Committing to Growth:
Experiences in small
European countries and regions

by

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Do I dare
Disturb the universe?
In a minute there is time
For decisions and revisions which a minute will reverse.

T.S. Eliot

[1] Introductory remarks

To be asked to present one of this series of prestigious lectures is a particular pleasure for an Irish economist. In Ireland we follow the fortunes of the economies of the Celtic “fringe” of the United Kingdom with singular interest. After all, we ourselves were constitutionally part of that fringe until 1922, and remained locked into close and normally harmonious business and economic relationships with Great Britain from then until well into the 1970s. After independence, British and Irish people continued to enjoy the benefits of a common work area, and were able to travel back and forth between our two islands, unhindered by passport controls or any other restrictions and with a frequency born of long-standing interaction and familiarity.

For reasons that are not part of our concerns in this paper, Ireland parted company from the UK in 1922 and embarked on the task of running its own political affairs and building its own economic institutions. But my grandparents remained convinced that this break had been a dreadful mistake, and they pined for the familiar certainties of British life to the day they died. As a young child in the 1950s, they would take me on bus rides to the seaside south of Dublin, and to my excruciating embarrassment, would loudly ask the conductor for tickets to Kingstown, a place-name that Irish nationalists had long ago changed to Dún Laoghaire!

However familiar the British-Irish link was to ordinary people, it proved more difficult to regularise at an official level. It was not until the advent of the European Common Market that this proved possible. The European movement had grown out of the ashes of the last European-wide civil war. An additional modest beneficial externality of that historical sea change in European affairs was that it provided an encompassing framework within which Anglo-Irish political and economic relationships could also become more relaxed, cooperative and mutually beneficial. Today it seems very natural to discuss the two economies of Scotland and Ireland not only within the context of these islands, but also as archetypes of the two main entities that make up the European Union: small states and regions of large states.

Scotland is a typical region of a great nation state, whose political institutions embed it in that state, but which leave its regional policy-makers with a degree of formal autonomy. Scotland relates to the outside world mainly through the institutions of its encompassing nation state, even if devolution has recently relaxed this bond to a degree. This is so obvious and natural that – like the air you breathe – it goes almost unnoticed! Yet it colours the way that you view the world.

Ireland, on the other hand, is a typical small nation state. Its political institutions after independence in 1922 gave it the potential for considerable policy autonomy. But prior to the
1960s the carry-over of dependency on Great Britain from the previous era placed severe physical and psychological restrictions on the practical exercise of autonomy. A symbol of this dependence was that British notes and coins circulated freely alongside Irish notes and coins, and Ireland maintained a strict one-to-one parity between them. Almost all of Irish exports – at that time made up mainly of agricultural produce – were sold to Britain. Only after 1960 did the Irish economy begin to escape from the constraints of this dependency and eventually succeed in restructuring and diversifying.

But the detailed bilateral comparison of the economic performance and potential of the Scottish region and the Irish state is not my central theme tonight. It is more useful to focus on both of them as European archetypes of small regional and national economies, and to reflect on the implications that this has for the design of successful growth strategies. Within the European context, the economies of small nation states (such as Ireland) and of the smaller regions of large nation states (such as Scotland) have more in common than is often recognised. In an earlier paper that reflected on the Irish growth experience, Paul Krugman stressed the need for a better balance between a purely regional paradigm, with growth driven by an export base, and the kinds of macroeconomic and productivity-driven issues that matter for national economies, even small ones (Krugman, 1997). In other words, to what extent do we have to look inside the economy, at its internal macroeconomic mechanisms and business interrelationships, in order to understand it? Ireland has already become familiar with thinking about its economy in regional as well as in state terms. It appears to me that Scotland still thinks of its economy mainly in regional terms, but needs to begin to take on at least some of the economic characteristics of a state.

Nevertheless, I feel obliged to start by sharing with you in section 2 a brief interpretation of the recent Irish growth experience because it is probably the main reason that I was invited to give this lecture and it is therefore expected of me! But I also do so because I fear that there is a risk that inappropriate policy lessons may be drawn from the Irish case by Scottish analysts and policy-makers. Misconceptions about the so-called Irish “economic miracle” need to be got out of the way in order to uncover insights that may be of mutual interest. The relevance for Scotland of the experience of a small country like Ireland, that managed to converge from less than two-thirds of the EU average standard of living to that average in less than 15 years, needs to be examined carefully. Even if I sometimes detect an air of pessimism in Scotland about its future, remember that in modern times you have never strayed very far from UK living standards, and the UK is almost exactly positioned at the EU average. In the sense in which the term is normally used, Scotland has never had to grapple with the challenge of convergence. Rather, it faces the challenge of renewal.

Having laid the Celtic Tiger to rest, so to speak, I then want to reflect on the fact that policy makers – however proudly they claim to be pragmatists in quest of the five (or whatever) essential things that must immediately be done– seldom if ever work in an intellectual or political vacuum. Rather, in the words of Keynes:

“The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood”.

Developing this theme, David Henderson, in his 1985 Reith Lectures on the influence of economic ideas on policy, coined the phrase “do-it-yourself” economics, by which he meant ideas and beliefs which owe almost nothing to recognized economics textbooks, yet still retain their power to influence people and events. And Paul Krugman has recently had some
very harsh things to say about “policy entrepreneurs”, a term he uses to describe those who offer unambiguous diagnosis, even when professors are uncertain, and easy answers where professors doubt that any easy answers can be found. Krugman’s “professors”, of course, are a saintly and abstemious group, who play strictly by the rules of academic peer review, and never sin by making wild claims and predictions that are unsupported by mathematical models and empirical evidence!

So, one should perhaps be wary of economists – professors or otherwise - who come to you bearing growth strategies! Since there is scope for confusion, misunderstanding and even error in the role of economic ideas in designing these strategies, it is worth reviewing their history as they have been implemented over the past few decades in small EU states such as Ireland. Please forgive me if, in section 3, I seem to dwell on the history of Irish development in excessive detail. The point that I wish to stress is that the actual facts of underdevelopment are seldom in dispute. But what is crucial is the way that local (and sometimes international) policy makers and analysts think about the facts. In other words, the conceptual frameworks that underpin policy actions are all-important. Failure to develop is usually associated with incorrect conceptual frameworks rather than with the absence of hard work. On the other hand, a framework that is highly appropriate seems to have the power to energise people, dragging them along in its train.

In section 4 I turn to a wider European aspect of convergence. In Europe, the word “cohesion” tends to be used instead of “convergence”. It is a characteristic of European policy-making that the concepts of efficiency and equity are both taken seriously. Since the late 1980s the EU has implemented a major programme of regional investment aimed at promoting “cohesion” among the poorer member states. The member states whose performance lagged most – Greece, Ireland and Portugal – as well as the poorer regions of Spain, Italy, Germany and the UK, received generous levels of development aid. Ireland had the very good fortune to be at the precise point of its development strategy that ensured optimal use of EU development aid. Not all aid recipients were quite so lucky! But in the case of Scotland the role of the EU in the area of regional policy may simply be a distraction from challenges that would be best treated by the more effective use of Scotland’s much larger local resources.

