1 Introduction

Despite the setbacks of the financial crisis and the pandemic, the last several decades have seen economic prosperity in Ireland make advances that seemed impossible half a century ago. This has also been the period of Ireland's membership of the European Union,[1] and it followed a long period of stagnation in the shadow of its large neighbour and former ruler, the United Kingdom.

Exactly where the turning point in Ireland's economic fortunes was, and what role EU membership played, are less clear. Population started to grow from 1961; productivity from the early 1970s; per capita consumption levels in the late 1980s; employment growth in the 1990s (Figure 1) (Honohan and Walsh 2002; Ó Gráda and O'Rourke 2022; O'Rourke 2017).

This book explores the ways in which the deepening relationship with Europe influenced the extent, nature and timing of the economic transformation.

The four freedoms of movement within the Union – of goods and services, of people and of capital – are all ingredients in the story of this transformation, which has happened in an environment significantly shaped by EU economic legislation.

But arguably more important has been the way in which joining the EU catalysed a much larger opening up of the Irish economy to the opportunities of an increasingly globalized world.

Free Trade in Goods and Services and the Transformation of the Business Sector

The Irish policymakers who advocated membership more than sixty years ago saw progress to free trade with Europe as crucial in expanding the market for Irish agriculture and industry. Agriculture clearly benefitted from the high prices secured at the outset, and there was an expectation that value added processing of agricultural products would drive industrial expansion. Removing the barriers to trade would force Irish firms to improve efficiency to compete with British and continental firms. But many of the old firms did not long survive.

Instead, inward foreign direct investment by firms that would supply both the European and other foreign markets, encouraged by grants, and especially by low rates of corporation profits tax, proved to be the distinctive characteristic of Ireland's industrial modernization.

[1] Although called this only from 1993, the term European Union (EU) will frequently be used for convenience for the Union's predecessors, Common Market, EEC, etc. Except where stated explicitly, Ireland refers to the Republic.

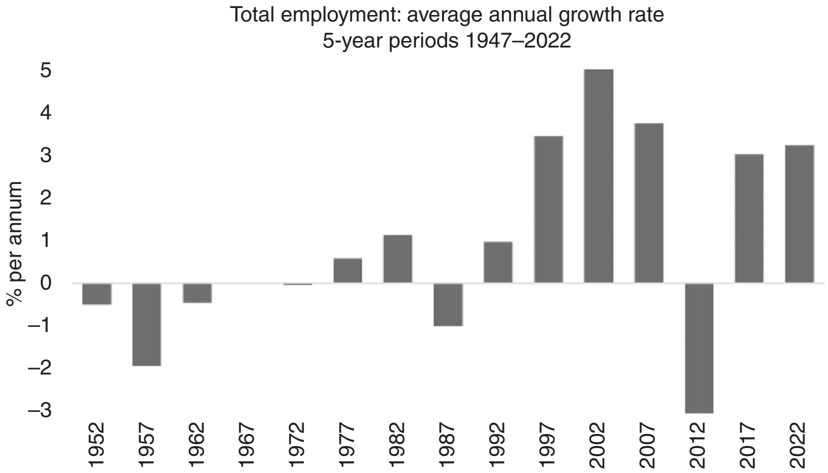

Figure 1 Total employment annual growth rates (five-year averages)
Source: Central Statistics Office.

The European Single Market, unleashed at the start of 1993, greatly deepened the process of European trade integration and increased the attraction of Ireland as an export platform for foreign-owned firms. Already an especially favoured destination for US foreign direct investment (FDI), Ireland experienced a disproportionate inflow in the 1990s as the Single Market came into effect, helping drive a delayed convergence towards the prosperity of leading economies.

Free access to the European market turned out to be only a part of the benefit of this globalization of production, though, as new firms increasingly supplied a world market. FDI featured new fields of production such as information services, information technology, medical instruments and pharmaceuticals.

Conventional accounting practice generates statistics on output, trade and productivity that overstate the true performance in Ireland of the world's major technology and pharmaceutical companies. Still, over the last fifty years FDI has made a major contribution to rising living standards in the form of growing employment, tax revenue and know-how. The multinational corporations (MNCs) did not create the Celtic Tiger of the 1990s, but their growth was a significant part of it. They did not provide much insulation of the economy from the Global Financial Crisis (GFC), but they greatly helped strengthen the public finances through the pandemic years 2020–2.

