

**Globalisation, economic growth and recession: learning from the 1980s  
to understand the challenges to the contemporary Irish welfare state**

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## **Introduction**

Ireland has experienced yet another rapid change in its economic fortunes over the last eighteen months. Having occupied prime position as an open and globally integrated economy with outstanding growth rates for over a decade, in 2008 Ireland emerged as one of the first and one of the most severe cases of economic recession. The speed and depth of the contraction in the economy is coupled with a substantial government deficit and escalating unemployment at the present time. This paper attempts to map the current economic and social challenges and contrast these with the long and difficult economic recession experienced by Ireland during the 1980s. The main characteristics of the last recession are reviewed and particular attention will be given to the challenges confronting Ireland and the nature of the policy responses pursued. One of the main features of the subsequent recovery strategy was the objective of making Ireland more competitive and attractive for foreign direct investment (FDI) and this yielded substantial results over the course of the 1990s, leading to recognition of Ireland as one of the most open and globalised economies in the world. The success of this approach, as evidenced during the 1990s has now given way to assessments that Ireland has become a victim of that very success, demonstrating the vulnerabilities attached to this particular approach to economic growth. The paper examines the causes and manifestations of the current and previous economic recession and the policy responses in order to identify potential insights from previous experiences. Our analysis points to the contingent relationship between domestic and international forces, which expose vulnerabilities which are not solely a product of being an open and globally integrated economy but are substantially influenced by problems with domestic policy which intensify economic vulnerabilities during periods of international economic recession. These periods propel further rounds of integration with the world economy, which focus on international competitiveness without considering how domestic policy, particularly social policy, could potentially mitigate the vulnerabilities of an economy very exposed to globalisation instead of exacerbating them which seems to be the case in the past.

### **Ireland: from basket case, to emerald tiger and back again**

Over the course of the 1990s the spectacular success of the Irish economy was widely identified in glowing terms. Sweeney (1999) documents some of the immense praise heaped on the Irish economy; for example, *The Economist* (17<sup>th</sup> May 1997) headlined an article on 'Europe's Shining Light', in which it noted that 'Ireland's transformation has been so dazzling...one of the most remarkable economic transformations of recent times: from basket case to "emerald tiger" in ten years.' Murray Brown of *The Financial Times* (26<sup>th</sup> May 1995) wrote that 'Ireland has been one of the unsung success stories of the past few years. With a productivity record which would be the envy of the Germans, and a balance of payments surplus in line with Switzerland or Japan, Ireland consistently outperforms its partners in the European Union.'

Newsweek (23<sup>rd</sup> December 1996) referred to the ‘Emerald Tiger’ in which, ‘Ireland is booming. We are talking about German style inflation, Asian style growth. Translation: an emerald tiger is at large’ (Sweeney, 1999). This stands in stark contrast with the commentary offered on the position of Ireland in recent months. Krugman’s recent New York Times (April 20<sup>th</sup>, 2009) article entitled ‘Erin go broke’, and Gow’s description in the Guardian (January 1<sup>st</sup> 2009) of ‘Celtic Tiger turned Deflated Baboon’ provide some illustration of the current characterisations. A recent Economist (March 2009) headline read ‘Ireland’s economy: the party is definitely over’ and Time (Smith, 4/6/2009) magazine’s coverage of Ireland and the global slump noted how ‘the Celtic Tiger grew frisky with foreign firms. They’re leaving’. While perhaps not too much should be read into such dramatic headlines, they do illustrate the nature, depth and speed of Ireland’s present economic difficulties. These headlines and media assessments also serve to illuminate the cause for concern expressed about Ireland’s ‘reputational crisis’ (NESC, 2009), and the risks this may present to Ireland inc. which is discussed in the later sections of the paper. The severity of the economic challenges confronting Ireland is best demonstrated by first considering some key economic indicators of relevance.

**Table 1**  
**Ireland: key economic indicators 2009**

Economic growth	-9.2 per cent of GNP (forecast, ESRI)
Unemployment (May 2009)	11.8 per cent
Government deficit	12 per cent (forecast, ESRI)
Debt/GDP ratio	47 per cent (forecast, NTMA)
Personal income taxation (new levies came into effect Jan 09, revised May 09)	Standard rate 20 per cent Higher rate 41 per cent Income levies 2/4/6 per cent of income

Sources: ESRI, 2009; CSO, 2009; Department of Finance, 2009a; NTMA, 2009

Recent economic forecasts from the Economic and Social Research Institute (ESRI), Ireland’s main independent economic think tank, presents further cause for concern. The present contraction in the Irish economy may be in the region of -9.2 per cent of GNP in 2009, with a further 1.2 per cent fall expected in 2010 (ESRI, 2009). The government deficit is expected to be of the order of 12 per cent for 2009 and is forecast to fall to 11.5 per cent in 2010. The Irish Debt/GDP ratio remains below the Euro Area average although it is expected to rise sharply in the coming years (to 73 per cent by 2013), but it is forecast to stay below the EU average (NTMA, 2009). Finally, the possibility that unemployment may average 16.8 per cent in 2010, an increase of 114 per cent on 2008 (ESRI, 2009), presents the most vivid and worrying throwback to the economic recession experienced in the 1980s in Ireland. Some of the main features of the last recession of that period are illustrated in table 2 below.

**Table 2**  
**Ireland: key economic indicators 1980s**

Economic growth (1980-1985)	Average 1.8 per cent per annum
Unemployment	17 per cent
Debt/GDP ratio 1987	117 per cent
Standard of living 1987	GDP per capita 64 per cent of the EC average
Personal income taxation 1987	Standard rate 35 per cent Higher rate 65 per cent

Sources: NESI, 1986; Government of Ireland, 1987; Somers, 1992

**From economic development to a ‘globally integrated’ economy: the case of Ireland**

A key strand of our argument is that there are two central and combinational forces at work in a small, open and dependent economy such as Ireland. The importance of and interaction between domestic and international factors are pivotal to understanding the nature and impacts of economic recession, particularly as felt in countries that are reliant on international conditions, foreign direct investment and global markets for export led growth. There are a number of specific observations to be made about the nature of this recession and the previous one, including the fact that the origins of the crises develop much earlier than their obvious manifestations. In the case of the 1980s, policy decisions and events of the late 1970s had a direct and substantial bearing on the nature of the recession experienced in the 1980s. Domestic expansionary fiscal policies, particularly those pursued from 1977 to 1979 came to be seen as extremely damaging to the health of the public finances during the 1980s. This combined with the external shock from the oil crises, offered an earlier lesson about the potency of the mix of national and global factors to undermine and put an open and dependent economy under considerable strain. Similarly this time around, significant aspects of the current economic difficulty (such as the overreliance on the construction sector and an asset bubble burst) have their roots in developments and policy decisions (or lack of them) of the last decade. This has undoubtedly been compounded by the current global financial crisis. Nevertheless, it is clear that domestic factors play a crucial part, firstly, in maintaining appropriate conditions for economic growth and secondly, in managing the state of preparedness for and ability to react to the risks that arise, and are inherent to Ireland’s strategy for economic growth in both recessionary periods. In addition, as Ireland has grown attuned to its open and dependent nature, there is a tendency to focus more on globalisation (and its dangers and opportunities) that on the connections between the domestic and the global and the role of national policy are often underestimated. The Irish case illustrates the particular combination of domestic and international factors that heightens attention to economic globalisation and its consequences.

