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Book Review

EOIN O'LEARY, *Irish Economic Development: High-Performing EU State or Serial Underachiever.*
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Sean Lemass, by some accounts, was so frenetic as a minister because he thought the entire economy would grind to a standstill in his absence. "In the pre-occupation with politics", James Meenan wrote in his classic 1970 book, *The Irish Economy Since 1922*, "… other factors such as thrift, self-reliance and enterprise were disregarded. The feeling grew that everything depended on what was done, or not done, by the state". Kieran Kennedy would later reflect that "… the tendency to look solely to government to solve all economic ills was not conducive to individual and local community initiatives".[1]

Eoin O'Leary, Senior Lecturer in Economics at University College Cork (UCC), posits that economic development is driven primarily by business development. Government policy is still important in this account of course, though – reversing the balance in Honohan and Walsh's 2002 *Brookings Paper* on the Celtic Tiger – the emphasis here is on industrial policy, innovation policy and business competitiveness, with relatively little attention to macro-economics. O'Leary's time span covers the entire period from 1970, though economic development is interpreted quite narrowly. While it must be funded by business development, the two cannot be equated because there are much broader social aspects, such as poverty and equity, to economic development.

The first half of the book is largely about issues of measurement and identification: the identification of Ireland's leading economic sectors, the factors that have led to them attaining this pre-eminent position, and the contribution each makes to Irish economic development. The second half steps

[1] Both of these quotations are from the book under review.

back to ask how we are to understand – and to rectify – the problems in Irish decision making and policymaking processes. These problems are seen as so myriad that the answer to the question in the sub-title of the book – high-performing EU state or serial under-achiever – is the more pessimistic one. I deal with these two main sections of the book in turn.

The difficulty with industry analysis in the Irish case is the opaqueness of the output data because of the FDI-intensity of the economy. The intra-firm trade of multinational corporations is recorded at *transfer prices*, which are supposed to reflect arms' length prices but may not do so. As Desai, Foley and Hines (2006) point out, "OECD governments require firms to use transfer prices that would be paid by unrelated parties, but enforcement is difficult, particularly when pricing issues concern differentiated or proprietary items such as patent rights. Given the looseness of the resulting legal restrictions, it is entirely possible for firms to adjust transfer prices in a tax-sensitive fashion without violating any laws". This contaminates measured productivity. The early chapters spend a good deal of time and energy trying to come up with measures to correct for this. In the end, the careful work done at the aggregate level does not come out with a measure very different from that achieved by using the conventional short-cut of replacing GDP by GNP.

I would have preferred a longer discussion – beginning from first principles – of the various methods proposed to tackle this problem. He dismisses the National Competitiveness Council's (NCC) suggestion that US productivity levels be substituted for Irish in the industries dominated by US MNCs. It would have been interesting to see a comparison of the outcomes generated by this and other methods and the author's own. The author sows the seeds of confusion by defining transfer pricing as "… the practice of foreign-assisted subsidiaries overstating the value of their output and/or understating the cost of their inputs in order to artificially locate inflated profits in the Irish jurisdiction" (page 33). Since the full resources of the US Internal Revenue Service cannot estimate the extent of transfer *mis*pricing (if they could, they would eliminate it), I am wary of attempts to correct for this. Even using EU-wide profit rates as some measure of normal profits to be applied as an adjustment in the Irish case is fraught because the aggressive tax-planning practices of MNCs can impact on their recorded profit rates across all locations.[2] I think the best that can be hoped for is a measure of Irish productivity net of profit outflows (i.e., the conventional short cut).

[2] The UK House of Commons investigation, for example, found that Google structures its operations so that very little profit is booked in the UK. It does this by selling the product directly from Ireland with the UK operation providing services to UK customers and being reimbursed on a cost basis by the Irish subsidiary (House of Commons Committee of Public Accounts, 2013).