In time, new or growing Irish-owned firms in such fields as agribusiness, building materials and air transport also became firmly established internationally, and again these took full advantage of the globalized world economy, and not just Europe.

Key Pre-requisites: Education and Macroeconomic Stability

Translating this transformation of productive forces into broad-based and sustained prosperity called for steps that lay largely in the hands of the national government, rather than with the EU. Arguably the two most important of these were education and macroeconomic stability.

In the 1960s, Government belatedly recognized that Ireland had fallen well behind in ensuring access to education at second and third levels. Measures were taken to correct this and to catch up with what had been happening in other European countries.

There was less success in the matter of macroeconomic stability. Fiscal policy mistakes following the oil price rises of the 1970s led to a loss of competitiveness, and a debt overhang which resulted in a deep macroeconomic crisis for most of the 1980s. This delayed convergence of the economy to its full employment potential.

Thus it was only by the end of the 1980s that both of these key ingredients were in place. Ireland then experienced two decades of rapid economic catch-up towards the living standards of the leading group of EU countries.

Capital Mobility and Crises

The benign environment created by the Single European Market, and by falling transportation and communications costs, ushered in the 'Celtic Tiger' period of export-led employment growth. Competitive and productive, the business sector at last ended the involuntary joblessness that had been endemic.

But, as the new millennium began, Government again allowed macroeconomic imbalances, associated with reckless and under-supervised banking, to re-emerge in the later years of the catch-up, leaving Ireland disastrously exposed to the GFC.

Freedom of mobile capital thus proved to be a mixed blessing, as these episodes of macroeconomic imbalance interacted with speculative capital flows from global financial markets to deepen the two severe macroeconomic crises. Neither of the two European currency arrangements in place during the two Irish macroeconomic crises provided much protection to Irish economic performance.

European financial architecture was not sufficiently developed to help: it was not until the 1990s that the Union started to pay attention to fiscal imbalances, and not until after the GFC that it centralized banking supervision. Whether enough has been done to ensure that the latest macroeconomic shocks are weathered remains to be seen.

Labour Mobility

Much of the sizable immigration of the last few decades has been from the new wave of EU member states after 2004, reflecting the EU freedom of personal movement. Population growth since 1961 was also boosted by returning migrants. In contrast, only a small proportion of Irish emigrants chose destinations in Continental Europe.

Armed with more years of education, the workforce was more productive, and the share of the population at work outside of agriculture grew rapidly in the decades of EU membership, with far more women participating than before, especially those who benefitted from the expansion of second- and third-level education. Elements of European social policy played a role here, for example on equal pay for women, and likely influenced Irish policies that helped limit the deterioration in income inequality.

Funding and Regulations from Europe

The Structural Funds made a considerable contribution to Irish economic progress in the 1990s (as the transfers associated with the Common Agricultural Policy had been doing from the start). Their expansion arrived at an ideal moment, encouraging the relaunching of many needed infrastructural and other Government spending programmes that had been deferred as the fiscal accounts were being repaired. The funds were well spent, and the governance of the spending helped improve Irish administrative processes.

Over a period during which public regulation of economic activity had to become more elaborate and prescriptive, Ireland's participation in the EU has helped ensure that its microeconomic policies reflect up-to-date international practice and are less prone to capture by sectional interests than might have been the case. Irish engagement in the design of these policies has varied, having been very active in respect of agriculture, for example, but notably weaker in environmental protection over the years. Restrictive practices in domestic service sectors such as the law persist.

Large areas of policy remain a national responsibility, though, and solutions to the many obvious deficiencies in fields such as healthcare, legal services and especially housing can only be sought at home.

There is a path-dependency in the story of Ireland's economic transformation which precludes any simple decomposition of the result into distinct contributions from each main causal factor: EU membership; stabilization policy; the openness to FDI and the low-tax approach to attracting it; investment in education; globalization and the European Single Market. For more than a decade after joining the EEC, the Irish economy was still in the doldrums, owing to macroeconomic mismanagement. But during that time, the investment in human capital and the arrival of the early waves of US MNCs were laying foundations of subsequent advances. Both of these ingredients were selected by policymakers whose awareness of international opportunities reflected an outward-looking attitude informed by personal links to the diaspora and growing professional and personal links to Continental Europe. Thanks to these foundations, the economy was uniquely well placed to benefit from globalization, and from the European Single Market which arrived soon after macroeconomic balance had been restored.

