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The role of the EU Financial Perspectives in the development of Ireland

COMMISSIONER, FELLOW SPEAKERS, DISTINGUISHED GUESTS

It is an honour and a privilege to have been invited to address this gathering on the role of the EU Financial Perspectives in the development of Ireland. The Financial Perspectives have had a major impact on the recent development of the Irish economy. This afternoon, I would like to focus on just two of the ways in which they have proved their value.

First, they provided a vehicle for the transfer to Ireland of Structural and Cohesion Funding and so directly contributed to our efforts to strengthen the competitive fabric of the Irish economy.

Second, the Perspectives have required the adoption of a seven-year focus for decision-makers in Government and their regional and private sector partners. In this way the Perspectives brought a welcome new dimension to the planning of public investment. I might add that the "use it or lose it" provisions in the accompanying financial rules have also been of value as they have increased the emphasis on getting the business done.

We are all aware, of course, that the largest single heading in the Financial Perspectives is that for Agricultural spending. Ireland continues to be a major beneficiary from this heading. The future of the Common Agricultural Policy is a matter of the highest importance for Ireland and the provisions for the CAP in the next financing round will be a major concern for us. Nonetheless, because this session is about the Lisbon strategy, I propose to focus this afternoon on the impact of the Structural Funds on strengthening Ireland's competitiveness. Before moving on it is useful to note that as the farming sector modernised the number of full-time farmers fell from over 180,000 to just below 80,000 between 1971 and 2002. This was accompanied by a large increase in part-time farmers with a source of earned income outside agriculture.

Ireland's use of the Structural Funds

Ireland has been a major target of EU regional funding since it joined the EU in 1973 when our GDP per capita was 58% of the EU average. Between 1973 and 2003, Structural and Cohesion Funds receipts averaged 1.3% of GDP. Between 1973 and 1986 receipts averaged 0.9% pa, between 1987 and 1992 and again from 1993 to 1999 they averaged 1.9% pa. Since 1999 these receipts have fallen sharply. They are now running at around ½% of GDP annually. Further declines are in prospect: Ireland is no longer eligible for Cohesion Fund assistance and receipts from Structural Funds are tapering-off reflecting the extent to which we converged on EU living standards.

In Ireland we deliberately concentrated our Structural Funds receipts on spending programmes designed to strengthen our competitiveness. In particular we have focused on Infrastructure, Human Capital and the Productive sector, including manufacturing, tourism and agriculture. Infrastructural investment will absorb 55%

of the total available for the period 2000 to 2006 as we seek to address the emergence of an infrastructure deficit as a major constraint on economic growth.

To a significant extent, the current infrastructure deficit can be traced to the exceptionally rapid growth rates attained in recent years. You will better appreciate this link when I tell you that between 1987 and 2003 gross national product in volume terms has increased by an annual average of 5½% and the number of people employed has increased by 63 % over the same period. This growth is net of the reduction in numbers working in agriculture I referred to earlier.

Human Capital investment in education, training and active labour market measures (aimed at integrating the unemployed into the labour market) has concentrated on increasing the stock of technological skills in the economy. This policy greatly facilitated the rapid expansion of our high tech sectors. The ready availability of skilled labour arising from this investment has played an important role in enabling the Irish economy to take advantage of the strong economic performance in the US and elsewhere.

The Structural Funds have also been used to support investment in the productive sectors of the economy, manufacturing, tourism and agriculture. In the current round of structural funds expenditure in the productive sector is focused on support for Research and Technological Development.

The Macroeconomic Impact of the Structural Funds

The raison d'etre for Structural Funds interventions is to raise the long-term growth potential of the economies which receive them. This long-term or supply-side effect has been measured by the Irish Economic and Social Research Institute (ESRI) under the direction of Professor John Fitzgerald. The ESRI estimates that Fund interventions over the first two programming periods from 1989 to 1999 will lead to a sustained increase in the level of GNP of at least 2%. Funding for the first three years of the current programming period will lead to a further permanent increase of ½% in GNP. Overall, the long-run macroeconomic impact of Structural Funds expenditure has been to raise the level of real GNP by about 2½ percentage points above what it would otherwise have been.