In my concluding section I turn to the challenges of today. It so happens that in the first years of the new millennium both Scotland and Ireland find themselves with a broadly similar standard of living.¹ In the case of Ireland, we are newly promoted into the Premier League. In the case of Scotland, you have been in the Premier League for a long time, but do I detect a fear of relegation? So, for the first time both economies face a similar challenge, namely how to stay in the economic Premier League. In analysing these issues, we economists are comfortable with the use of formal analysis in its modern guise. We endlessly gather data, and never cease to complain about its poor quality or absence. We adopt theoretical frameworks, build models and test hypotheses, and some of us – *mea culpa* - go on to use these models to guide and support our policy advice. But if the Irish and wider EU small country development experience tells us anything, it is that the success of small economies is almost always associated with a far wider range of overlapping and mutually reinforcing strategic approaches than are normally used by economists, and that strategy best operates

¹ The assertion of similar Scottish and Irish standards of living has to be heavily qualified. It is merely a statement about the approximate equality of Scottish GDP per head and Irish GNP per head (smaller than GDP due to profit repatriation by foreign firms). Consumption per head remains higher in Scotland, but not spectacularly higher.
within robust and appropriate institutional frameworks that must be carefully designed and implemented. I will contend that the challenges that face Scotland and Ireland are likely to be very similar.

Perhaps I should signal up front an insight that colours my analysis. Over the past decade, as I have interacted with Scottish and other UK regional economist colleagues, I have detected an unwillingness – verging sometimes on an inability - to think of Scotland’s challenges in a truly international way. I am driven to interpret this phenomenon as a consequence of the sheer strength of the centripetal intellectual and financial pull of London, combined with the fact that Scottish Ministers, their advisors, and academics do not regularly have to sit around tables in Brussels and Frankfurt explaining themselves robustly to their peers, and listening in turn to other national and regional narratives. In contrast, our Taoiseach (or Prime Minister) is obliged every few years to act as EU President for six months, and our Ministers as well as our entire civil service must perform on the EU and world stage. I hasten to add that nobody is foolish enough to imagine that Ireland is very influential in this role. But the process has an electrifying effect on the country and exposes it to a vast array of international challenges that might otherwise pass us by! Happily, the consensus appears to be that we have not yet disgraced ourselves!

[2] Reflecting on Ireland’s “great leap forward”

Let me start with a somewhat sombre interpretation of Ireland’s convergence story. Since my purpose is to discuss policy frameworks for growth, it is very appropriate to examine Irish economic performance in terms of the so-called “Lisbon Agenda”. This important initiative arose out of a nagging realisation on the part of the European Commission and the major EU states that the Single Market, established in the late 1980s and early 1990s was not delivering as dynamic a growth performance as had been hoped. Based on a wide range of performance indicators, many of the European economies were failing to catch up with the USA, and some were even falling further behind.

These concerns came to a head at the Spring European Council meeting held in Lisbon in 2000, where an ambitious programme was launched, entitled An Agenda of Economic and Social Renewal for Europe. The Agenda had four major political aims:

- To establish inclusive, dynamic and knowledge-based European economies;
- To produce accelerated and sustained economic growth;
- To restore full employment as the key objective of economic and social policy, and reduce unemployment to the levels already achieved by the best performing countries;
- To modernise the social protection systems.

After ten years of strong growth, we in Ireland were initially a little complacent about the Lisbon Agenda. After all, Ireland had dynamic clusters of high technology sectors (mainly computers, software and pharmaceuticals); our growth had accelerated dramatically in a sustained way; we had slashed our unemployment rate from one of the highest in Europe (lower only than Spain) to one of the lowest (and even lower than our neighbours across the Irish sea!); and we believed that we had improved our social protection systems beyond recognition. But as we examined the Lisbon agenda, our complacency was not to last very long!
As a means of giving substance to the task of monitoring progress on the Lisbon Agenda, the European Commission began to publish regularly a broad and balanced set of over one hundred socio-economic indicators, gathered into six main areas, as follows:

- **General economic performance** (11 indicators of growth in GDP, productivity, employment, inflation, and balance in public finances)
- **Employment performance** (21 indicators of work related issues, such as unemployment, participation, retirement age, accidents, lifelong learning, etc.)
- **Innovation and research** (16 indicators of spending on human capital, R&D, venture capital, telecommunications, etc.)
- **Economic reforms** (23 indicators of utility deregulation and pricing, state aids, market integration and business investment)
- **Social cohesion** (18 indicators of income distribution and poverty, regional aspects, education participation, long-term unemployment, etc.)
- **Environment** (15 indicators of greenhouse and other pollutant emissions, quality of transport systems, waste treatment and natural resource protection).

Such lists as these, as also with other popular international indicators of competitiveness, give rise to “beauty contests” that generate lots of heat and excitement, but are not always soundly based on reality. But if you stand back from the details of the Lisbon indicators, some fairly robust conclusions emerge. Using the most recent data, Figure 1 shows the frequency of appearance of each of the 15 EU states in the top and in the bottom three of the structural indicators. In terms of appearance in the top three, the international pecking order is Sweden, followed by Finland, Denmark, Ireland and the UK. In terms of appearance in the bottom three, the order is Greece, followed by Portugal, Spain, Italy and the UK.²

But if you move from the indicators taken as a whole (Figure 1) down to the level of the six main areas listed above, a less comforting picture of Ireland emerges. Eighteen of Ireland’s twenty-five “top three” scores arise in the areas of “general economic performance” and “employment performance”. One can designate these two areas somewhat loosely as “outturn” indicators, i.e., growth, exports, jobs. In the other four main areas, which might be loosely designated as “input” indicators, Ireland achieves very few “top three” scores, but many “bottom three”. So, we are presented with something of a paradox. Ireland is apparently a country that succeeded in delivering a top class performance in terms of a series of outturn indicators, while simultaneously displaying modest to mediocre performance in a series of indicators of quality inputs. On the other hand, the three Nordic countries – Finland, Sweden and Denmark – performed excellently in both output and input indicators.

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² Unfortunately, the Lisbon indicators are not yet published at the EU regional (or NUTS 2) level, so we cannot pinpoint Scotland’s performance.
So, what were the drivers of Ireland’s top class “outturn” performance, that propelled it to convergence in terms of GDP per head? It was clearly not the expected Lisbon Agenda drivers: i.e., innovation, structural reforms, social cohesion and the care for the environment. How did Irish policy makers manage to leverage top class growth and jobs out of apparently so few top class inputs? How did they manage to out-perform many of the other advanced and less advanced small EU states? Are there useful lessons for other states and regions?

To tell this story properly, we need to examine three interrelated issues in the rest of the paper:

- The quest for smart policies that maximise the use of the limited policy autonomy and the constrained resources available to a small state like Ireland as it attempts to converge;
- The returns to a strategy of taking full advantage of an orientation towards EU policy initiatives and European markets at a time of great change and dynamism in the world economy;
- The sustainability of a tiger-like performance in the longer term, or how to avoid falling behind, as well as the payoff that can come from integrating all the different strands of policy-making within a coherent national strategy.

The first of these issues might appear to be of limited interest to Scottish policy makers, but it serves to highlight the importance of having an appropriate strategic policy framework. But the other two are as important to Scotland as they are to Ireland.
[3] Ireland’s convergence: why it was necessary; how it was done

Information on economic strategies is freely available, and strategies are non-rival goods. Winning strategies that originate elsewhere can be copied or adapted. But how interchangeable are strategies between small states and regions? Are the outcomes so conditioned by region-specific historical, locational and political factors that regional strategies are *sui generis*? One often comes across the opinion that “Irish” strategies are all very well for Ireland, or “Danish” strategies for Denmark, but neither would ever work here, because we are different! But this is to miss the point that all policy makers draw from a common base of existing economic knowledge, and they succeed if they can adapt this knowledge base to fit their local context and constraints. Let me illustrate the march of ideas on economic strategy by exploring Ireland’s post-war development and convergence experience.