There are two opposing perspectives on the position of Ireland and globalisation. On the one hand there is the view, prominently held, that globalisation has been good for Ireland, that it has delivered opportunities for economic growth and that Ireland must position itself to maintain maximum advantage in the context of more globalised markets and intensifying competition. According to this perspective, competitiveness is key. As the former Taoiseach, Bertie Ahern (2003), put it, 'We have no option but to stay competitive. We cannot make the world as we want it to be. We have to take it as it is'. The implication that the state is severely constrained in what it can do has become a notable element of the discourse on globalisation, particularly as it applies to the direction and scope of economic and social policy in Ireland. The contemporary limits that globalisation impose are arguably the most recent manifestation of a longer-standing prioritisation of developing Ireland's attractiveness as a location to invest, which has intensified in terms of its impact on national social policy, since the late 1980s in particular as discussed below. The other view on globalisation is that it has not altered Ireland's status as a dependent economy. O'Hearn (2001: 200) for instance describes Ireland's position as an 'intermediating periphery' within the Atlantic economy, 'the point through which US products flowed into European markets and in which profits were accumulated and removed back to North America.' In O'Hearn's view this over-dependence limits Ireland's capacity to steer its own course in how it responds to globalisation. Kirby (2002) assesses the role of the state in the over reliance on FDI differently, noting that the state plays a key role in the pursuit of policies that produce such outcomes. Drawing on the concept of the 'competition state' (Cerny, 1997: 263) where the aim is 'getting the state to do both more and less at the same time', Kirby (2006: 116) notes that the move to a competition state 'marks a decisive shift in the nature of state regulation: from a regulation that sought to harness market forces for the welfare of society to one that seeks to impose competitive disciplines on society for the good of the market'. One might expect the merits of these respective positions to be open to more scrutiny as the global economic crisis and its impact on Ireland accentuates the need to develop viable policy responses. However, so far, the need to restore competitiveness, work harder and smarter etc. indicate a certain continuity in policy terms in which 'Ireland copes with globalisation by concentrating first and foremost on competing' (Dukelow, 2005: 127). There is no sign of this trend abating in the current policy for recovery, suggesting that in the case of Ireland 'in hard times the response is to try harder' (ibid.: 130). This is a theme we return to below after the background to the recession of the 1980s is briefly laid out.

### **The Irish economic recession of the 1980s in context**

The pursuit of a more open and expansionary economic model began in Ireland in the late 1950s, at the end of a dismal decade in which economic growth was substantially weaker than experienced elsewhere in Europe. The policy of economic protectionism was finally recognised as a failure and the consequences were evident in the stark unemployment and emigration figures of that time. A change in government policy in 1958 signalled a shift to a more open economy. As the key policy for Economic Development (Government of

Ireland, 1958, p.36) put it: 'we must be prepared to welcome foreign participation, financial and technical, in new industrial activities aimed at exports'. Foreign direct investment was attracted to Ireland on the basis of factors such as comparatively low wage costs, and substantial financial incentives, such as 'liberal grants for fixed assets and training' (Walsh, 2002:216), and a very competitive corporate tax regime<sup>1</sup>. Historically in terms of the policy of pursuing and attracting FDI 'Ireland was well ahead of the field' (Ruane and Görg, 1997: 20), and by 1973, for instance, one third of all manufacturing jobs were in multi-national companies (Ó Gráda, 1997). Investment from foreign companies grew from 2.3 per cent of gross output in 1960 to 15.9 per cent in 1973 (O'Malley, 1989 in Ó Riain and O'Connell, 2000). This approach to economic development, as Ginsburg (2001: 176) notes, marks Ireland as 'an early example of a state-orchestrated opening of the economy to the forces of globalisation.' The arrival of multi-nationals, while broadly welcomed for the economic opportunities they would provide, were only one element in the overall employment landscape in Ireland at that time. Indigenous industry struggled to keep pace with the growth in FDI and competition from imports made it difficult for existing industries. There were other distortions in the employment expansion of the 1970s too; the state was the major employer of the decade with five of every ten jobs created outside of agriculture being located in the public sector (Sexton, 1986). These frailties in the employment situation were compounded by other troubling economic indicators. Inflation (and greater wage demands) became a significant difficulty in Ireland over the course of the 1970s. The international scenario also became increasingly difficult with the oil crises and subsequent worldwide recession.

Internally, the general election of 1977 provided the largest overall majority secured by any political party in Ireland. Fianna Fáil was returned with 50.6 per cent of the total vote (Lee, 1989) and their manifesto is frequently referred to as an ambitious and expensive programme for government, which it transpired the country could ill afford. The abolition of the wealth tax (introduced in 1975) and the removal of domestic residential rates were amongst their pre-election promises delivered. In addition the low, standard and higher rates of personal income taxation were substantially lowered<sup>2</sup>. Notwithstanding the severe economic outlook, domestic demand and economic growth continued. By the end of the decade however cracks were beginning to appear in the Irish economy; PAYE workers protested over their dissatisfaction with the equity of the tax system, demands for wage increases were considered increasingly unsustainable, and the national debt was mounting. The public sector borrowing requirement rose from 13 per cent of GNP in 1976 to almost 17 per cent by 1979 (Hogan and Murphy, 2008), and there was greater borrowing need to come. In short, the domestic

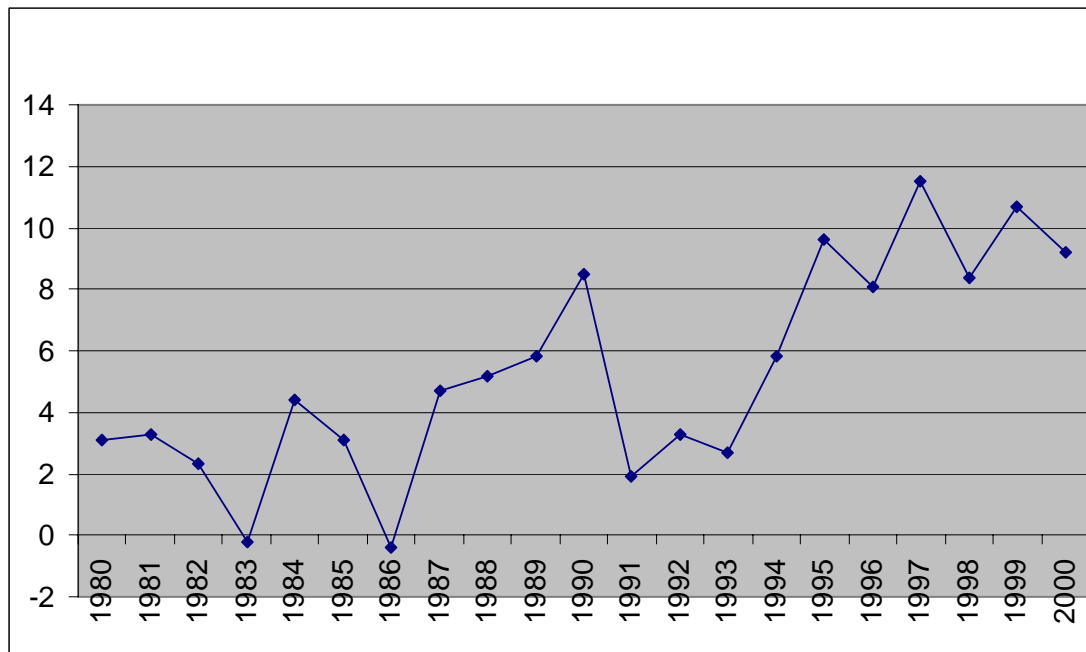
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<sup>1</sup> Either no or very low taxes were imposed until 1978, at which point a 10 per cent corporation tax for all foreign manufacturing was imposed from 1981 to 2000. This was extended to firms in the internationally traded services sector in 1981 and guaranteed until 2010. More recently a 12.5 percent corporate has been guaranteed until 2025.

