Markets Created a Pot of Gold in Ireland

by Benjamin Powell

Benjamin Powell is a Social Change Fellow at the Mercatus Center in Arlington, Va. He has a forthcoming article "Economic Freedom and Growth: The Case of the Celtic Tiger" in the Winter 2003 Cato Journal, published by the Cato Institute.

Over the last 10 years Ireland has catapulted from Europe's economic backwater to the forefront of European economies. More recently Ireland's economic growth has slowed. Although many observers attempt to attribute Ireland's success to funds transfers from the European Union, more careful observation shows that Ireland's success should be attributed to an increasing reliance on free markets.

In 1987 the Irish Republic's per capita income hovered at 63 percent of the United Kingdom's. From 1990 to 1995 Ireland's economy grew at more than 5 percent per year and from 1996 to 2000 it raced at more than 9 percent a year. Today, Ireland's $25,500 per capita income bests the United Kingdom's per capita average by $3,200.

The country's astounding 10-year economic history has led some to dub Ireland the Celtic Tiger. Understanding the causes of Ireland's success can help Ireland avoid policy mistakes during its current slower growth that would undermine its future potential.

After a stagnant 13-year period with less than 2 percent growth, Ireland took a more radical course of slashing expenditures, abolishing agencies and toppling tax rates and regulations. At the same time, the government made credible commitments not to engage in deficit spending or inflate the currency.

Ireland's long history of free and open trade has also played a role in its recovery. However, only since freeing other aspects of its economy by lowering taxes, decreasing regulation, maintaining low inflation, and providing a stable fiscal environment has Ireland been able to grow rapidly enough to surpass greater Europe's standard of living.

Ireland's progress is reflected in *The 2002 Index of Economic Freedom* published by the *Wall Street Journa*l and The Heritage Foundation, which ranked Ireland the world's 4th freest economy.

Many outside observers attribute Ireland's success in improving its standard of living over the last 15 years to subsidies from the EU. In fact, though, EU subsidies do nothing but hinder consumer-satisfying economic development.

Agricultural subsidies are one component of EU transfers and are an example of how well-meaning transfers can get in the way of economic development. The subsidies boost rural incomes, but they retard economic adjustment by keeping rural populations artificially high. Some of these workers could produce more valuable products by moving to the cities. As long as people are subsidized to stay in particular professions, Ireland will not fully exploit its comparative advantage in the international division of labor. This depresses incomes and slows growth.

The presence of EU funds retards growth in another way as well. Although the total supply of entrepreneurs varies among societies, the productive contribution of the society's entrepreneurial activities varies much more because of their allocation between productive activities, such as innovation, and unproductive activities, such as lobbying for government subsidies or privileges. The presence of EU funds creates a pot of gold for Irish entrepreneurs to seek. This will cause some entrepreneurs, who were previously engaging in productive and innovative activity, to lobby for subsides instead. This lobbying wastes both physical and human resources that could have been used to satisfy consumer demands and increase economic growth.

Not surprisingly, when comparing EU transfers and economic growth rates, we find no positive relationship.

If the subsidies were a major cause for Ireland's growth, we would expect Ireland's growth to be highest when it was receiving the greatest transfers. But growth rates and net transfers as a percent of GDP have actually moved in opposite directions during Ireland's higher growth rates in the 1990s though.

Ireland began receiving subsidies after joining the European community in 1973. Net receipts from the EU averaged 3 percent of GDP during the period of rapid growth (1995-2000), but during the low growth period (1973-1986) they averaged 4 percent of GDP.

In absolute terms, net receipts were at about the same level in 2001 as they were in 1985. Throughout the 1990s Ireland's payments to the EU budget steadily increased from 359 million Euro in 1990, to 1,527 million Euro in 2000. Yet, in 2000, the receipts in from the EU were 2,488 million Euro, less than the 1991 level of 2,798 million Euro.

Ireland's growth rates have increased while net funds from the EU remained relatively constant and have shrunk in proportion to the size of Ireland's economy.

If the subsides were really the cause of economic development in Ireland, we would also expect other poor countries in the EU, which receive subsidies, to have high rates of economic growth. EU Structural and Cohesion Funds represented 4 percent of Greek, 2.3 percent of Spanish, and 3.8 percent of Portuguese GDP. None of these countries achieved anywhere near the rate of growth the Irish economy experienced. Spain averaged 2.5 percent GDP growth, while Portugal averaged 2.6 and Greece averaged only 2.2 percent growth from 1990-2000.

The remarkable success Ireland has experienced in improving its economic performance over the past 15 years is due to market-based forces. Although EU subsidies have been present, they have not been the driving force and may actually be holding Ireland back from growing faster. A policy environment that promotes economic freedom, enabling private entrepreneurs to promote economic development was the key to creating the Celtic Tiger.

Although these policies have been remarkably successful, they cannot prevent normal fluctuations in the economy. The correct institutional environment fosters long term economic development. In the short run, normal business cycles will still occur. It is not surprising that as the US has dipped into a recession, Ireland, a major trading partner with the US, has experienced slower growth and increased jobless claims.

The greatest danger for Ireland is that the short-run fluctuation will cause them to undermine the very policies and environment that created the 'Celtic Tiger' in the first place.

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