Although the flashy convergence performance of Ireland over the past decade attracts most attention, the origins of that success lie in the 1960s. The rapid recovery and growth of the main economies of Western Europe after an initial period of post-war reconstruction, had cruelly exposed the poor performance of the Irish economy. Policy thinking until the early 1960s had been dominated by a decision taken in the 1930s to attempt to build an Irish industrial base from behind high tariff barriers. Recall that the partition of the island in 1922 had split off the only heavily industrialised region, centred on Belfast, leaving the Free State with the very modest remainder. The simple, unqualified and dogged embrace of protection by Irish policy-makers had appeared to offer exactly what the country needed at that time, and was in tune with an unfolding political and economic drama being played out in the rest of the world as it lurched towards war.

The switch to protection by the Fianna Fáil government after 1932 must have appalled the pro-free trade politicians of the previous administration. John Maynard Keynes had been invited to deliver a lecture in Dublin in April, 1933, and there was an expectation that the speaker – a well-known advocate of the benefits of free trade – might help bring an end to what some felt to be policy madness (Keynes, 1933). One can almost sense the horror of the ranks of pro-free trade politicians and academics of the previous administration when Keynes declared that:

> “Ideas, knowledge, science, hospitality, travel – these are the things which should by their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, let finance be primarily national”.

and concluded:

> “If I were an Irishman, I should find much to attract me in the economic outlook of your present government towards greater self-sufficiency”.

What is seldom quoted is what immediately followed these remarks, and heavily qualified them.

> “But as a practical man and as one who considers poverty and insecurity to be great evils, I should wish to be first satisfied on (some) matters. … I should ask if Ireland is a large enough unit geographically, with sufficiently diversified natural resources, for more than a very modest measure of national self-sufficiency to be feasible without a disastrous reduction in a standard of life which is already none too high”.

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Keynes’s was the wider vision that may not have struck much resonance in a country preoccupied with its own internal post-independence development problems. He had abandoned the liberal economic agenda for reasons associated with the deterioration in the world political climate, but was to work diligently during and after the coming war to restore this agenda and to avoid repeating the errors of Versailles.

The new Fianna Fáil government of 1932, on the other hand, had domestic objectives of industrialisation and needed to erect protective barriers to shield the infant industries. The failure of Ireland to diversify its economy away from an almost total dependence on the UK had serious consequences for its economic performance when compared to a range of other small European countries. While policies and policy makers in Ireland may have been less assertive and innovative than might have been desirable, in the absence of a competitive and export-oriented industrial sector there is probably very little that could have been achieved to accelerate an earlier economic decoupling from the UK. The consequences followed inexorably. In the words of the Norwegian sociologist, Lars Mjøset:

"Ireland became a free rider on Britain's decline, while Austria and Switzerland were free riders on Germany's economic miracle" (Mjøset, 1992)

Even while the war was in progress, and before it was clear that the Allies would be the victors, Keynes and others worked to ensure that post-war barriers to trade and currency exchange would not disrupt the proper functioning of the international economy as it had after WW1. The European scene was further transformed by the European Recovery Programme (Marshall Aid) from April 1948 and the major devaluations against the dollar of September 1949. In addition, the Schuman Plan of 1950 set up the European Coal and Steel Community, and led eventually to the signing of the Treaty of Rome in March 1957. This was the international context that was to expose cruelly the Irish structural weaknesses.

The 1950s in Ireland were disrupted by a series of serious balance of payments crises that were simply the consequences of the fundamental lack of competitiveness of the manufacturing sector. Not only had protection failed to produce self-sufficiency – since the protected industries still needed to import materials and capital goods – but any increase in consumption also quickly ran into the sands of the balance of payments constraint. In other words, this was exactly what Keynes had warned about back in 1933! Ireland was simply too small to be an inefficient producer of goods where it had no comparative advantage.

The disparate policy changes that evolved during the crisis-wracked 1950s were consolidated in 1958 in a seminal report, *Economic Development* and codified in a government White Paper, *First Programme for Economic Expansion* (Ireland, 1958). A diverse range of ideas and proposals were advanced, mainly in the areas of agriculture and the agri-food sector. But with the benefit of hindsight, we can now recognise *Economic Development* and the *First Programme* as a transition between old and new perspectives, and not a whole-hearted embrace of a modern view of the economy. For example, we now appreciate better that a zero rate of corporation profits tax, combined with the liberalisation of trade and foreign investment as well as the freedom to repatriate profits, were to become absolutely central factors in a process that would inexorably lead to the decline of much of the inefficient indigenous manufacturing sector and the rise and eventual dominance of a new foreign-owned sector. Yet the corporation tax initiative lay buried in an appendix of *Economic Development* and was not even mentioned in the main text. Perhaps there ought to be a statue erected in
Dublin to celebrate the policy-makers of the mid-1950s who slashed export profits tax to zero. Had they been less radical, Ireland today might be more like Greece than like Silicon Valley, and I would almost certainly not be giving this lecture!

We also now understand better that when a mainly agricultural country attempts to modernise, the primary requirement is for the farming sector to shrink in size as a proportion of the overall economy, and for the manufacturing sector (and elements of services) to expand and develop in a way that drives export growth through improvement in cost competitiveness. Given Ireland’s dismal record of native entrepreneurship in the post-war period, this involved attracting direct investment from America. Yet the vision of *Economic Development* was mainly one of agriculture-led export growth, with a continuing mainly indigenous base. The official aim was to emulate Denmark. In fact, thirty years later we had become a bit like Massachusetts! While the official rhetoric of development stressed continuity with the agricultural past, the newly created state development agency (the Industrial Development Authority, or IDA) buzzed with excitement at the potential offered by the new policy regime (McSharry and White, 2000). A crucial characteristic of the IDA approach was its pro-activity, described provocatively as follows:

“It is IDA policy to gear itself to discharge the total process to the limit of its legislative permit, and while it will not encroach on areas which are clearly the responsibility of other state organizations, it will err on the side of doing rather than not doing where the returns on effort appear to be high” (McLoughlin, 1972)

The policy changes made in the 1950s, that were brought together in the strategy of *Economic Development* in 1958, were a heady and novel mix of a commitment to trade liberalisation, a range of direct and indirect grant aid to private firms, and the incentive of zero corporation profits tax on exports. But this policy mix was precisely what was needed to ride the coming tidal wave of American foreign direct investment, in contrast to the declared policy aim of growing on the back of an expanding indigenous agri-industrial base. The policy thrust was uniquely appropriate to Ireland’s development challenge, but the outcome eventually produced by these policies turned out to be very different from that originally envisaged by the policy makers! This provides a nice illustration of the distinction between the factors that influence the design of policy and how economic agents actually exploit any new freedoms. One cannot always predict the latter simply from a knowledge of the former!

The Irish economy emerged into the 1960s still in a very weak state, but at least was now equipped with a policy strategy that happened to be uniquely in tune with the changed times. Furthermore, Ireland was no longer alone in having difficulty in coping in a new European and international environment. American investment into Europe at that time was so dynamic and threatening that it presented the major European economies with what Jean-Jacques Servan-Schreiber characterised as *The American Challenge*. In his book, Servan-Schreiber wrote:

While French, German, or Italian firms are still groping around in the new open spaces provided by the Treaty of Rome, afraid to emerge from the dilapidated shelter of their old habits, American industry has gauged the terrain and is now rolling from Naples to Amsterdam with the ease and speed of Israeli tanks in the Sinai desert. (Servan-Schreiber, 1968).