<sup>2</sup> The lower rate was reduced from 26 to 20 per cent, the standard rate from 38.5 to 25 per cent and the higher rates were reduced from 49.5, 60.5, 71.5 and 77 to 35, 45, 50 and 60 per cent respectively (Hardiman, 2000, table 7).

management of the economy at that time was weak and left Ireland vulnerable to compounding damage from the worldwide recession of the early 1980s and it ultimately became the payback decade for the economic laxity of previous years.

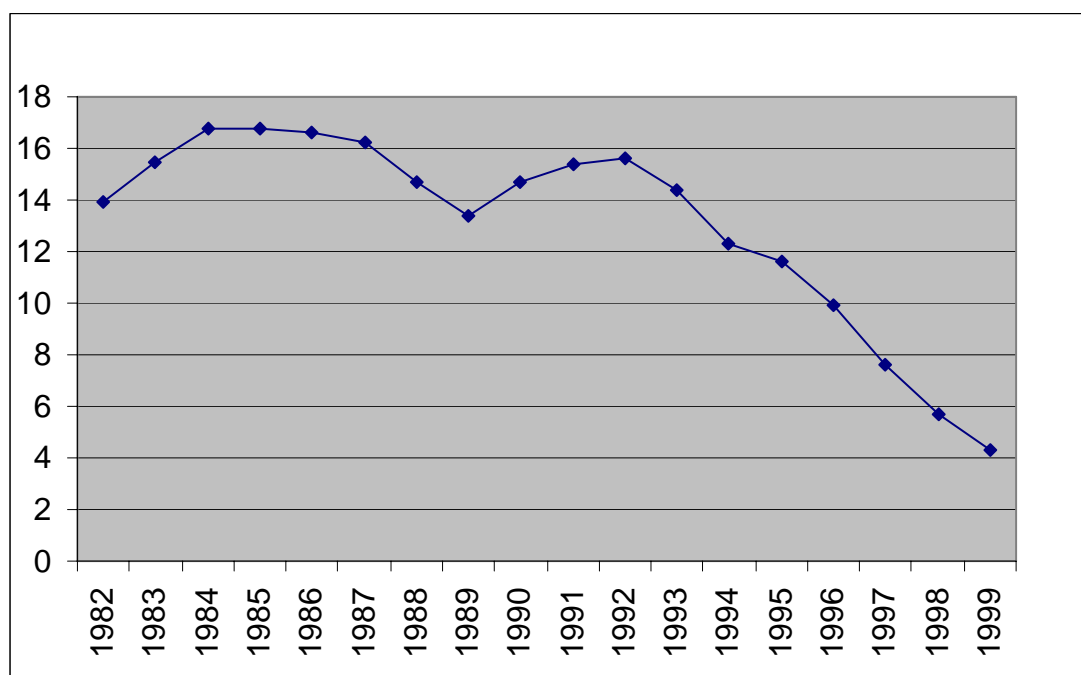
**Figure 1: Real GDP Growth 1980-2000**



Source: OECD

Economic conditions continued to deteriorate and the sluggish and uneven economic growth of the early 1980s (averaging 1.8 per cent for the period 1980-1985) indicated the scale of the challenge. One of the key reasons for the economic crisis experienced by Ireland in the 1980s was that borrowing was used as a bolster to government spending during the 1970s at a time when it should have done without. By 1986 government borrowing had reached crisis point with the external debt estimated to be of the order of £10,000 per person at work (Whitaker, 1986). As the debt level rose so too did the cost of servicing it, with four out of every five pounds collected in income tax needed to cover the interest on the national debt alone (Mac Sharry, 2000). In addition to the sharp declines in economic growth, the steady fall off in the numbers at work in agriculture, along with serious job losses in the manufacturing sector throughout the 1970s and 1980s outstripped the gains made in creating new employment. Unemployment grew sharply from 1981 onwards, and it remained stubbornly high for the entire decade, peaking at 17 per cent in 1986. Unemployment remained above 10 per cent for a full decade thereafter indicating the intractable nature of the unemployment challenge in the Irish context.

**Figure 2: Unemployment in Ireland 1982-2000**



Source: OECD

The demographic profile of the country during the 1980s compounded the situation. The fact that fertility rates remained high until 1980, long after the post-war baby boom had subsided elsewhere meant that there was a large cohort of young people and families for whom social services needed to be provided (Fahey and Fitz Gerald, 1997). In 1987 for example, there were 23 'dependants' for every 10 workers (Kennedy, 1998). This particular demographic profile imposed a heavy financial burden on the state, an impact felt more acutely in the context of persistently high unemployment and according demands on the health, education and social welfare systems. The number of recipients of unemployment payments, for instance, grew by 221.9 per cent between 1980 and 1985 (NESC, 1986). The lack of work also resulted in renewed emigration on a scale comparable with 1950s Ireland. The net outflow of emigrants totalled 130,000 for the years 1983-1988. Young people in particular left; 70.6 per cent of those who emigrated between 1981 and 1986 were aged 15-24 (NESC, 1991). The proportion of university graduates that emigrated during this period highlighted the scale of the problem; in 1988, for instance 26.1 per cent of graduates left the country (Ó Gráda, 1997). For those who remained, the pain was also felt. There was a 12 per cent fall in personal disposable income between 1979 and 1982 alone (Cooperation North in Lee, 1989). In short, mass emigration, mass unemployment and the most serious national debt in the history of the state meant that the prospects for Ireland were decidedly bleak.