The remaining sections are organized as follows.

Section 2 focuses on how the freedom of trade in goods and services affected the modernization of Ireland's productive capacity. We emphasize how this was not confined to European links, but saw Ireland embracing globalization to a remarkable extent.

Section 3 is about people, ranging from the large immigration from Eastern Europe that has happened in recent years (thanks to the freedom of movement of people within the EU) to how educational attainment increased labour force participation and productivity, especially for women. It also discusses the distribution of income between households.

Section 4 looks at how Ireland's engagement with the microeconomic legislation and policies of the Union, and its Structural Funds, have influenced the extent and quality of economic growth.

Freedom of capital movement has been a mixed blessing for Ireland. Before concluding, Section 5 looks at Ireland's chequered macroeconomic policy experience within the EU, noting how mistakes slowed the convergence of living standards in the early years and again resulted in another serious setback during the GFC.

2 The Modernization of Production

A small economy can exploit the economies of scale available in modern production processes only through specialization and export. Maintaining barriers to international trade, whether inward and outward, will ultimately prevent this progression. That is why Irish policymakers saw membership of the European Common Market – and eventually the Single Market – as presenting more of an opportunity than a threat to Ireland over the past half century.

The efficiency and competitiveness of the Irish economy did improve, though not in quite the way that was expected. Rather than simply diversifying its exports into Continental Europe, Ireland built also on the cultural links with the United States to attract and build enterprises engaged in the global economy to an extent and in ways not conceived of sixty years ago. Instead of simply adding value to Ireland's traditional agricultural products (livestock, milk and eggs), production for exports swung into sectors such as pharmaceuticals, information and medical technology and software.

The role of Europe in this modernization was at first largely catalytic, in motivating the initial shift of policy, in opening new horizons, and in underpinning a stable regulatory framework on which entrepreneurs could build. Europe also provided an increasingly important market, especially when non-tariff barriers to trade were progressively removed as the Single Market process matured.

Of the four freedoms at the heart of the European Union, trade came first. As European countries recovered from the Second World War, the political as well as economic desirability of free trade re-asserted itself.

Sixty years ago Ireland was not well placed to benefit from this new trend towards free trade. Its agricultural and industrial structure had been formed in the shadow of the much larger British economy and was shaped by the trading opportunities that that provided. Furthermore, it had retained a high level of tariff protection from the interwar period: indeed rates of effective protection were among the highest in the world (McAleese 1971).

Thus, for example, the Anglo-Irish 'economic war' of the 1930s, which exacerbated the – then global – trend towards protection, reinforced a switch to import substitution, with the creation of numerous manufacturing firms in Ireland in sectors such as textiles, clothing, footwear and building materials. However their scale and efficiency were insufficient to allow them to compete internationally.

The top four principal export products from Ireland in 1949 were live cattle and horses, fresh eggs and beer, mainly sent to Britain. By the late 1950s, despite grant and tax advantages offered to firms to encourage exports, live animals and food, drink and tobacco still accounted for almost 70 per cent of Ireland's goods exports.

The limited employment and income-generating capacity of Irish economic activity had long resulted in a steady net migration outflow and population decline. With imports likely to make further inroads into the ability of inefficient Irish firms to stay in business, and agriculture offering no growth in employment, Irish policymakers of the 1950s concluded that the only way forward was to encourage a drive for efficiency in manufacturing production for export and that this would be helped by the encouragement of inward FDI. Manufacturing efficiency was not to be achieved behind protective tariffs.

The emergence of the two free-trade blocs (the European Free Trade Association EFTA as well as the European Economic Community EEC) made the international competitiveness of Irish industry an even more pressing matter. Together with global trends towards freeing of trade, competition in Ireland's traditional export market Britain, and in new markets, was going to be increasingly tough.

'It seems clear,' wrote the top official of the Department of Finance in 1958 (in a widely read report that was influential in shaping subsequent policy), 'that, sooner or later, protection will have to go and the challenge of free trade be accepted.'