The strong web of dependency between Ireland and the UK that had endured relatively unchanged from independence until the late 1950s only began to weaken after the shift to foreign direct investment and export-led growth that followed the various French-style
Programmes for Economic Expansion in the late 1950s and during the 1960s. Starting from a point in the 1950s when about 90 per cent of Irish exports went to the UK, the share declined steadily thereafter, and stabilized at about 20 per cent by the mid-1990s (Figure 2).³

**Figure 2: Irish trade with the UK:**
**Export and import percentage shares 1960-95**

The opening of the economy and the removal of tariff barriers were necessary policy changes to kick-start from stagnation. Free trade with the UK happened in the mid-1960s. This initiative provided a very useful opportunity of “testing the water” of outward orientation. Free trade with Europe came later when Ireland joined the then EEC in 1973. Irish economic policy-making since the late 1950s has always emphasised the need to face the consequences of extreme openness, to encourage export orientation towards fast growing markets and products, and to be aligned with all European initiatives. Thus, we joined the European Monetary System in 1979, breaking a long link with sterling and its deep economic and psychological dependency. We embraced the Single Market of 1992, the Social Chapter of the Maastricht Treaty, and most recently, Economic and Monetary Union from January 1999. Perhaps this is the main legacy bequeathed to us by the prescient policy-makers of the late 1950s. Since then, the enthusiastic embrace of openness provided the strong and enduring strategic backbone of our economic planning.⁴

But Ireland was still not a very attractive place in which to invest in the early 1960s. It was remote and unknown, had little by way of natural resources, and had no industrial heritage. The main inducement provided to inward investors was initially a zero rate of corporation tax on exports of manufactured goods. This tax policy, combined with aggressive and sophisticated initiatives designed by the IDA to attract and aid inward investors, provided the initial impetus to the modernisation of the economy through export-led growth.

³ Figure 2 also neatly illustrates the fact that the Irish share of imports from the UK declined only marginally over the 25 years between 1960 and 1995. Over their history, the Irish had developed a strong taste for British goods that only the recent strength of sterling against the euro has eroded. Exports, on the other hand, were to be an engine of convergence, and diversification beyond the UK market was essential.

⁴ The Scottish economy is as “open” as the Irish, measured in terms of the ratio of exports to GDP (Fraser of Allander Institute, 2001). But almost half of these “exports” are external sales to the rest of the UK. In this sense the rest of the EU market is simply not as important as it is to Ireland. Combined with the pervasive “eurosceptic” views of many UK policymakers, it is easy to see why European initiatives are likely to play a weaker role in the UK regions.
However, an attractive corporation tax rate and the absence of tariffs were only a start. They would not in themselves have made Ireland a major host for high quality foreign direct investment. Other factors came together to reinforce Ireland's success and interacted to create a virtuous circle of superior performance that replaced the previous vicious circle of decades of under performance. Educational standards in the Irish work force had lagged behind the world. Policies were urgently needed to bring about a steady build-up of the quality, quantity and relevance of education and training, and this had been initiated by farseeing educational reforms starting in the 1960s. These reforms were later to be extended by the emphasis given to scientific and technical skill formation through the use of EU Structural Funds from the late 1980s.

A Polish journalist recently asked me to explain how the Irish were so prescient as to prioritise investment in human capital over all other investments in the first two EU Structural Fund programmes during the Celtic Tiger years, 1989-1999. None of the other recipient states or regions – Greece, Portugal, Spain, Northern Ireland, the Italian Mezzogiorno, or East Germany – had done so, preferring to focus on physical infrastructure. I found this a difficult question to answer, and could only reply that education and skill formation had been strategically prioritised as far back as the 1960s. It would have been simply inconceivable not to have prioritised human capital in the Structural Fund programme!

Perhaps the most striking consequence of foreign investment inflows was that it hastened the de-coupling of the Irish economy from its almost total dependence on the United Kingdom (Figure 2 above). Ireland’s development dilemma had always been that it could either stick closely to UK economic policy and institutional norms and be constrained by the often erratic UK growth performance, with little prospect of rapid convergence to a higher standard of living. The alternative was to implement a politically acceptable degree of local policy innovation that offered hope of a faster rate of growth than its dominant trading partner.5

The Irish economic policy-making environment during this period can be characterised as having shifted from one appropriate to a dependent state on the periphery of the UK to that of an region more fully integrated into an encompassing European economy. Foreign direct investment renovated and boosted Irish productive capacity. The Single European Market provided the primary source of demand. All that remained was for a long overdue “big push” on improvement in physical infrastructure, education and training, and this arrived in the form of a dramatic innovation in regional policy at the EU level, with the advent of Structural Fund aid from the late 1980s. We will examine that issue in the next section.

It is clear that there were some special circumstances surrounding the Irish switch to trade liberalisation and active encouragement of inward investment. First, the manifest failure of the previous protectionist policies had been so obvious that no political party or domestic lobby favoured their retention. Second, the range of abilities and expertise available within the Irish public sector was considerable, in part as a legacy of our previous incorporation into the UK, and there was a willingness to learn from European experiences, in particular the indicative planning experiences of France (Chubb and Lynch, eds., 1969). Third, the completion of European reconstruction, and the growth in importance of the EEC, provided the opportunity to capture some of the rapidly expanding flow of American investment into

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5 Ireland, of course, was an underdeveloped economy in the 1960s, seeking to converge. Its close links with the UK would probably never have delivered that convergence. Scotland, on the other hand, faced no such challenge. However, the issues are complex, and we will return to them in section 5.
Western Europe. Fourth, rapid advances in technology and declining transport and communications costs during the 1960s facilitated the process of foreign investment by multinational corporations, which flourished spectacularly in the 1980s and particularly in the 1990s.

You may feel that I have dwelt too much on the transition that took place in the 1960s. You may be puzzled that I should consider that this policy inflection point is still of relevance today. My justification goes deep into how policy-makers plan and implement long-term strategies. In the hurly-burly of daily life, one can live with a certain lack of co-ordination; one can switch direction many times and experiment; one can be inconsistent. Tactical policy mistakes and errors can usually be detected before too much damage is done, and revised policies implemented in a learning game of trial and error. However, this is only the case when the strategic thrust of policy has been set correctly. Getting the medium-term strategy right is vital mainly because change is very difficult and errors are very costly, and sometimes terminal. When strategy is wrong, retribution usually follows. This is as relevant today as it was in the 1950s, for Ireland as well as for Scotland.

[4] Cohesion for all: the EU takes action

The desire for equitable development had been expressed in the Treaty of Rome, but prior to the late 1980s the EU budget was largely dominated by the need to finance the Common Agriculture Policy (CAP). The redistribution of the EU budget to reform and expand EU regional aid policy into a sophisticated system of National Development Plans (NDPs) and their accompanying Community Support Framework (CSF) treaties, was driven by two main factors. First, the progressive enlargement of the EU after its foundation in 1956 brought about an ever increasing degree of socio-economic heterogeneity with the accession of Ireland (1973), Greece (1982), Portugal and Spain (1986). In addition to the process of enlargement, the parallel evolution from a common market into a more integrated economic union obliged EU policy makers to address the task of aiding the preparation of weaker states and regions to meet the challenges of such initiatives as the Single Market and Economic and Monetary Union.

While all nation states had previously operated internal regional policies of various types, what was different about the new EU regional policy initiatives was that very significant Structural Fund financial aid was made available by the wealthier member states (including the UK) to co-finance national and regional policy initiatives in a limited number of the poorer member states as well as poorer regions. After 1989 there was a major shift of resources from the CAP to regional development aid directed at a limited number of countries, but remaining within a similar EU budgetary envelope (i.e., about one and a quarter per cent of EU GDP).