## **The 1980s – responding to the crisis**

After a period of political instability, the government of 1982-1987 were in the unenviable position of having to stabilise and correct the public finances through higher taxation, at a time of massive inflation, growing unemployment and very weak economic activity which meant that in many ways the Irish economy 'seemed to be sinking under the stabilization effort' (Walsh, 2002, p.212). Not unlike today, it faced large scale manufacturing closures, some government takeovers (such as the largest motor insurance company in the country) and an escalating welfare bill. The personal income tax reductions introduced in 1977 were short-lived; rates increased again from 1979. In 1984 the lower band was removed, the standard rate was 35 per cent and there were higher rates of 45, 55, 60 and 65 per cent (Hardiman, 2000). This higher personal taxation and the introduction of a residential property tax, was used to off-set the rising demands on the social welfare system. Social welfare expenditure rose substantially, from 16.8 per cent of GDP to 21.8 per cent between 1980 and 1985 (OECD, 2008a). There was some tightening of conditions introduced to curb the rising costs such as the introduction of a 'genuinely seeking work requirement' for receipt of unemployment benefit. The provision of a Family Income Supplement in 1984 was designed to support families in low-income employment and from 1985 onwards a number of schemes were developed to provide work, encourage job-seeking and promote further education, marking the origins of activation policy in Ireland. However, the scale and depth of the unemployment problem meant that there was a shift towards greater reliance on assistance based payments and significant poverty problem. Almost 23 per cent of persons had incomes below 50 per cent of mean income in 1987 (Callan and Nolan, 1994 in Kirby, 2008).

The economic recovery hoped for in 1986 failed to materialise and by 1987, an unrelentingly poor economic outlook, with Ireland 'weeks away from the IMF taking over control' (Butler, 2001 in Baccaro and Lim, 2007: 28) indicated the scale of the crisis. The mood was grim but a number of domestic developments appear to have worked to offer a greater sense of shared purpose around the need for economic and fiscal reform. The commitment given by leaders of the opposition to work with the new (minority) government in the best interests of the country, the fear of neo-liberal politics (particularly within the trade union movement) which was in evidence elsewhere taking hold in Ireland and the emergence of social partnership stand as particular points of note.

The opening statement of the national agreement, the Programme for National Recovery (PNR) indicates the prevailing mood of the time. 'The Government, the [social partners], conscious of the grave state of our economic and social life, have agreed on this Programme to seek to regenerate our economy and improve the social equity of our society through their combined efforts' (Government of Ireland, 1987: 5). Reflecting on 'The Challenge of 1987', the new Minister for Finance Ray Mac Sharry (2000: 63) recalled that:

On the election of the government, the Taoiseach and I quickly agreed a common approach. We recognised we had to seize the initiative from the spending departments, and do so from the outset... We also knew, and fully accepted, that major financial surgery would have to be performed. Except this time, the operation would have to be carried out on the patient without the benefit of an anaesthetic.

The fiscal crisis was managed by way of severe austerity measures involving a reduction in public spending and cutbacks in the public services. A freeze on public sector recruitment was coupled with severe cutbacks in services. Over 6,000 public hospital beds were closed during the late 1980s and early 1990s (Curry, 2003). There was a sharp decline in the public housing output and this occurred alongside a tenant purchase scheme which further depleted the social housing stock. Total current expenditures dropped by approximately 10 per cent in real terms between 1987 and 1990 (Ó Riain and O'Connell, 2000). This amounted to a painful adjustment in government spending on the main social services, made all the more acute by virtue of the comparatively late expansion in welfare provision in the Irish context.

Macro-economic reform was another key component of the recovery strategy, with an emphasis on the need for consistency, continuity and credibility (NESC, 1986). These principles were highlighted because 'the general effects of an economic strategy based on these three principles are that the economy moves from a downward spiral of low investment, low growth, deterioration in the public finances to a virtuous circle with improvements in some areas giving rise to and augmenting improvements in others' (NESC, 1986: 311). Tax reform, including reductions in personal income tax rates, improvements in the procedures for tax collection amongst the self-employed, while widening the tax base was also recommended by the NESC.

The policy response sought to strengthen indigenous industry while also securing and promoting Ireland's attractiveness as a destination for FDI. There was a significant emphasis on manufacturing jobs in the PNR (Government of Ireland, 1987), which, again with the benefit of hindsight, has turned out not to be the most viable over the longer term. Attention was given too to particular areas of Irish economy such as agriculture, marine, forestry, the construction industry and tourism. The development of the Irish Financial Services Centre (IFSC) was also noted in the PNR, a centre that came to be seen as a symbol of Ireland's subsequent economic success. The PNR also states that greater social equity was 'a prime objective of Government policy' (ibid.: 13) and very brief indications of some policy priorities were outlined. Notable amongst these, particularly given the economic conditions that prevailed, was the government commitment to maintain the value of social security benefits as far as resources permitted, with special consideration for those in receipt of the lowest payments. This commitment was seen as a development that set Ireland apart from the more stringent New Right backlash to social welfare experienced elsewhere.

## **From recession to recovery**

The economic situation showed signs of improvement from 1988 onwards. Economic growth averaged 4.7 per cent per annum in the period 1987-1991 and this was notably higher than the EU average of 3 per cent (Bacon, 1997). In addition, employment in the non-agricultural economy rose by 14,000 per annum between 1987 and 1991 and in the private sector by 18,000 per annum over the same period (ibid.). The debt to GNP ratio started to fall as did interest rates. The economic recovery in the UK meant the appreciation of sterling which helped to make Irish wage levels more competitive. A tax amnesty returned a larger than expected revenue windfall to the government and a doubling of EU structural funding provided an opportunity to invest in some capital projects (Honohan, 1999). In fact in overall terms, EU funds are widely regarded as significant in the development of the Irish economy and these funds amounted to about 5 per cent of GDP at their peak during the early 1990s (Walsh, 2004). It took somewhat longer for the improved economic circumstances to filter down to the population at large. Emigration and persistent unemployment continued for the remainder of the 1980s and into the early 1990s. Unemployment dropped back to 13 per cent by 1990 thanks to a total increase in employment but also sustained emigration (Kennedy, 1993). It was clear therefore that in employment terms Ireland remained unable to provide adequate opportunities to those in need of them, although all of that changed with the remarkable growth in employment witnessed during the 'celtic tiger' years. By 2000, the unemployment rate in Ireland stood at less than 5 per cent, a position that was maintained until the recent recession began to take hold.

Social partnership is seen by some (e.g. O'Donnell, 1998; Mac Sharry and White, 2000), but certainly not by all (e.g. Allen, 2000; Kirby, 2002), as central to the creation and maintenance of more favourable domestic conditions for economic growth. The correction in the public finances and the relative industrial peace and wage restraint secured through the early pay agreements was viewed as central to the economic recovery of the 1990s. Wage restraint was secured by means of the significant tax reform which followed, and it became a key negotiating tool in subsequent social partnership agreements, although the long-term wisdom of this approach may, with the benefit of hindsight, be seen to have been flawed. In time, Ireland has become a 'low-tax' economy, with much less or arguably no scope to adopt a similar strategy this time around. The broader consequences of this we return to below.