And so it was. Ireland began to liberalize, signing, for example, a free trade area agreement with Britain in 1965, which would eliminate Irish tariffs on UK manufactures over a nine-year period, greatly increasing the competitive pressure on Irish firms producing for the domestic market. The agreement was explicitly portrayed as a stepping stone towards the rigours of EEC membership and was signed in the full knowledge that not every Irish manufacturer would survive. What concessions were made in this agreement on the British side mainly referred to agriculture, as most Irish manufactured exports to Britain were already tariff-free (Blackwell and O'Malley 1984; Daly 2016, p. 30).

Although Britain's 1961 application to join the European Economic Community was unsuccessful, implying that Ireland too would not join yet, Ireland's economic policies had turned definitively towards generating sufficient productive efficiency to compete successfully in Europe. With Ireland's per capita income less than two-thirds that of the original six member states, Ireland was not obviously well qualified to join the Common Market (Laffan 2021). Unless the efficiency and productivity of Irish industry could be raised, Ireland's economically underdeveloped status might impede admission, if and when Britain was eventually admitted. Irish industry would have to adapt, and there was a push for firms to rationalize and reach scale, including through mergers (Ó Gráda 1997). Many of the old firms did not successfully shape up, though, but gradually retreated.

Retreating Industries

Back in 1960, Ireland's industrial structure was dominated by firms producing for the domestic market. Some of these were subsidiaries of British firms that had entered to jump tariffs that began to be applied already in the 1920s. A further wave of firm creation had happened in the 1930s as tariffs and quotas became much tighter (Neary and Ó Gráda 1991; Ryan 1949); but more of the owners were local in this wave, reflecting legislation that curbed inward FDI. The result had been highly profitable for Irish owners of firms thus endowed with monopoly powers, whether through protection from import competition, or through being awarded import licenses. Some of these firms retained close British connections, despite the restrictive legislation.

There was a limit to the extent to which import substitution behind tariff walls could support the growth of firms. Manufacturing employment grew little after 1938, with the local market saturated and most of the firms unable to compete in international markets.

Just as Belfast had world-leading export firms in shipbuilding, linen and tobacco in the early decades of the twentieth century, Dublin did have the long-established brewing concern Guinness, and, on a smaller scale, the biscuit manufacturer Jacobs; and Cork the Ford tractor plant. But these and a few others were exceptions, and even they came under pressure from protection in Britain and competition from further afield (Bielenberg and Ryan 2016; Jacobson 1977).

Many of the old firms succumbed in the early years of free trade, especially during the recession of the mid-1970s and mid-1980s. Few managed to make the breakthrough to becoming successful exporters in the wider EU market now available to them. Weaknesses in management, marketing and design were widely cited as reasons; perhaps also (as Blackwell and O'Malley 1984 suggested) the set-up costs required to break into this market presented too high a barrier for the small firms that dominated the Irish industrial scene.

Some of the existing firms did modernize. For example, the three largest alcohol distilling firms merged into what became Irish Distillers, which did succeed in expanding the international market for Irish whiskey and other spirits, before being taken over by a French group. Guinness survived also – albeit as a division of the British group Diageo, with only about 1,200 employees now in Ireland – and it continues to brew stout for the UK market in Dublin. As discussed later, the important beef and milk processing sectors also modernized and consolidated, and a few of the merged firms were transformed into significant international firms with outward FDI.

In most cases, though, it was ultimately not a question of re-equipping and modernizing existing firms, but rather a process of replacement of failing firms, unable to survive without protection, by new entrants. The vehicle turned out to be inward foreign direct investment.

The Multinational Firms

Countries

Efforts in this direction already began in the early 1950s with the creation of the important promotion agency then known as the Industrial Development Authority (IDA), and its work expanded in the 1960s. At first the IDA managed to attract a number of significant German firms – their nationality partly reflecting a reluctance to see a return to British dominance, and partly the preference of some German entrepreneurs, needing access to labour, to locate in Ireland rather than in Britain (Daly 2016). Other prominent early arrivals in the 1970s included Italian, British and Japanese synthetic fibre plants. Soon, however, the main fruits of the IDA's promotional activity were coming from the United States.