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6 In his illuminating account of the post-War success of Japan, the economist Mikio Morishima felt it necessary to go back to the fourth century (Morishima, 1982)!

7 For simplicity, we will henceforth refer (somewhat inaccurately) to EU regional aid as “Structural Funds”
Here in Scotland your experience of EU regional aid has been as a rather minor addition to the massive financial transfers that take place between the regions of the UK. However important it is to have the Highlands and Islands designated as Objective 1, this designation is probably unlikely to bring about a fundamental change in the way public investment is planned and implemented in Scotland. But Ireland, together with Greece, Portugal and Spain, being considerably less developed than Scotland, obtained a much higher level of EU co-finance. The magnitude of the financial aid, combined with the requirement to take a medium-term strategic approach to public investment planning, brought about a sea change in the way in which the Irish public sector approached this crucial aspect of development.

The main political rationale behind the expansion of Structural Fund aid came from the fear that not all member states were likely to benefit equally from the Single Market, whose purpose was to dismantle all remaining non-tariff barriers within the Union. In particular, the less advanced economies of the Southern and Western periphery (mainly Greece, the Italian Mezzogiorno, the southern Spanish regions, Portugal, Ireland, and Northern Ireland) were felt to be particularly vulnerable unless they received assistance.

What was special about the Structural Fund policies was their ambitious goals, i.e., the provision of financial aid (in the context of a domestic co-finance requirement) to implement policies whose explicit aim was to transform the underlying structure of the beneficiary economies and to prepare them for exposure to the competitive forces being unleashed by the Single Market and EMU. Thus, Structural Fund policies moved far beyond a conventional demand-side, cyclical stabilisation role of public expenditure, and were directed at the promotion of structural change, the acceleration of medium-term growth, and the eventual achievement of real convergence mainly through efficiency improvements in supply-side processes.

The EU financial aid was made available within explicit multi-annual investment programmes that started as National Development Plans, and when approved by the European Commission, were codified into formal development aid treaties, or Community Support Frameworks. An important economic consequence for public investment planning was that a more strategic approach could be taken. An important fiscal consequence was that public investment policies in the recipient states could shift from a short-term, purely domestic process to a more stable medium-term process. In the Irish case, this allowed successive administrations to break with annual capital budgeting and put in place systematic development plans of longer duration (i.e., for five, six or seven years).

Is such EU intervention justified? Conventional neo-classical economic theory takes the view that all one has to do to promote real convergence between the regions of any state or between grouping of states is to put in place policies that facilitate the free movement of goods and the factors of production. If all markets are competitive, any initial regional disparities are likely

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8 The EU contribution to the Highlands and Islands Structural Funds programme for the period 1994-99 was only 293 million euro. Total expenditure (EU, local public and private) was 696 million euro (ECOTEC, 2003). It has recently been claimed that: “The Structural Funds, often regarded as a means of regional emancipation, in fact have the opposite effect. Since the UK does not recognise additionality at the territorial level, the effect of structural fund designation is to earmark a part of the block grant deemed to represent the European contribution and oblige the devolved administrations to allocate another tranche as ‘matching funds’. These moneys are then ring fenced and unavailable for allocation to other priorities” (Keating, 2001).

9 A region or country is designated as “Objective 1” when its GDP per head is less than 75 per cent of the EU average. This Objective is intended to target general underdevelopment, rather than a specific development problem such as de-industrialisation (Objective 2).
eventually to vanish and there is no need for specific structural regional policies.

But one of the more interesting consequences of recent advances in the study of spatial economic processes is that the conditions required for automatic convergence to take place are increasingly seen as not holding in practice (Krugman, 1995; Fujita, Krugman and Venables, 1999). Policy has come to focus attention on the importance of such factors as the initial level of regional physical infrastructure, local levels of human capital, or on the fact that regions that start off at a structural disadvantage may never converge in any reasonable time period. Research has even suggested that the removal of barriers to trade and factor movements may actually lead to a relative deterioration rather than an improvement of some regions.

Thus, regional policies can be justified in many ways and every EU member state operates a wide range of such policies. Some of these operate automatically, such as the income support mechanisms of the social welfare transfer system. Others are more discretionary and involve policies designed to address specific problems (such as regional de-industrialisation) and often targeted at specific underdeveloped regions (such as Northern Ireland, Merseyside and the Scottish Highlands and Islands in the UK; the Mezzogiorno region of Southern Italy, and the Eastern länder of Germany). At the level of the EU as a whole, it was the lagging states and macro regions on the southern and western periphery that constituted Europe’s “regional” problem and called for European regional policies.

Influenced by growth theory, and by a desire to implement policies that have long-term benefits, the EU-inspired Structural Funds came to dominate Irish policy-making during the 1990s, and had three main priority areas of investment:

a) Direct support for productive investment as well as other measures to improve the environment of enterprises;

b) Infrastructure expenditure to offset structural and geographical disadvantages;

c) Spending on human resources to augment human capital.

The Structural Funds influenced the evolution of the Irish economy over the past 15 years. But equally, it could be held that the evolution of the economy also influenced the redesign of successive programmes. Table 1 shows the percentage shares of each of the three main economic categories of public investment, for each of the three cycles of Irish Structural Funds that have operated since 1989.

<table>
<thead>
<tr>
<th>Economic Category</th>
<th>CSF 1989-93</th>
<th>CSF 1994-99</th>
<th>CSF 2000-06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aid to productive sector</td>
<td>56.0</td>
<td>47.0</td>
<td>16.0</td>
</tr>
<tr>
<td>Human resources</td>
<td>25.0</td>
<td>32.0</td>
<td>36.0</td>
</tr>
<tr>
<td>Physical infrastructure</td>
<td>19.0</td>
<td>21.0</td>
<td>48.0</td>
</tr>
</tbody>
</table>

The first programme focused heavily on direct aid to the productive sectors, with a strong emphasis on human resources, and a substantial programme of investment in physical infrastructure. This programme had been designed at a time when the economy had not fully
emerged from the crisis of the 1980s, and the direct aid sub-programmes appeared to offer the fastest and best immediate return, while the other sub-programmes built up and offered the promise of longer term returns.

By the time of the second Structural Fund programme, the increased emphasis on human resources (up from 25 to 32 per cent) reflected concerns about the continuing high level of unemployment, and had a strong “equity” element that complemented the “efficiency” element.

The third programme was designed at a time when the success of the Irish economy had already become a topic of international discussion. By the late 1990s Ireland had moved to what was effectively full employment, and major infrastructural deficits had been exposed by the rapid growth in the volume of traffic on the congested road systems both in the major cities, and connecting these cities. In order to address these bottlenecks, there was a major shift to infrastructure investment (increased from a 20 per cent share during the first two NDPs to a share of 48 per cent). The share going to human resources also increased (to 36 per cent), with a focus on upgrading skills, and there was a reduction in direct aid to the now booming productive sectors.

Clearly it is not sufficient to point to the step-change in economic performance (Figure 3) and to assign all the improvement to the Structural Fund interventions. In fact, the impact of Structural Funds in isolation is relatively modest, but when added to the impact of the Single Market and foreign direct investment, the effects are much larger (ESRI, 1997). Analysis suggests that a ranking in terms of effectiveness is topped by Ireland, followed by Portugal, Spain, and with the smallest impacts on Greece (ESRI, 2002). In the EU “macro” regions (the Italian Mezzogiorno, Northern Ireland and East Germany), the Structural Funds appeared to have only modest impacts. It has been suggested that the effectiveness of Structural Funds depends on “conditioning” variables, and the most important of these is economic “openness” (Ederveen et al, 2002). The Irish economy is the most open in the EU. Portugal is also quite open, relative to its size. Spain is less open, but Greece is the least open.10 Structural change in an economy – involving openness, institutional quality, etc. – is driven by forces beyond the Structural Funds. These funds may serve to accelerate change, but it is the wider challenges of EU membership that probably dominate.