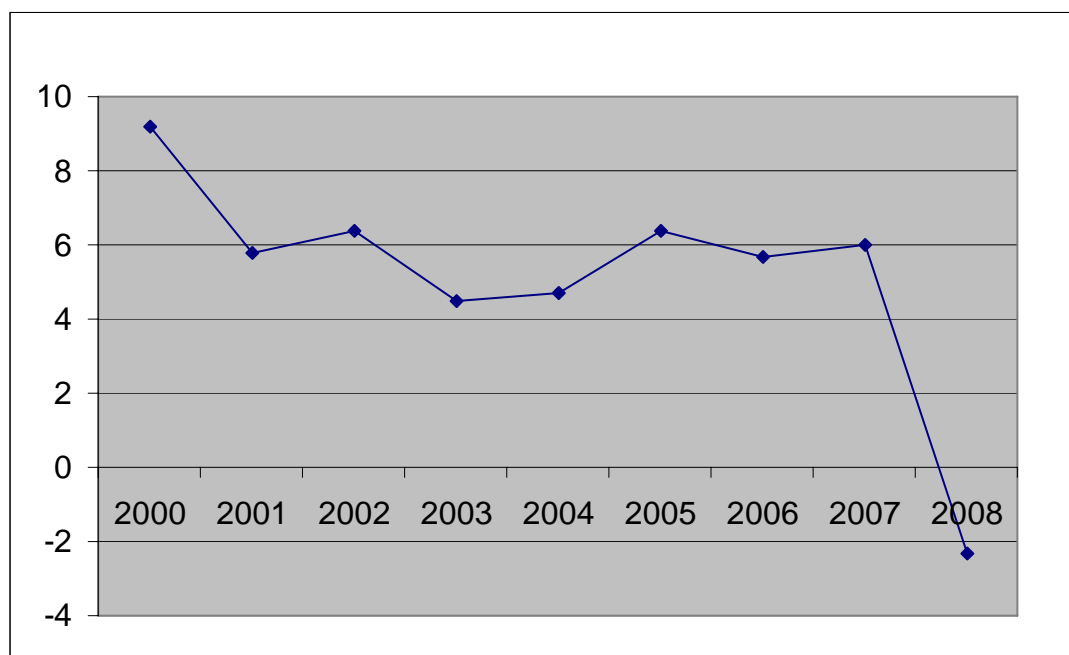
It has frequently been commented that by the late 1980s the domestic policies pursued were beginning to yield results and that this was helped by the fortuitous timing of events. Sweeney (1999: 82) for instance states that 'many elements came together to create a benign conjuncture to allow the Irish economic transformation to take root'. The discipline imposed on fiscal policy and macro-economic reform took place in time for the much more favourable trading conditions of the late 1980s. In addition, the success of the IDA in attracting firms 'at a relatively early stage in their (technological) lifecycle, immediately after the new product development stage' (Bradley, 2002, in

Kirby, 2008: 13) began to pay off. Irish exports were able to withstand the recession of the early 1990s experienced elsewhere. The key to this was to be found in the sustained demand for some of the main exports including computers, pharmaceuticals and chemicals (Sweeney, 1999), which were, at that time at least, 'recession-proof' (ibid.: 84). The scale of the inward investment flows grew dramatically over the course of the 1990s, up from 2.2 per cent of GDP in 1990 to up to 49.2 per cent in 2000 (World Bank, 2002 in Kirby, 2008). It is hardly surprising in this context that many commentators noted Ireland's position, both in terms of its success but also reliance on attracting FDI, and some pointed to the need to maintain and protect competitiveness in the adoption of this approach to economic growth. Krugman (1997) observed how, in the context of the 1990s 'Ireland is prospering from a phase of globalisation that turns out to be 'just right' for its geographical situation: distance matters much less than it used to, but by and large firms still want to serve the European market from a European location' (ibid.: 52), but he noted that advances in technology may change this. Krugman also saw the potential for greater competition from other European countries in the FDI market which 'could pose a threat to Ireland's special advantages' (ibid.). Sachs (1997: 57), in his assessment of Ireland, warned that 'FDI-led export growth requires a taut discipline in domestic economic policy in order to keep the country attractive as an investment site.' Concern about the intensification of competition for FDI has been evident for some time and was for instance, also noted by the NESF (1986: 117) at the height of the recession in the 1980s: 'Ireland's share of US foreign direct investment in Europe has recently been coming under pressure because of the increasing competition between European countries and, within countries, between regions and urban areas, for industrial projects.'

### **The Irish economic recession of the late 2000s in context**

The economic contraction Ireland is currently experiencing has quickly overtaken the scale of the 1980s recession and is unparalleled in its history both in terms of speed and depth. Compared to the 1980s for example, the drop in GDP which occurred between 2007 and 2008 was 7.8 percentage points, and it took five years, from 1978 to 1983 for a similar drop to occur in the 1980s recession (see figure 1). The speed with which forecasts were being revised over late 2008 and early 2009 was similarly rapid. In the 2009 budget, announced in October 2008, the Department of Finance forecast a decline in GDP of .75 per cent for 2009 (Department of Finance, 2008). By January 2009 the Department of Finance (2009b) revised this figure to an economic contraction of 4 per cent of GDP, while by April 2009, the ESRI (2009) forecast a decline of 8.3 per cent of GDP.

**Figure 3: GDP growth rate, Ireland 2000-2008**



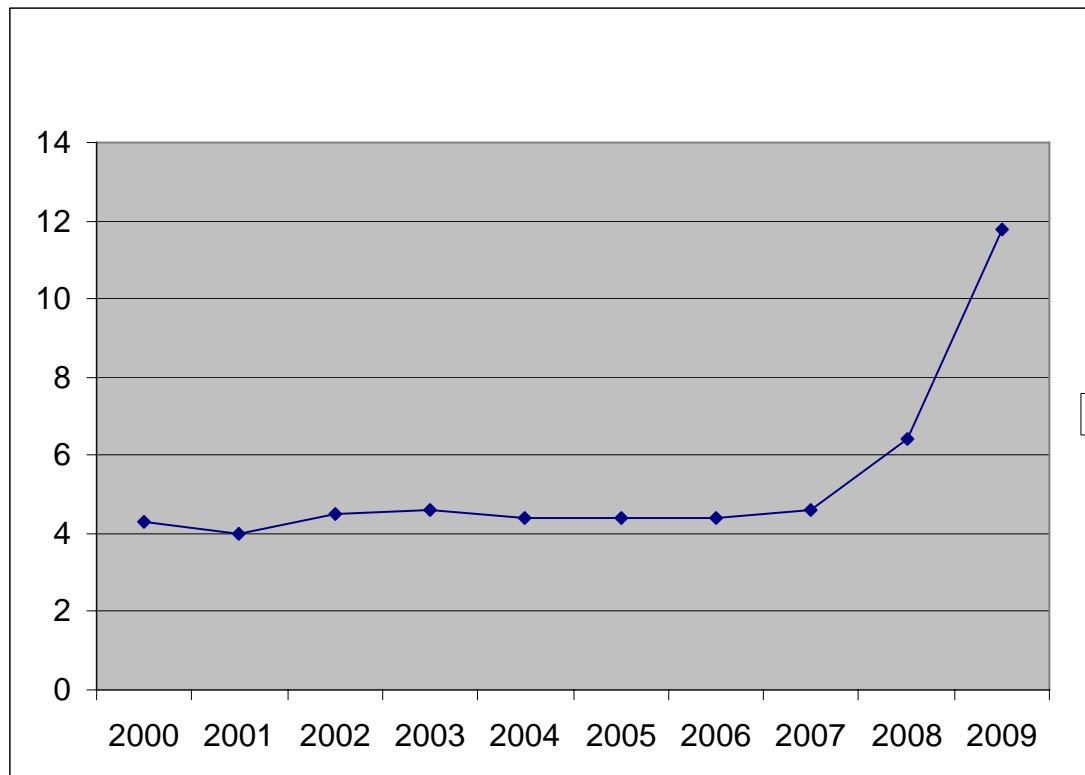
Sources: OECD, CSO

Forecasts of the exchequer deficit for 2009 were also in a state of constant revision over that period of time. The overall economic contraction plus the fact that much of this is construction related has meant that a decline in 'tax-rich activities' have contributed to a dramatic drop in tax revenue, which exceeds the extent of economic contraction. The fall in tax revenues were initially tied to property related taxation, principally capital gains tax and stamp duty, the pattern of decline has subsequently spread to corporation tax and consumption taxes. Again, looking to the initial budget for 2009, the Department of Finance predicted a general government deficit of 6.5 per cent of GDP (Department of Finance, 2008). By its April supplementary budget that figure was revised to a deficit of 10.75 per cent of GDP (Department of Finance, 2009a), while the ESRI (2009) estimates a general government deficit of 12 per cent of GDP.