O'Leary's adjustments at the sectoral level involve stronger assumptions than are made at the aggregate level. In calculating productivity for Industry and for Market Services he allocates profit outflows to these sectors in proportion to the shares of value added in the broad sub-sectors dominated by foreign MNCs.[3] There are other ways of doing this besides the NCC approach. Honohan and Walsh for example re-price the output of foreign-dominated sub-sectors at "shadow" prices chosen to make the re-estimated apparent labour productivity equal to the mean for corresponding sectors in other European countries. The images that emerge from O'Leary's analysis do not overturn the conclusion that the productivity performance of Irish industry over the period since around 1990 has been impressive by international standards.

Chapter 3, entitled "Evaluating Standard Explanations for the Celtic Tiger", is largely critical of the "delayed convergence" hypothesis espoused by Honohan and Walsh – the notion that a succession of bad policies held the country back and that convergence followed naturally when these policies were rectified. The chapter comes down on the side of export-led growth, which was associated with the completion of the Single European Market. My perception is that this perspective has gained more adherents in the years since 2002. The conclusion that sustainable Irish growth is driven by the performance of the economy's export base then leads to a focus on identifying the main internationally-competitive sectors.

To sidestep the difficulties associated with using output data, Chapter 4 identifies the main internationally-competitive sectors through the use of employment specialisation ratios, with clearly non-traded sectors excluded. This is preferable to the use of export-specialisation ratios as in the standard measures of revealed comparative advantage. The sectors identified are food processing, ICT, pharma, tourism and finance. It is interesting that even using these methods three of the sectors are dominated by foreign concerns. It is also worrying if one is of the opinion, as O'Leary seems to be, that Ireland's corporation tax regime is not sustainable over the longer term.

The following chapter, Chapter 5, is located at the heart of the book. Here Porter's perspective is brought to bear on the competitive strengths and weaknesses of these leading sectors. Porter attributes a nation's capacity to innovate to four broad sets of conditions: the factors of production available, prevailing demand conditions (by which is meant the encouragement given to businesses to innovate to meet customer needs), prevailing industrial clusters, and "firm strategy, structure and rivalry". Overseeing the whole process of course are the various arms of government.

[3] Another way of doing the sectoral allocation might be to make use of the sectoral corporation tax payments reported in Table 2 of Pigott and Walsh (2014).

The only well-known previous use of this framework in the Irish case was by the National Economic and Social Council, which, as the author notes, "… curiously excluded consideration of the role of foreign-assisted businesses". Porter himself had originally advocated such exclusion but given what is known of the spillovers from foreign industry in Ireland, this means ruling out *a priori* an area of potentially substantial importance. Chapter 5 emerges as relatively underdeveloped however. It is largely a review of existing literature. Ireland's leading indigenous food-producing businesses are identified as Kerry Group, Glanbia, ABP Food Group, the Irish Dairy Board and Greencore. We are given little detail, however, of how these firms emerged and evolved and what their key innovations were. Similarly with respect to the foreign-dominated sectors, it would have been interesting if the main competitor locations – and their offers – could have been identified. The chapter is valuable however in setting out a research agenda for the future.

The last chapter in this first segment of the book – "Innovation by Invitation" – could also be developed further. I agree that "… the Irish policy of innovation by invitation has been largely focussed on Ireland remaining an attractive location for FDI", and that the "… science-push model of innovation… is not likely to be well-suited to the needs of sectors such as food processing and tourism". These conclusions are supported by the recent findings of Ramirez, Love and Vahter (2013) who point to the high costs and long-term payback time of the university-industry partnerships involved and the distance between the complexity of the knowledge base of the projects and the absorptive capacity of existing indigenous enterprises.

These is scant analysis of the overall national innovation system however (a term introduced into the Irish policy conversation in a 1992 NESC report by Mjøset). The innovation system includes venture capital provision, angel-investor presence and so on, which are absent from the present analysis.[4] There is also no mention of the recent shift in Science Foundation Ireland's focus from basic to applied research.[5]

The second segment of the book, which looks at the problems in Irish policy-making processes, begins with an interesting chapter on decision making in micro states. Some of this same ground was covered by UCC historians Andy Bielenberg and Raymond Ryan in their 2013 *Economic History of Ireland since*

[4] The Silicon Valley model has been described as an ecosystem consisting of two elements: an economy of established firms, universities, research laboratories, etc., which produces output and innovations, and an institutional infrastructure, with venture capital at its core, which enables the creation and growth of new start-up firms (Kenney, 2004).