Figure 3: Irish GDP growth, before and after Structural Funds (including forecasts)

![Figure 3: Irish GDP growth, before and after Structural Funds (including forecasts)](image)

Source: Bergin et al, 2003

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10 On the measure of exports to GDP, the Scottish economy is as open as that of Ireland. But this may be misleading as a true measure of openness, and we will examine it in the next section.
After almost a decade and a half of Structural Funds and the Single Market, how have the so-called “cohesion” countries performed? In Table 2 we show the convergence experience of these four countries (with the Denmark as an additional small-country benchmark), where it is seen that some quite rapid convergence has taken place in recent years.

Table 2: Relative GDP per capita
Purchasing power parity: EU15 = 100

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Ireland</td>
<td>63.2</td>
<td>62.3</td>
<td>65.9</td>
<td>122.0</td>
</tr>
<tr>
<td>Greece</td>
<td>43.7</td>
<td>71.0</td>
<td>62.8</td>
<td>69.9</td>
</tr>
<tr>
<td>Portugal</td>
<td>40.6</td>
<td>57.5</td>
<td>54.5</td>
<td>73.7</td>
</tr>
<tr>
<td>Denmark</td>
<td>126.0</td>
<td>120.9</td>
<td>117.8</td>
<td>120.8</td>
</tr>
</tbody>
</table>

Source: European Economy, 2003

Adaptation to the competitive rigors of the Single Market and efficient use of Structural Funds undoubtedly underpinned the dramatic convergence of Ireland. This combination was a primary force driving Irish convergence. But it operated in the wider context of public support of growth in human capital that went back to the mid 1960s, a major fiscal stabilisation in 1987 that preceded the first Structural Fund programme, a social partnership that ensured that the transition to high growth would take place with harmonious industrial relations, and a firm policy of moving towards deeper monetary union in Europe. This distinguished Ireland from, say, Greece, which faced a broadly similar convergence challenge, but which was very late in setting its wider policy framework in the context of embracing internationalisation. Portugal probably represents an intermediate case of partial convergence.

Looking at the way poorer regions in the EU can seek to accelerate their growth rate in order to catch up, one might suggest that the Irish experience is essentially a working out of different types of beneficial externalities:

i. There was an initial clustering of similar industries. This process had been kick-started in Ireland early in the 1960s by incentives based mainly on very low rates of corporate taxation, and a range of other attractive incentives towards investment and training. Two such clusters grew strongly in the 1980s: pharmaceuticals and computer equipment. Although they were mainly foreign owned, they were supported by the rise of local suppliers of specialised inputs.

ii. These clusters generated a local labour market for skilled workers which further facilitated the expansion of the cluster. The early focus on human capital during the

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11 Scotland’s performance on this uniform EU basis is not available. But the UK Regional Accounts show that its GDP per head tracks at about 95 per cent of the UK average, and the UK itself is at about the average of EU GDP per head. Since there are unlikely to be differences in purchasing power parity between the British regions (i.e., differences in regional price levels), this is probably a good measure of Scottish performance on the EU basis.

12 It should be noted that GDP overstates Ireland’s national income (or GNP) by about 15 per cent, due to large-scale outflows of corporate profits of foreign-owned multi-national firms that operate in Ireland.
1960s and 1970s was enhanced by the training and human resource policies of the Structural Funds. This provided a vital boost to ensuring an elastic supply of highly trained labour during the 1990s when there was a massively increased inflow of foreign investment;

iii. Spillovers of information and skills from the high technology clusters further encouraged growth in high technology areas and provided the basis for additional clustering effects, often in traditional areas that could benefit from new technologies in their supply chains (e.g., food processing, music and films, high fashion clothing, etc.). It became important to facilitate internal transport and communications, and the urgent need for improvements in physical infrastructure and in the productive environment supported by the Structural Funds became crucial.

iv. Finally, the efficiency externalities operated against the background of a consensual process of social partnership that had been put in place to ensure that there were as few losers as possible in the fiscal and wider economic restructuring that were required to drive a virtuous circle, with the result that growth was less likely to be choked off by industrial unrest.

Thus, openness to the full rigors of competition in the international marketplace was a necessary condition for Irish economic success, but was not sufficient. Nor did the availability of EU development aid guarantee rapid convergence, as the comparison of Ireland with Greece and the Italian Mezzogiorno illustrates. The barriers to faster growth needed to be correctly identified, a broad growth-promoting policy environment had to be put in place, and the specific Structural Fund public investment policies had to be appropriate, efficient and effective.

The sheer complexity of the convergence challenge demands a concerted national focus on breaking out of the previous regime of slow and erratic growth. In small peripheral countries like Ireland, it became important to develop and articulate a culture of excellence in economic and business analysis so that realistic policies could be identified that would command broad agreement among the Social Partners. Regional policy within EU member states, on the other hand, often tends to be “palliative”, in the sense that it attempts to make the regional disparities easier to endure rather than making any serious attempt to eliminate them. The main policy instrument used is often income support transfers from richer to poorer regions, a process that does not exist at anything like the same extent between richer and poorer countries of the EU. It seems to be politically difficult to design regional policies that introduce fundamental differences between regions of a nation state other than in terms of the level of income redistribution. But if the Scottish economy is to be transformed and renewed (Krugman’s “second wind”), that is precisely what may be needed! We now turn to this issue, and examine the challenges facing Scotland as well as the newly converged Ireland.

[5] Staying ahead: tougher than convergence?

Today, on the global economic map, the lines that matter are those defining "natural economic zones", where the defining issue is that each such zone possesses, in one or other combination, the key ingredients for successful participation in the international economy. These zones can be regions (like Scotland) or they can be states (like Ireland). With falling
transportation and telecommunication costs, economies have become increasingly interdependent, and in the words of former US Labour Secretary, Robert Reich:

"The real economic challenge ... [of the nation or region] ... is to increase the potential value of what its citizens can add to the global economy, by enhancing their skills and capacities and by improving their means of linking those skills and capacities to the world market." (Reich, 1983)

This process of global competition is organised today mainly by multinational firms and not by governments. Production tends to be modularised, with individual modules spread across the globe so as to exploit the comparative advantages of different regions. Hence, individual small nations and regions have less power to influence their destinies than in previous periods of industrialisation, other than by refocusing their economic policies on location factors, especially those which are relatively immobile between regions: the quality of labour, infrastructure and economic governance, and the efficient functioning of labour markets.

Thus far we have been using a mainly economic framework of analysis. But there are severe limitations to using a purely economic perspective on development and transformation. In the case of a UK region like Scotland, the challenge facing its policy makers is to design and implement strategies that will enhance the welfare of its people. A major constraint on its freedom of action is the rather limited range of significant policy instruments that it can use, since Scotland is integrated into the UK fiscal and monetary union.