Sectoral Impact

At the sectoral level the funds enabled Ireland bring forward some major capital programmes. The expansion of the funds in 1989 came at a time of necessary fiscal retrenchment in the Irish economy. The availability of Structural Funding in the 1989-1999 period allowed essential infrastructure projects to progress at a faster rate than would otherwise have been possible. In terms of transport infrastructure, the Structural and Cohesion Funds have supported the construction of major inter-urban road projects as well as improvements in mainline rail and urban transport infrastructure.

The Funds have also supported the development of large scale waste water projects such as the recently completed Dublin Waste Water Treatment plant, which is the largest of its kind in the EU. Water supply projects have also been supported throughout the country. The Cohesion Fund supported water conservation and leakage control projects which reduced the requirement for additional drinking water capacity.

The European Social Fund (ESF), by supporting education and training, accelerated the improvement in the skill base of the Irish labour force. In the 1994-1999 period, in addition to a very substantial number of people who took part in ESF funded short training courses, an average of 125,000 persons per annum completed longer education and training courses supported by the ESF. To put this in context, this annual throughput was equivalent to 8% of the total Irish labour force. This was an important factor in Ireland's success in attracting Foreign Direct Investment.

In the productive sector, as well as support for the modernisation of agriculture, Structural Funds have made a substantial contribution to the development and marketing of the tourism sector which is a very substantial employer in the Irish economy. Structural Funds have also contributed to the development and modernisation of indigenous industry.

There is no doubt that without the Funds, Ireland would not have been as well-positioned as it was to take advantage of the longest upswing in the history of the international economy. Without the Funds we would have encountered bottlenecks in infrastructure and in the stock of skilled labour at a much earlier stage when the upturn in the Irish economy took hold in the 1990's.

Impact on management of public sector programmes

As well as the direct economic benefits which I have mentioned, the Funds have had other less tangible but nonetheless important benefits. With the introduction of the programming approach for the Structural Funds in 1989, Member States were required to take a more strategic longer term approach to their co-funded investment programmes. This required ex-ante assessment of investment priorities, monitoring of performance against pre-defined indicators and mid-term evaluation of expenditure programmes.

This culture of evaluation and measurement of output and impact was not new but it was further developed and became much more widely applied. For example, in Ireland

- We have now moved on to a system of 5 year capital envelopes for all capital expenditure.
- There are regular expenditure reviews of all expenditure programmes.
- Cost benefit analysis and capital appraisal techniques have been improved and are more widely applied to capital programmes.
- Measuring outputs of expenditure programmes as well as accounting for inputs is gaining increasing currency.

The Structural Funds programming and its evaluation approach can at least take some of the credit for these developments. In total these developments have contributed to the improvement in the quality of public expenditure and to obtaining greater value for money.

Broader impact of EU membership

I am now going to say a few words about the broader impact of EU membership on the Irish economy. There is certainly no question but that Irish living standards have improved significantly since we joined the EU. In 1972 Ireland's GDP per capita stood at 58 per cent of the EU average. The figure today is estimated to be 120 per cent. This was supported by an increase of over 70% in the overall numbers at work at a time when the numbers employed in agriculture fell sharply as the sector consolidated and modernised.

There is no doubt that membership of the EU has played a major role in helping Ireland achieve its current level of economic and social advancement.

However, it is important to remember that membership of the EU was not sufficient in itself to deliver the advances that we have experienced in Ireland.

We ourselves had to make the domestic policy choices needed to move to a position where we could take advantage both of the doubling of real global trade in the 1990s and of the benefits which EU membership offered.

Domestic policy choices

Time does not permit me to go into detail on the domestic policy choices we were required to make but I will briefly mention a few of the more important ones.

Firstly, and perhaps most importantly, we vigorously corrected the imbalances in the public finances in the late 1980s, transforming a General Government deficit of over 8 per cent of GDP in 1987 to less than 3 per cent by 1990 and more recently to a surplus or modest deficit. This has enabled us to reduce our debt from about 115 per cent of GDP in 1987 to its current level of around 33 per cent of GDP, the second lowest in the EU. The restoration of order to the public finances created investor confidence in our economy and laid the foundation for foreign investment in Ireland.

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Secondly, we had an industrial policy explicitly based on attracting foreign direct investment, so that we now have a significant multi-national sector in Ireland. This investment, much of it in the ICT and pharmaceutical sectors, has been the engine which has driven our economic development.