The impact of the economic contraction on employment has been severe. The numbers employed began falling in 2008, when the overall number employed fell by 4.1 per cent, and the rate is set to worsen in 2009 with a further 8.9 per cent drop forecast by the ESRI (2009). To date the most dramatic drop has been in the construction sector. From 2007 to 2008 the sector has lost 45,900 jobs which accounts for 70 per cent of the loss of male employment (NESC, 2009). The unemployment rate has correspondingly grown at an unprecedented rate; in 2008 it grew to 6.1 per cent and by February 2009 at

10.4 per cent it entered 'double-digit territory for the first time since October 1997' (NESC, 2009: 14) (see figure 4 below). The ESRI (2009) predicts an unemployment rate of 13.2 per cent for 2009 as a whole and, 16.8 per cent for 2010, which brings us back to 1980s levels of unemployment, but at a much more rapid rate of decline this time.

**Figure 4: Unemployment in Ireland 2000-2009**



Sources: OECD, CSO

Given these indicators, Ireland has the distinction shared with Iceland, of having the most severe economic contraction over 2007-2008 in the OECD member states (OECD, 2008b). In September 2008 Ireland became the first economy in the euro area to enter into recession measured as two consecutive quarters of negative economic growth (Central Statistics Office, 2008a). Since Ireland entered recession, the Euro area as a whole is now also in recession. However by May 2009 Ireland's situation seems to be shifting from recession to depression, measured as a fall of GDP in excess of 10 per cent (Slattery, 2009). In historic and international terms, the current Irish situation is, as the ESRI (2009:32) comments 'a truly dramatic development'. Predicting an overall contraction of 14 per cent of GDP from 2008 to 2010, this would outpace Finland's 11 per cent decline in GDP in the early 1990s, which until now has been 'the largest decline for an industrialised country since the 1930s' (ibid.).

If we begin to look at the reasons why this is happening, many of patterns which unfolded during the 1980s recession can be again observed. To begin with, the roots of the problem occur much earlier, and primarily within the

national policy domain, stemming from inadequate action and intervention, and an overall tendency towards a pro-cyclical fiscal policy stance. This later exacerbates the consequences for Ireland of external shocks when they occur. Therefore economic recession is not just about the impact of outside forces on Ireland as a small open economy, but a combination of domestic policy with international factors, which in contrast to the 1990s when everything seemed to go 'right' at the same time, by the late 2000s everything went wrong at the same time. In substantive terms then, the economic contraction has occurred because a severe housing market correction has coincided with a sharp fall off in export activity. On its own the housing market correction would have impacted on economic growth, employment and government revenue, however the onset of the international economic crisis would appear to have accelerated the housing market correction and deepened its effects. In addition the international crisis has negatively impacted on exports and foreign direct investment meaning that this sector of the economy does not currently have the potential to compensate for the losses of the construction sector. A virtuous cycle of growth has transformed into a vicious cycle of decline.

### **Housing market correction and economic recession**

In something of a parallel with the US where problems with sub-prime mortgages led to the economic crisis, in Ireland housing and a market-led housing policy forms a substantial element of the Irish economic crisis. There are multiple elements to the nature of the housing market correction which have contributed to the recession. The origins of the booming housing market stem from the mid 1990s when house prices began to accelerate in unprecedented fashion. Initially increased demand was generated primarily by demographic factors, including an increase in the population of young adults at house formation stage, and the tendency to form smaller households (Redmond and Norris, 2005). Demand was in turn facilitated by increasing wealth as the benefits of economic growth in the 1990s took effect, and mortgages became easier to obtain due in part to lower interest rates, which were reduced in Ireland in preparation for joining the EMU (Fahey, Nolan and Maître, 2004). Housing policy which always favoured home ownership failed to regulate the housing market in a manner which would modify house prices. While some minor attempts were made to curb house price growth, these were overpowered by 'market ideologies [which] have become the dominant forces underlying recent policy evolution in Ireland' (Drudy and Punch, 2005: 41). Houses were essentially treated as commodities, and an important element of economic activity, while the state paid insufficient regard to issues of access, affordability and housing inequality.

Housing stock increased by 53.4% from 1991 to 2006. At its peak in 2006, 88,188 private residential units were built. The increase in housing stock meant that by 2007 Ireland had 434 housing units per 1,000 inhabitants, representing a substantial rise from 292 housing units per 1,000 inhabitants in 1990 (CSO, 2008b; Ministry of Infrastructure of the Italian Republic, 2006). Prices escalated despite the increase in supply. Nationally, new house prices

increased, on average by 250 per cent between 1996 and 2006, and by 333 per cent for second-hand houses. In Dublin over the same period, new house prices rose by 318 per cent, on average, and second-hand ones by 390 per cent (calculations based on Department of Environment housing data). As prices rose, houses and land became lucrative commodities and speculative demand drove prices even higher.

Construction and related domestic demand became a substantial element of growth in the Irish economy from the early 2000s. Due to an international downturn in the early 2000s, a dip in economic growth occurred and the contribution of exports to economic growth declined. The growth in exports fell to an average of 4.9 per cent for 2001-2006 compared with an average of 17.6 per cent growth between 1995 and 2000 (Kirby, 2008). However the dip was relatively short-lived and economic growth returned at a relatively high rate, with an average of 5.6 per cent per annum between 2001 and 2007. At the time the celtic tiger economy was appraised for being relatively robust and being able to hold up against the international downturn. However the continuance of high economic growth and rising living standards obscured the fact that these were now stemming from domestic demand rather than export trade. As NESC (2009:18) notes 'beneath the surface...the construction industry took over from the traded sector the role of driving the economy... the full implications of which did not - and could not have been expected to - register with most of the public at the time'. Over the course of the 2000s the economy became hugely reliant on construction. This also took the focus away from the fact that Ireland began to lose its competitive edge in terms of costs over the 2000s, as Ireland moved from being one of the least expensive countries to conduct business to one of the most expensive. Despite the exhortation of the necessity of competitiveness in policy and political discourse, Ireland recorded a 32 per cent loss in international price competitiveness since 2000 (National Competitiveness Council, 2008). Part of the problem with price inflation in Ireland stemmed from rising property costs during the construction boom, as well as inflation in the cost of utilities and domestically traded services.