By the mid-1970s, the IDA was attracting FDI flows on a disproportionate scale compared to the rest of Europe – though inflows slowed markedly during the 1980s, before recovering strongly thereafter. The share of foreign-owned firms in industrial employment grew rapidly, stabilizing only in the late 1990s (as indigenous enterprises expanded, including in the construction sector).

Being able to export into Europe without tariffs or quotas was, of course, an important part of what generated interest in an Irish location. But it would be a mistake to see this FDI as solely engaged in tariff jumping into Europe. Instead it should be noted that MNCs also exported a considerable fraction of their output to the United States and elsewhere.[2]

Through the early decades of the Community, considerable non-tariff barriers persisted in Europe, including those associated with home preference in government procurement and discriminatory national technical standards. The Single Market reforms of the 1980s dismantled many of these non-tariff barriers, thereby opening up additional opportunities especially in sectors which were now particularly well represented in Ireland, thanks to FDI (Barry et al. 1999).

Aside from the absence of a language barrier, the attractions emphasized by the IDA for these firms included not only location within the Common Market, but also sizable grant-aid, including (as emphasized by Crafts 2014) the relatively light degree of product market and labour market regulation, compared to other parts of the EU.

But increasingly important was the ability of many MNCs to exploit the low Irish rate of tax on corporate profits.

The tax rate gap relative to other European countries was considerable. Around the turn of the millennium, a typical new investment, if located in Ireland, could expect to pay in corporate taxes only a quarter of what it would have to pay in other euro area countries (Oxford University Centre for Business Taxation 2017). One international econometric study estimated that, if all EU countries had the same tax rate in the 1990s, the net inflow of FDI to Ireland

[2] Using regression analysis of detailed (4-digit) US import data by product, Romalis (2007) shows that Ireland's share in US imports tended to be higher for more capital-intensive sectors with lower trade costs.

would have been less than a third of what it was (Gropp and Kostial 2000; cf. Davies et al. 2021).

Because of the structure of US corporate taxation, the tax advantage was most attractive to large US-based multinational groups.[3]

US Firms

It was US firms that responded most strongly to the advantages and inducements to locate production facilities in Ireland. Already in 1975 they accounted for a quarter of employment in foreign-owned IDA supported firms, compared with 39 per cent in British companies, and 8 per cent German.[4] By 1995, the British share had fallen to 14 per cent with the US at 59 per cent. The share of firms from Continental Europe fell from 32 per cent to 24 per cent (Ruane and Görg 1997). After 1995, the growth in employment at US firms accelerated until the turn of the century, and again after 2012, until by 2020 they accounted for more than 70 per cent of the employment in foreign-owned firms in the corresponding sectors (i.e. those assisted by the IDA), with the UK now only accounting for 3 per cent and Continental Europe for about 11 per cent (cf. Brazys and Regan 2021).

In fact, Ireland has been a specially favoured destination for outward US FDI (Figure 1). Capital investment by US MNCs in Ireland, which averaged 5 per cent of GDP per annum between 1983 and 1995, was proportionately the highest of any EU country and about five times the average (Görg and Ruane 1999). Even Spain and Portugal, new members whose accession triggered an economic expansion in those years, experienced nothing like this inflow.

From 1993 US firms saw new advantage in having a production location within the Single Market. FDI flows from the US increased in the following years, and Ireland increased its share of those flows (Görg and Ruane 1999; Jacobson and Andreosso 1990). By 2019 US MNCs paid more corporate income tax to Ireland than to any other foreign jurisdiction, other than the UK (and that country was only slightly ahead) and, relative to population, more people work for US MNCs in Ireland than elsewhere.

Clearly, EU membership did not guarantee what happened in respect of inward US investment to Ireland. Ireland's experience in attracting US investment was quite unique, as illustrated in Figure 2, which shows the share of total employment in EU countries provided by foreign firms from different regions.

3 For example, the profit rate of German firms in Ireland is not out of line with Irish firms, or with the profit rate in their home market, suggesting that they have little scope to reduce their overall taxation by locating profits in Ireland (FitzGerald 2022a).

4 The industrial development agencies maintain a database of the firms supported by their activities. This does not include all foreign-owned firms, such as supermarket chains; on the other hand, it is not limited to 'newly arriving' firms.