Foreword

It is an honour to be invited to write a foreword to Fred McMahon's book *Road to Growth*. I was first introduced to Mr. McMahon, and to the Atlantic Institute for Market Studies, through the latter's web site.

I was preparing a speech for delivery in St. John's, Newfoundland, on the lessons that Atlantic Canada might draw from Ireland's recent economic success.

I have long been a regular visitor to Newfoundland, because southeastern Newfoundland is the most Irish place in the world outside Ireland itself, and an Irish visitor feels more at home there than anywhere else.

At the time, Mr. McMahon gave me a very clear insight into the factors that have prevented Atlantic Canada from achieving its full economic potential.

In Ireland's case, our full economic potential was not achieved for a long time. Generations of Irish people had to emigrate, never to return.

Between 1949 and 1989, it is estimated that 815,295 people emigrated from Ireland. This represents 22% of our current population. I understand that the equivalent emigration figure for Newfoundland over the same period would be about 25% of its current population.

Now, thanks to our success, instead of having to bid up wages to recruit staff, expanding firms in Ireland find that they can recruit among the Irish abroad. Descendants of earlier Irish emigrants also help us achieve a good audience in the boardrooms of multinational companies.

So the population loss of an earlier era has become a benefit in this era.

The challenge for Atlantic Canada is to create the conditions whereby it too can tap the talents and influence of Atlantic Canadians who have gone to live elsewhere.

Ireland and Atlantic Canada have had a common proclivity towards accumulating government debt. At one time, Ireland's debt reached 125% of our GDP, a debt of crisis proportions. It is now back down to about 60% of our GDP, thanks to the economic success described in Mr. McMahon's book.

The problem of Ireland's debt has had some beneficial side effects. In the 1970s, the initial borrowing enabled us to maintain social and educational infrastructure through the hard times of the oil crisis. It was a cushion against radical political upheaval at a time of a fall in real national income.

In the 1980s, the necessity of debt control meant that Ireland avoided some of the costly political errors of continental Europe. We did not undertake unrealistic pension commitments, or overprotect labour markets. The debt problem also brought about social partnership between employees, employers, and government in the late 1980s. This kept wage increases below productivity growth.

Both Ireland and Atlantic Canada have been recipients of transfers respectively from the European Union and Canada.

The motive for these transfers has been laudable in both cases – to narrow the gap in incomes between regions and to build political cohesion.

As Fred McMahon's book shows, there is a price to be paid for such largesse. The natural process of economic adjustment is postponed. Vested interests opposed to change are built up. This leads to a misallocation of resources.

In Ireland's case, the E.U.'s Common Agricultural Policy has maintained agricultural incomes and prices in Ireland at a far higher level than would have been possible using Irish taxpayer's money. But Irish agriculture is now less efficient than it was in 1972, when we joined the E.U., and this has happened because of E.U. subsidies.

Ireland does not participate in an E.U.-wide system of employ-

ment insurance, in the same way as Atlantic Canada participates in a Canadian E.I. system. If there had been a uniform rate of unemployment benefit for all of Europe, at rates that would be acceptable in (say) Germany, both minimum-wage rates and consequent unemployment in Ireland would undoubtedly have been much higher. This would probably have killed off the Celtic Tiger at birth.

There are many very valuable insights for policy-makers in Mr. McMahon's book. He makes the very important assertion that there is a natural rate at which economic growth will tend to raise the incomes of poorer regions towards those of richer regions. The "convergence theory" of Barro and Sala-i-Martin suggests that, each year, a lagging region closes the gap with a leading economy by between 2 per cent and 3 per cent, which implies that it would take about 25–35 years to close the gap by a half. This theory would suggest that, if politicians were to do nothing except let markets operate, the poorer will catch up with the richer over time.

McMahon's chapter on Ireland is, to my mind, comprehensive, fair, and accurate. I would enter only one caveat. That concerns his analysis of the economic mistake that was made by the incoming Irish government of 1977. The Irish economy was well into recovery by 1975, and Mr. McMahon claims that this new government "promised to spend the nation's way to new economic growth". The 1977 programme was not principally about increasing spending. In fact, it involved tax cuts, but the wrong kind of tax cuts. The taxation on motor cars was eliminated and so was the taxation on houses. These tax cuts had no beneficial economic effect. They were a windfall for car and house owners, and contributed to an import-led boom which caused big problems later on.

Achieving economic success is not simply a question of cutting taxes. It is a question of cutting the *right* taxes. The lesson of Irish economic history is that one should have a low and predictable rate of tax on the factors that generate growth. Companies and people at work generate growth. That is why the priority should

be on reducing taxes on working people and on profits, rather than on reducing taxes on other activities. Ireland still has a pretty high rate of taxation on goods purchased in shops, but this has not inhibited economic growth.

The analysis of the impact of regional policy in this book is very important. In the European Union there is a commitment in the treaties to reducing regional disparities between poorer and richer parts of the Union. Mr. McMahon points out that in the United States "at no time has there been a commitment to reducing regional disparities."

Yet, in the United States, no matter how far a region falls, no matter how high unemployment soars, no matter how unique the problems, regional economies keep booming back. Because flexible labour markets tend to adjust quickly, regional recessions in the United States are usually short lived. In other parts of the world, a safety net intervenes to slow down the process of adjustment. This softens the blow but also prolongs the agony.

There should be a debate amongst policy-makers about the quality of government spending, as well as about quantity. Government spending programmes should promote flexibility. There should be an inbuilt mechanism to automatically adjust them to rises and falls in tax revenue. They should be designed so as not to carry forward existing commitments regardless of external economic circumstances. They should be focused on measurable improvements in services.

In Ireland we have tried through the Strategic Management Initiative (SMI) to improve the quality of government spending. Public-service agencies are supposed to set their own objectives and monitor their own performance against them. Unfortunately the objectives are often expressed in abstract and subjective terminology. In effect, the exam is so set that no one is allowed to fail.

My own experience in Ireland is that predictability is what business needs from government. One of the reasons for Ireland's economic success was that we have had a low corporate tax rate – previously 10 per cent now 12.5 per cent – which was guaranteed

not to be changed by both government and opposition. If government, working with opposition, can guarantee predictable economic conditions, it will be doing the best it possibly can to help create economic success.

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