But does Ireland really possess many policy options that would be denied to Scotland by Whitehall? A low rate of corporation tax? But this was essentially a once-off Irish initiative taken in 1956, almost half a century ago, at a time when the economy was one large green field, and the population was emigrating in droves! The changes since then have been modest, and largely dictated by EU law. And far from being a “free lunch”, the low rate of corporation tax condemned the long-suffering Irish tax payer to decades of penal rates of direct and indirect taxation! The societal choice presented was that you could have a job in Ireland with a foreign-owned multinational (rather than in London, Manchester or Glasgow), but you paid for it by high personal taxes. With that exception – and I admit that it is a rather important one – you should ask yourself if there is much else that an Irish government can do in the economic sphere that could not also be done by a Scottish government today without necessarily incurring the wrath of the UK Treasury!13

Rather than searching for ever more clever fiscal tricks, I believe that a better way is to accept the constraints of being in the UK fiscal union, and to broaden the debate beyond the strictly economic issues, embracing the insights of a business research perspective. But if one attempts to combine the insights of economics and business, one quickly becomes aware of the differences and tensions between them. Economic policy research, and in particular trade and macroeconomic research, often tends to be directed at issues and challenges that arise at the level of regions, nations or even groupings of nations such as the EU. Business policy research, on the other hand, is focused on the performance of individual firms or groups of firms. This distinction was highlighted by Michael Porter in his analysis of the competitive advantage of nations, when he stressed the point that it is more helpful to consider firms as

13 An unsettling feature of public policy debate in Scotland is the air of uncertainty that seems to surround its policy autonomy. For example, in a recent report published by the Scottish Executive, attempts were made to achieve lower Scottish tax rates by persuading the UK government to reduce UK tax rates. These proposals were slapped down by the Treasury in a peremptory fashion! (Scottish Executive, 2003).
competing in industries, not in nations (Porter, 1990). This simple insight lies at the heart of the tensions that can arise between the mainly regional/national-based perspective of economic researchers, and the mainly firm-based perspective of business researchers, particularly in matters concerning the design and execution of industrial strategy. The distinction that I draw is overstated for the sake of emphasis. Nevertheless, it is particularly relevant in small countries and regions, where the economic research agenda is often heavily influenced and distorted by trends in international monetary and macro economics, and where regional problems, including industrial strategy tend to be neglected.  

At the risk of over simplification, the economic approach to policy is appropriate for the study of how a “representative” firm is likely to behave when subjected to changes in the wider external policy environment. Business research frameworks, on the other hand, are more appropriate for the analysis of the consequences of management actions directed at improving the prospects of a “specific” firm within a given (usually fixed) external policy environment. Because of this very basic difference in the main emphasis of their disciplines, economic and business researchers often tend to misunderstand, discount, reject or ignore each other. This should not, and need not, be so!

Unlike economic research, business research tends to be organised eclectically in terms of a framework that consists of three concentric circles, labelled broadly as:

i. The outer business environment;
ii. The middle ground of business strategy;
iii. The inner ground of business/marketing tactics;

The outer circle contains all the factors that serve to make up the strategic environment over which any individual firm has little or no control, and from which emerges the strategic opportunities and threats that face the firm as it operates in the marketplace. It contains all the economic and competitive forces that are the domain of the economic policy researcher, in addition to the forces of technical progress, social forces, legal issues, environmental protection rules, and political forces (such as ideology). Business researchers dip into these matters only when they need to, mainly as sources of opportunities and threats, but it is not their main domain of research activity. Economists talk of little else.

The middle circle of business strategy is the domain where much business-oriented research is focused. Key issues include the determination of a company’s competitive advantage within a given outer business environment. Here, it is common for knowledge and research insights to be systematized into explanatory frameworks or taxonomies of useful and revealing facts and insights. Influential examples include Raymond Vernon’s Product Life-Cycle framework explaining the sequential nature of the different stages of industrialization, trade and foreign direct investment (Vernon, 1979); Michael Porter’s diamond of competitive advantage, which suggests how policy can be used to create competitive advantage even in situations where initial national factor and other endowments are unfavourable (Porter, 1990); and Michael Best’s capability and innovation perspective – the Capability Triad – which points to the need

For example, the experience of the SCOTECON initiative suggests that it is difficult to persuade Scottish economists to direct their research towards tackling important regional problems (such as industrial strategy, regional development, the scope for greater fiscal autonomy, differential regional performance, etc.). The UK-wide Research Assessment Exercise (RAE) tends to crowd out local topics in favour of more “publishable” national topics. In view of the importance of regional economics on the European stage, this is an inexplicable failure of nerve!
for synchronized advances on many fronts if dynamic business growth is to occur (Best, 2000).

The inner circle is the environment of business tactics and encompasses all aspects of the so-called “marketing mix”. Here one has moved away from the wider role of public "environmental" policy and medium to long-term business strategy, and emphasis is placed on the shorter term actions of managers within individual firms (e.g., pricing policy, product development, promotion activities and distribution channels). There may be a public policy regulatory oversight of this inner business environment to ensure fair play and open competition, as well as some targeted aid directed at improving marketing skills of small or newly formed firms. But actions within the inner environment are normally left to the discretion of individual firms. Of course, some regions may be populated by smarter firms than others.

One might characterize a key challenge of industrial policy making in any small nation or region as that of blending the techniques and insights of the predominantly economic analysis of the outer business environment with those of the business analysis of the middle ground of strategy. These two areas are often studied in isolation from each other by non-overlapping groups of researchers. Seldom are the two different perspectives looked at as being entirely complementary and mutually supportive.

At the level of the individual firm or corporation, strategy is usually formulated in a context where government policies are largely exogenous, and firms address the challenges of assessing the business portfolio and identifying strategic goals. The crucial role of management is to formulate a corporate strategy that aligns with the nation’s or region’s wealth-building strategy. So, this issue is usually examined largely from the point of view of domestic or of regional companies adjusting to national strategy.

In Ireland, however, causality as often as not ran in the opposite direction. In other words, the Irish industrial development agency – the IDA – constantly scans the world for inward investment in high technology sectors. Quite often the domestic environment initially is not sufficiently attractive to persuade leading-edge firms to locate in Ireland. But information on firms’ expressed needs are fed back to the Irish government authorities by the IDA, and major policy changes can be executed quite rapidly. A case of information feed-back was the transformation of the Irish university system in the mid-1970s, where massive resources were put into the enhancement of electronic engineering and chemistry to create a skilled labour force for potential inward investors (MacSharry and White, 2000). A more recent example was the provision of generous resources to the university system to fund basic research in the areas of electronics and biotechnology, when a lack of such skills was identified as a potential bottleneck to future inward investment.

Thus, the national wealth creating strategy in Ireland often needed to adapt to the requirements of firms in the global corporate environment, and not the other way around. Hence, the strategic challenges facing small open economies like Ireland and like Scotland are very different from those facing large developed nations like the US, Japan, Germany, France, the UK. A question that one might ask is whether Scottish Enterprise has quite so close and symbiotic a relationship with the highest policy-making levels in the Scottish government as the IDA has had with Irish policy-making? How quickly can the Scottish administration

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15 For a description of how the three business strategy frameworks can be used to illuminate Ireland’s experience, see Bradley (2003).
develop the cross-economy networking skills that were less in demand before devolution but will be crucial in the future?

In the case of Ireland, the success of its industrial strategy was due in large part to the innovative and flexible behaviour of government policy makers as well as to the expertise and dynamism of the state’s development agency (the IDA). However, policy makers are usually most effective when they are, so to speak, swimming with the tide of events rather than against it. Irish policy making was, to a considerable extent, pragmatic and opportunistic. But it was characterized by a form of pragmatism that appears to have been singularly in tune with the best thinking on international industrial policy frameworks. To characterise the Irish strategy as “picking winners” is to misunderstand its fundamental thrust. Perhaps “picking winning environments” might be closer to the mark! A winning environment is essentially a public good, and is a legitimate target of public policy.