At its peak, construction output accounted for 24.5 per cent of GNP in 2006 (NESC, 2009) and 13 per cent of total employment (CSO, 2008a). Construction related taxes also significantly boosted government revenue, principally through stamp duty and value added tax. In 2006 for example, revenue from stamp duty on property transactions yielded €3 billion for the exchequer, which was 3.5 times more than the amount of revenue derived from the same source in 2002 (€666 million) (ibid.). Property-related revenue streams allowed governments to continue to reduce income taxation rates into the 2000s, from a standard rate of 24 per cent and a 46 per cent higher rate at the start of the decade to eventual rates of 20 and 41 per cent respectively, while also increasing the income thresholds at which the rates apply. The shift from income tax to transactional taxes left exchequer extremely vulnerable to a drop in revenue triggered by a house price crash.

The Irish housing boom drew international attention and 'the level of Irish house building was as remarkable internationally as the growth rate of Irish

manufacturing exports had been in the late 1990s' (NESC, 2009:18). Both national and international commentators warned of a house price crash. As early as 2003 the IMF pointed to the risks of a house price bust (Caffrey, 2003) while the OECD (2006) frequently recommended action to curb housing demand and avoid the risk of overheating the housing market, through the introduction of a property tax (the one introduced in the 1980s being short lived) and the modification or abolition of mortgage interest relief. Prominent national commentators such as Alan Ahearne (2005, 2007) and Morgan Kelly (2007) both pointed to the potential for an Irish housing bust of a much greater scale than other housing busts which have occurred across the world since 1970. However such commentary was steadfastly ignored by the government, which consistently pointed out that the 'fundamentals' of the Irish housing market were different, based principally on the influence of a changed demography on demand for housing. Housing policy developments not only failed to curb house prices but stimulated the market in various ways, such as increasing mortgage interest relief and reducing stamp duty in order to assist first time house buyers get on the 'property ladder'. Recently the OECD (2008c:5) has commented that 'the Irish housing tax system is among the most favourable in the OECD'. As house prices faltered in 2007, these were interpreted by the government as signs of a soft landing with the expectation that house prices and house completions would return to a 'normal' and 'sustainable' pattern.

The emerging scale of the housing market correction is evident in indicators such as house completions and house prices. From high of over 88,000 private residential house completions in 2006, 17,500 completions are forecast for 2009 (ESRI, 2009). Regarding house prices, the decline from the peak of the market to the present varies from index to index because of the different methods used to calculate house prices. Thus the level of decline varies from -9.1 (new houses) according to the Department of Environment index to -30.2 per cent according to the Sherry Fitzgerald index (ibid.). Regardless of which index is used, 'the pattern of monthly declines shows no evidence of an easing in the pace of decline' (ibid: 17).

### **The property asset bubble, banking crisis and 'reputational crisis'**

Essentially an asset bubble formed which became 'the steepest and longest of the several national property bubbles around the world in the late 1990s and early 2000s' (Honohan, 2009 in NESC, 2009:21). The inter-relationship between national and international factors leading to economic recession begins to take shape when the fact that Ireland's property bubble was facilitated in part by the availability of money on the international finance markets at low interest rates is taken into account. As the NESC (2009: 19) note '...banks and other mortgage providers in Ireland began, effectively, to 'import' funds on a large scale ... in order to provide mortgages to house buyers and loans to builders and developers'. Inflation within the housing market from about 2003 onwards can be attributed to Irish financial institutions large scale borrowing from this source (Honohan, 2009 in ibid.). However the risks of this practice were not exposed until late 2008 when the international credit crunch unfolded. Unlike many other countries, Ireland's

banking crisis stems not from exposure to international bad debts originating in the sub-prime lending crisis in the US, but from its exposure to Irish property debts on foot of the housing market correction. The full implications of the banking crisis are still only emerging and are discussed below.

The banking crisis is in turn related to what has become known as Ireland's 'reputational crisis'. In the 1980s Ireland had little of a reputation to preserve, throughout the decades of independence it maintained a status as a 'Catholic backwater of Europe' (Breen et al. 1990) or as the 'poorest of the rich' (Economist, 1988). In the 1990s as the success of its global integration and economic growth seemed to become more embedded Ireland became a significant site of inward investment in terms of global financial services and Irish financial institutions moved up the ladder in terms of credit ratings. However much of this seems built on a 'light approach to regulation', which was presented as one of Ireland's competitive advantages and designed to attract foreign investment to the Irish Financial Services Centre in Dublin in particular. Charlie McCreevy, the Minister for Finance from 1997 – 2003, who subsequently became the European Commissioner for Internal Market and Services, is noted for his espousal of minimal government and maximum freedom to do business. For example in a speech he delivered to the Irish Financial Services Regulatory Authority (now the Financial Regulator), he suggested that

'many of us in this room are from generations that had the luck to grow up before governments got working and lawyers got rich on regulating our lives. We were part of the "unregulated generation" ...My appeal to you today is when regulating to give due weight to the need to strike the right balance between prudential and investor protection considerations and the need for competitiveness and innovation in financial services' (McCreevy, 2005).

As recently as December 2008, prior to the full realisation of the Irish reputational crisis, Ireland's reputation for imposing a light regulatory burden on business was being promoted as a source of competitive strength. In *Building Ireland's Smart Economy A Framework for Sustainable Economic Renewal*, one of the characteristics ascribed to a smart economy which Ireland aspires to become is listed as 'light and adaptive regulation', also referred to as a 'smart approach to business regulation (Government of Ireland, 2008:34, 42), which essentially is recognised as a pre-existing strength to be further secured. In light of the problems regarding loans given to property developers and builders by Irish banks, this 'hands off' regulation approach has contributed to significant problems. As NESC (2009: 22) comments:

'it is... clear that the regulation and supervision of Irish financial institutions was ineffectual. A strong preference to operate in a principles-based rather than rules-based regulatory regime was abused by the senior managers of at least one major institution and may explain why significant instruments available to the Irish Financial Services Regulatory Authority – such as its ability to insist on prudent loan-to-income or loan-to-property ratios, higher

risk weightings for property lending, higher capital ratios, more diversified loan books and key personnel being 'fit and proper persons' – were not used'.

Another dimension of Ireland's reputational crisis relates to the government's ability to borrow money on the international money markets. In a return to the scenario of the 1980s, Ireland has had to resort to the practice of large scale borrowing in order to compensate for the government deficit. However doubts about Ireland's ability to repay its debt and its risk of bankruptcy, gained ground very quickly in early 2009 given the speed of its fiscal deterioration and the plummeting reputation of the solvency its banking system. Consequently the interest rates that apply to Irish bonds are the highest in Europe and the premium attached to Irish credit default swaps which insure against payment defaults on bonds are similarly high. Mirroring the 1980s again, but unfolding much more rapidly, Ireland finds itself caught in a bind of having to fund approximately 25 per cent of its current expenditure for 2009 with borrowed money, while the interest payments on these borrowings amount to approximately one third of the revenue derived from income tax receipts (Lenihan, 2009).

