elsewhere (Fitzgerald, 1986), what we are now faced with is a domestic income distribution problem. We are borrowing large sums from ourselves and the taxes necessitated by the interest payments cause serious distortions in the domestic economy.

In paragraph 8.12 I think that the authors give an unfair press to the 1960's. As shown in the following table, the debt/GNP ratio fell in the 1960's and early 1970's. On the criteria of sustainability and the rate of growth over the period this result must be considered a success. To what extent this growth was sustainable or was a bounce back from the depressed years of the 1950's when growth was held back by trade restrictions, remains to be determined.

DEBT/GNP RATIO	
per cent	
1960	64
1965	66
1970	62
1973	54
1975	68
1980	81
1985	121

Finally, in judging the appropriateness of economic policies in the past we can adopt two different stances. The normal one for economists is to look at what might have been with the full benefit of hindsight both in terms of data on the past and knowledge of current economic theory. However, the stance of the historian is rather different and provides a cautionary tale for those advising on policy today. When policy was developed in the 1970's our knowledge of economic theory was more limited and our understanding of what was happening in the economy at the time was handicapped by the absence of full current data. For example, in early 1973 it was not clear that that year was going to be a boom year. While the budget of that year had more to do with

political necessities than economic advice, it should be recognised that the incorrect diagnosis of the state of the economic cycle was a potential contributory factor to the inappropriate nature of the policy actually adopted. On the other hand, the stimulatory effects of economic policy in the later 1970's had less to do with economic ignorance. However, this policy would not have been nearly as damaging if world interest rates had not risen in the 1980's. These mistakes from the past should highlight the fact that we are making our decisions today without full information. The risks involved in making wrong decisions are clearly high and this should be taken into account in formulating policy.

Dr Patrick Honohan I will confine myself to three points of the many I would like to make on this interesting paper.

First, I note that the authors believe that the main objective of budget policy has been to increase the level of per capita incomes in Ireland. While that was certainly an aspiration, it does not ring true to me as a description of the sole or principal objective. I believe that the budget has been primarily addressed to what might be called distributional and employment objectives, neither of which is precisely the same as a real income objective. The distributional objective included not only income maintenance programmes but also the public provision of a variety of services which might have remained in the private sector but which it was thought preferable to bring into the public domain. The employment objective often conflicted with the real income objective – or at least seemed to. Many projects were proceeded with because of the direct employment they offered, despite the fact that they would reduce real income in the economy. Job creation schemes may often have displaced other employment and to that extent the dichotomy between employment and income may have been a false one, but I think that it would be a mistake to underrate the importance of direct job creation as opposed to income generation in policy design.

My second point refers to taxation, on which the authors have laid some emphasis in their conclusions without providing supporting analysis. It is too easy to blame all the country's economic problems on the overall level of taxation. I would identify three important channels for a negative impact of tax on economic performance: (a) welfare losses arising from a distortion of economic decisions, (b) increases in involuntary unemployment resulting from unions bidding up before-tax wages to insulate the after-tax wages of those who maintain their jobs, (c) uncertainty of the future incidence of tax changes discouraging investment decisions. Each of these negative effects can be greatly reduced by careful design of tax and other policy (and that has been done in other countries which have a higher share of tax in GNP). I would conclude that it was not so much the resort in the early 1980's to an increase in the overall share of taxation to reduce the budgetary imbalance that should be faulted as the failure to reform the tax system on the way.

Finally, I would like to comment on what is the most interesting proposition in the paper, namely the "continuity thesis" by which I mean the authors' view that the seeds of budgetary deterioration were already sown by 1973. To some extent the authors have exaggerated the degree of continuity by looking at the average of very long periods, and also by their choice of periods. I understand why they chose 1973 as a break point because it is close to one of Dr. Whitaker's "turning points". But their second period should have ended at 1981/82, the next turning point, instead of covering the years of (modest) retrenchment 1982/84. That would have resulted in greater contrast between the earlier and later period and highlighted the more liberal spending policies of the 1970's, by comparison with the 1960's. Where I agree with the authors is in their aggregation of the Public accounts without distinguishing between current and capital. They show that a pattern of considerable public indebtedness was well established by 1973. From this point of view what changed in 1973/74 was not so much the breaching of the current account balance rule (helpful though that discipline had been), as the scale on which public indebtedness was allowed to expand. So long as the public debt does not exceed around 60 per cent of GNP, it can be absorbed in the portfolios of domestic wealth holders. But when it exceeds that amount, any attempt to place the debt at home results in very high interest rates. The result is clear from Table 6, despite all the borrowing of a quarter of a century, the domestic debt/GNP ratio increased only slightly, while the share of foreign debt in the total jumped from less than 10 per cent to almost a half.