It is clear that sophisticated policy making requires sophisticated policy makers. On the basis of what I have read of Scotland’s experience, I would find it difficult to believe that there is much difference in the level of administrative and technical competence as between Scotland and Ireland. Indeed, given the greater number, and world class nature of Scottish universities, one might expect a higher level of expertise in Scotland. But Brussels is much further away from Dublin that London is from Edinburgh! Perhaps what Irish policy makers lack in terms of narrow administrative and technical expertise they more than compensate for in terms of a willingness to test the extent of their limited autonomy and experiment with novel solutions to apparently intractable problems. If one plays broadly according to the international rules, Brussels seldom interferes! But the more pervasive checks on policy innovation in Scotland may extend beyond Whitehall’s blocking role. For example, Whitehall could not prevent the evolution of an innovative form of Social Partnership in Scotland. But local trade unions, employers organisations and politicians could and possibly would!

Luck also plays a large part in industrial strategy. The expected external conditions needed to support success do not always conveniently arrive, and their absence may frustrate otherwise admirable policy initiatives. Nor is the true significance of the internal elements of a strategy always fully understood even by its own designers. But luck and chance, however random, can be handled best within well thought out and coherent frameworks that take full account of the nature of the external environment (opportunities and threats) as well as realistic views of domestic capabilities (strengths and weaknesses). Policy frameworks such as those of Vernon, Porter and Best do not provide all the answers. But they can help policy makers in both the public and private sectors to bring focus and synergy to the disparate policies that make up broad industrial strategy in small open economies like Scotland and Ireland.

At the risk of oversimplification of what are very complex issues, what the recent industrial performance in Ireland shows is that the intelligent combination of economic policy and business strategy can generate huge synergies in terms of rapid national growth and

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16 When I spoke to the IDA Research Department in the early 1980s, they had never heard of Raymond Vernon! When Michael Porter (of the Harvard Business School) published his seminal book *The Competitive Advantage of Nations* in 1990, it generated great interest and excitement in Ireland. Yet the IDA had been implementing Porter-like strategies of industrial focus and clusters since the 1960s!

17 In section 3 we saw that the outcome of the policy strategy of openness and low corporation taxes that was implemented in Ireland in the early 1960s was quite different from what was anticipated.

18 Business and economics professors are notorious for ignoring each other. But I note that Paul Krugman has given a modest nod of approval to Porter’s suggestions “as long as you’re talking about tens of pounds per capita, not hundreds of pounds per capita” (Krugman, 2003).
convergence. To achieve these synergies requires a certain degree of economic policy autonomy that can be used, for example, to exploit opportunities and remedy weaknesses shown up by frameworks such as Porter’s and Best’s. In this case, Ireland was lucky in that it could build a growth and convergence strategy around its Structural Fund programmes, and articulate them in National Development Plans. Perhaps what the Scottish dilemma illustrates is that circumstances were never quite so dreadful as to precipitate a dramatic sea-change in the direction of policy. Could it be that an unwritten and perhaps subliminal condition of funding the Scottish public sector through a Barnett-type formula (i.e., fair shares for all), is that you are not meant to be too innovative about the way you spend the money?

Perhaps the most striking aspect of the Irish development experience is that it did assign such an important role to the public sector in an era when the dead hand of government interference is almost universally castigated, at least in the Anglo-American world. The role of government as “strategic organizer” in a global economy driven by market forces is very different from the previous role of Communist governments as “central planners”. Government as “strategic organizer” carries out its functions in collaboration with private businesses and not as a substitute for the market economy. Any Irish government must decide its own strategic posture, since there is nobody else waiting to carry out the task. The Scottish situation is made more complicated by the division of responsibilities between London and Edinburgh.

What are the major strategic tasks that any government needs to tackle? I believe that there are four elements:

Assessing a state’s strengths and weaknesses: The state must play a crucial role in shaping and reshaping the conditions within which the market operates, through promoting research, analysis and dialogue. In Ireland this is perhaps easier to implement than in Scotland, since Irish political life is only weakly differentiated on a left-right axis. Irish political parties (with the exception of Sinn Fén) tend to present themselves as “national managers” of a mainstream globalised economy. The great nationalist debates are now over, and there never was much of an ideological debate! There is a broad understanding of the strategic needs of the economy, and governments are judged on how well they appear to be implementing the agreed strategy. We suggested how the integration of the Scottish university system in the UK-wide Research Assessment Exercise (RAE) seems to induce a reluctance to focus on Scotland’s strategic challenges. Do Scottish economic researchers not understand that one of the hottest topics today is regional economics, and that research on Scotland – if presented correctly – is of great interest to other European regional economists?\(^{19}\)

Recognizing trade-offs between policy options and building coalitions for action: The dilemmas to be faced here are complex, and involve issues such as efficiency (or growth) versus equity (or redistribution); sectoral diversification versus sectoral concentration; the optimal pace of change and renewal (shock versus gradualism); inward investment versus domestic “bootstrapping”, etc. In Ireland, debates on all these topics are pursued vigorously. Decisions are not always to the liking of economists, but can never ignore the implications of solid research. For example, during the 1960s there was a major public debate about whether inward investment ought to be concentrated into a few large cities, with a view to reaping agglomeration economies. But the efficiency benefits of growth poles were rejected at that time in favour of greater spatial equity (Bradley, 1996). More recently, the rise of urban

\(^{19}\) Irish economists learned at an early stage to market their work for international journals in terms of the analysis of a small, open economy (which is of universal interest), rather than in terms of Ireland (which is not)!
agglomerations about Dublin and Cork has revived this debate, as it becomes obvious that certain sectors (computers and software in Dublin and pharmaceuticals in Cork) only thrive in large urban areas.

**Building a healthy business-government relationship:** When this relationship is with locally-owned businesses, political tensions can easily arise. But in the case of Ireland, the crucial internal relationships are between government and the social partners (i.e., trades unions and employers’ organizations) on the one hand, and with foreign multinational firms, on the other. The Irish experience shows that, although such firms often have turnovers larger than the national GDP, the relationship can be mutually beneficial and these firms have a long record of providing long-term, secure and well-paid employment. In exchange, they expect that their requirements will be taken seriously, and lines of communication will work efficiently.

**Enhancing government-government co-operation:** Government-government co-operation in Ireland takes place almost entirely under the auspices of the EU, where Irish government Ministers and civil servants negotiate with other member states, and are part of external EU negotiations where their domestic interests are affected. With the exception of Structural Funds (which are coming to an end in Ireland), and the CAP price supports (which are applied to all EU member states), the Irish relationship with Brussels deals more about policy than directly about money. Scottish policy-makers have to deal with London in a very different context: one where major decisions on fiscal matters are decided over their heads. But the price for loss of fiscal autonomy is a guaranteed equitable share-out of UK tax revenues!

As I review the performance of successive Irish governments, these are the four key strategic issues that I monitor. We in Ireland are very conscious that the European Union is about to be enlarged by ten new states, and all but one (Poland) could be classified as small open economies. Some of these states have made rapid and successful transitions to liberal policy regimes, and will soon become remarkably attractive alternative locations for inward investment. The quality of Irish strategic thinking will be what distinguishes our future performance.

How is strategic thinking likely to evolve in Scotland? Will it continue to focus on its role within an encompassing UK-wide policy context, and try to extract the maximum benefits from this relationship through UK regional policy instruments? This might be termed an “easy” option, and is likely to guarantee a performance and a standard of living that is only modestly below that of the UK as a whole. Is that an acceptable goal for Scottish policy makers? Alternatively, will it take on and exploit greater local powers, and use them to diversify from the UK within a wider European policy context? My Celtic heart favours this option, but my economic head tells me that Scotland has barely begun to analyse why this might be a wise policy direction, and what would be the likely consequences.
References