Unlike the 1980s when mentions of needing IMF assistance were more circumspect, the notion of having to resort to a bailout by the IMF has become widely discussed. The first mention of needing IMF assistance surfaced in the media in January 2009 but was swiftly denied by the Taoiseach Brian Cowen. However commentary subsequently proliferated on the precarious nature of Ireland's reliance on international borrowing (Kelly, 2009), and the severity of the consequences of having to borrow money from the IMF (Ahearne cited in Holland, 2009). For example, Alan Ahearne (who has subsequently become an advisor to the Minister for Finance), warned in an address to a Labour Party conference that 'if we are not agile enough we are going to need external assistance, from the IMF. ... We are climbing an extremely steep cliff and if we fall from it we will be washed out to sea' (Ahearne cited in Holland, 2009). By February statements by the Minister for Finance began to reflect the urgency of Ireland's situation and the need to restore Ireland's reputation as a viable economy amongst international investors:

'it is no exaggeration to say that this country is now fighting for its economic future. Unless we demonstrate the will to restore stability to our public finances, there will be no economic recovery. The world is looking on. We need to persuade the international markets that we are capable of taking the tough decisions now to get our house in order. If we cannot do that, we are in danger of losing all the gains we have made over the last twenty years' (Lenihan, 2009).

What has followed is a process of ongoing fiscal retrenchment, presented as Ireland's only route to stabilising the economy, and in which welfare retrenchment is considered inevitable. In contrast to other Euro area countries which are beginning to introduce various fiscal stimulus packages, so far Ireland shares its notable turn towards fiscal retrenchment with only two

other OECD countries, namely Hungary and Iceland, both of whom have been recipients of IMF loans (OECD, 2009)

### **Fiscal retrenchment and its impact on welfare**

The budget for 2009 announced in October 2008 heralded some minor changes to taxation and social policy, based on what have turned out to be very inaccurate forecasts about the state of the economy. By May 2009 two further emergency series of changes have been implemented in attempt to stabilise government revenues that were falling by the month and to convince international markets of the country's economic viability. The first of these, announced in February effectively introduced public sector pay cuts (but called a pension levy) which on average amount to 7.5 per cent of pay. This was part of a package of measures designed to generate €2 billion worth of revenue, with public sector pay cuts constituting the greater share. This intervention effectively ended the model of social partnership agreements in place since 1987. The measure was implemented without the support of trade unions and while social partnership has not formally ended no agreement between the partners on dealing with the economic crisis has emerged despite sporadic talks. Given the cost of rising unemployment on social welfare, the February changes had little effect on closing the gap between government income and expenditure, and in April a more far-reaching set of changes was announced in a supplementary budget. These changes mark the beginning of a longer programme of expenditure cuts and taxation increases designed to reduce the budget deficit to 3.5 per cent by 2013 in line with the EU stability and growth pact requirements. Income tax has been increased by doubling the rates of the income levy introduced in the original budget for 2009, and by doubling existing health levies. Mirroring the fall in incomes over the late 1970s and early 1980s, these budget changes are estimated to reduce incomes of those in work by between 4 and 6 per cent (Callan, Keane and Walsh, 2009). New forms of taxation are anticipated later in the year pending the recommendations of a Commission on Taxation, and these are likely to include a property tax and a carbon tax.

Regarding social welfare, the system has been increasingly characterised as 'generous' in political discourse, paving the way perhaps for a programme of more far-reaching welfare retrenchment. As already noted, major welfare reform and retrenchment did not take place in the 1980s and the social welfare system did not suffer a major backlash. Traditionally characterised as a liberal system, with heavy reliance on means testing, greater resources available in the 1990s until the mid-2000s were used to address some of the poverty traps and unemployment traps in the system. In addition, as the burden of unemployment on the system eased, greater resources were targeted at groups such as children through increases in Child Benefit which is a universal payment and the introduction in 2006 of another universal payment, the Early Childcare Supplement, originally payable for each child until they reach six years old. Yet contrary to the notion of generosity within the welfare system, despite these changes Ireland's expenditure on social

protection as a percentage of GDP remains well below the EU average. In 2006 for example, Ireland spent 18.2 per cent of GDP on social protection in contrast to a figure of 26.9 percent for the European Union as a whole (EU27) (Puglia, 2009). In addition significant reductions in relative poverty have not been achieved since the 1980s, while the child poverty rate is particularly high, both of which are reflective of the system's lack of redistributive effort (Nolan and Maître, 2007) and a level of social development that is left trailing economic development in terms of priorities and outcomes.

Social welfare changes either implemented or imminent point to a curtailment of universal benefits and a return to a more targeted system. For example the Early Childcare Supplement is to be abolished and replaced with one free year of pre-school, while Child Benefit will be either means-tested or taxed from 2010. In addition social welfare rates have been cut somewhat indirectly by removing the extra week paid at Christmas time while the Minister for Finance also referred to having 'to review rates of payments in future years if reductions in the cost of living materialise' (Department of Finance, 2009a). The condition of the 1980s are returning across the social services as more stringent budgetary conditions have been imposed in areas such as education and health, and a ban on recruitment on recruitment and promotion has also been imposed across the public sector.

Future fiscal retrenchment as well as forecasts regarding the general government deficit are overshadowed by the as of yet unknown impact of the banking crisis on the public finances. The April 2009 supplementary budget announced the creation of a 'bad bank', to be called the National Asset Management Agency (NAMA), which will buy toxic property assets from Irish financial institutions in an attempt to address the banking crisis and the related reputational crisis. As of yet, the prices at which NAMA will buy these assets have not been settled, but regardless of what the costs will eventually be, as the ESRI (2009:24) comments, 'it is clear that this will increase the level of government debt substantially for many years', suggesting that while the speed with which Ireland entered recession this time around was much quicker than the 1980s, recovery may take far longer and levels of retrenchment may be more far reaching.

## **Conclusion**

'...we must regain the competitiveness we have lost through over-reliance on domestic spending during the boom. The future of our economy lies in exports. We must work harder to gain market share. We must drive down our costs and improve the quality of our products so that we are well placed again when the tide changes' (Department of Finance, 2009a)

This remark, made by the Minister for Finance during the April 2009 supplementary budget encapsulates the challenges and dilemmas facing Ireland at the present time. It is evident that Ireland's economic future is predicated on the 'tide turning' in the global economy, while the Irish economy

prepares for this moment by racing downwards by regaining cost competitiveness whilst also racing upwards in terms of working harder and smarter, as reflected in the previously mentioned white paper *Building Ireland's Smart Economy A Framework for Sustainable Economic Renewal* (Government of Ireland, 2008). It is also evident that this reaction is driven by a repetitive form of market based thinking: essentially we need to re-discipline ourselves to the rules of global markets given the in-discipline that developed in domestic policies. In the rush to get back in the global game, little space is left to deliberate the role the relationship between the domestic and the global. This is important not only for looking at how in the past this has exacerbated our vulnerability to external shocks as this paper has attempted to do, but also perhaps looking at alternative ways as to how domestic policy, particularly social policy, can be used to protect against and mitigate the inevitability of negative economic trends outside the country's control if it is taken as given that the way of the future is global economic integration.

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