[5] This was based on warnings issued by the 2009 Special Group on Public Service Numbers and Expenditure Programmes which called attention to "… the substantial amounts invested to date" and "… the lack of verifiable economic benefits resulting from these investments" (Section D7). It was also concerned that it took 200 employees and €16 million a year in the seven Universities solely to administer research funding (Section D5).

Independence. The benefits of small size include speed and flexibility. Visiting MNC executives clearly appreciate the access to government ministers that the importance of their projects to the national economy yields them. In terms of downsides, small and cohesive elites might be especially vulnerable to corruption and regulatory capture. (Greece may be *sui generis*, but do Iceland, Ireland, Cyprus and Latvia fit a pattern?) The argument is interesting and deserving of further consideration.

The micro-states argument focuses attention on the destructive role of special interest groups. The fact that the legal profession is probably the only group in Ireland to have emerged unscathed from the Troika years does not receive much attention. The observation that social learning on the part of the trade unions from the turmoil of the late 1980s was relatively short-lived may be a little unfair. The industrial peace to be seen over the period of austerity seems to me to have been unprecedented, which brings to mind the observation of Paddy Teahon, former Secretary General of the Department of the Taoiseach, that the partnership process had promoted a shared understanding between unions, employers and government of the key mechanisms and relationships that drive the economy. The lack of attention to macro policy means that the determinants of Ireland's tendency towards pro-cyclical fiscal policy are not considered.

We may also be confining our search too narrowly if we just look at interest-group influence in seeking to understand recent decision failures. As Lunn (2013) remarks, any comprehensive analysis "… must include an account of why so many people, in a range of different circumstances and roles, took decisions or made judgments they would later regret".

Policy suggestions are contained in the final two chapters, entitled respectively "the Irish policymaker's mind-set" and "charting the way ahead". Besides advocating a move away from the science-led innovation strategy, the author advocates that greater attention be devoted to establishing linkages between indigenous and foreign industry, and that there be much greater decentralisation of local and regional economic development strategies. There may well be merit to these suggestions but the outcome of previous efforts with respect to linkages and the reasons why we have ended up with a highly centralised system of government both need to be recognised in this debate.

Padraic White, former MD of the Industrial Development Authority wrote in his book with Ray MacSharry of how the IDA used a see-through model of a computer in 1979 to identify its components with a view to promoting linkages. A National Linkages Programme (NLP) was established in 1985 as a response to the "Culliton Report". As Frances Ruane has pointed out however, linkage development involves chasing a moving target as globalisation had made the global sourcing of inputs the most efficient strategy for many firms.

I am aware that advocacy of decentralisation of the type proposed in the book has a long tradition in Ireland. Supporters of local government argue that centralisation leads to a lack of coherence in regional development. (See Tierney, 1982, for example). But even Tierney recognises that "… the most frequently encountered justification for the centralising tendency in Ireland is unwillingness, born of actual or assumed corruption, to trust local authorities". Given that the author determines Ireland to be a serial underachiever, this strikes me as a somewhat risky position to be advocating.

In the face of Department of Finance antagonism (from the era of Joseph Brennan to T. K. Whitaker and beyond), industrial decentralisation was eventually spearheaded by the IDA. This was particularly successful in the 1970s but was replaced by a new strategy that prioritised national over regional goals during the macroeconomic crisis of the 1980s (Barrios, Görg and Strobl, 2006). This strikes me as an appropriate response and I would worry that such a response might not be forthcoming under decentralisation.

These are complex issues, however, and worthy of debate. The book sets out a commendably long and comprehensive research agenda for the future.

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