Thirdly, we have invested heavily in education and training over a number of decades. This was key to raising the productive potential of the labour force, which is vital in any economy looking towards export led growth. This meant that our high proportion of young people was well-educated and was therefore well-equipped to work in the expanding economy and in particular in the new companies locating in Ireland.

Lastly, the policy of developing social partnership led to a consensus between employers, trade unions, Government and other partners about the nature of the challenges Ireland faced and the best solutions to them. This policy has provided certainty regarding wage developments, typically for up to three years, and provided a large measure of industrial peace.

The one thing we did not do was use EU funding to cut domestic tax rates. In fact in the period since 1980 we have been increasing tax rates on exports and the manufacturing sector from zero to 10% and now 12½%. The cut in general corporation tax rates to 12½% has only taken effect since 1999, the period in which EU funding fell off sharply.

What should be of interest to policymakers is the fact that the cuts in business taxes have generated a large increase in receipts and in some cases have been self-financing. Consequently, we have been able to cut taxes and at the same time adhere to the terms of the Stability and Growth pact.

Other EU Membership benefits

As I have said, the successful implementation of these domestic policies allowed Ireland to take full advantage of EU membership. Apart from the gains from EU Structural Funds I have mentioned earlier, Ireland's economy also benefited from EU membership in a number of other ways.

Single Market Firstly, as a small, open economy whose trade represents **over 150** per cent of GDP, we have benefited significantly from being part of a large single market. The statistics speak for themselves. In 1973 Ireland had a trade deficit of **about 10** per cent of GDP and by 2003 this had been transformed into a trade surplus of 30 per cent. Since 1973 our total trade in goods and services has increased from **82** to **151** per cent of GDP.

Access to a Single European Market of 380 million people, soon to be enlarged to over 450 million people, was an integral part of our attraction to foreign investment. Ireland has become a major channel of US technological innovation into Europe. It is seen as a `gateway' to the European export market and our exports to euro area countries have risen from **17** per cent of total exports in 1972 to **38** per cent in 2002.

Access to the European market has meant that merchandise exports to the United Kingdom while still significant, have fallen from **61** to **24** per cent in 2002.

For Irish companies, the internal market provided both new market opportunities and an opportunity to assess their readiness for increased competition. Irish firms have expanded, many becoming multinationals in their own right, ensuring that the Irish economy is now thoroughly internationalised. The opportunities presented have promoted the creation of the appropriate entrepreneurial ethos combined with a highly educated and productive workforce.

Of course, the single market brings challenges as well as opportunities. There is no doubt that Enlargement will increase the competition for trade and investment within the EU. While such competition brings short term challenges, it also put us in better shape in the longer term to deal with competition from other parts of the world, such as India and China.

EMU

Of course, the establishment of Economic and Monetary Union and the creation of a single currency area were of benefit to our economy. The main benefits were in relation to the single currency and lower interest rates and bond yields.

However, EMU presents a challenge to Member States policymakers because they no longer have national interest and exchange rate policy instruments at their disposal. In the new EMU context, policymakers have to rely on fiscal policy, wage policy and structural reform to manage the economy. Consequently these policies have much greater importance than before.

The establishment of the euro certainly benefited Ireland's export sector. By removing exchange rate uncertainty and foreign exchange handling and transaction costs, trade between participating member States was made simpler and cheaper. Of course, while the introduction of the euro was an opportunity for Irish firms to increase their penetration of continental markets, it also meant that Ireland had to compete with European firms who sought to expand their presence in Ireland.

However, the existence of the euro does not change the fact that a significant part of Ireland's export sector must continue to cope with exchange rate movements. Unlike most of the other euro area members, a significant proportion of our exports still go outside the euro area .Indeed, the weakening of the US Dollar and to a lesser extent Sterling against the euro has again reminded us of the competitiveness implications of such exchange rate movements.

Budgetary policy

We are all aware of the fact that participating in the EU involves commitments regarding budgetary policy. The Maastricht Treaty and the Stability and Growth Pact, which was agreed in Dublin in 1996, are the key agreements in this regard. They are designed to provide a stable macroeconomic framework within which Member States can pursue national policies which will promote employment, competitiveness and sustainable growth. The Pact seeks to ensure that a single monetary policy is supported by sustainable fiscal policies.

As far as Ireland is concerned, we adhere to the Pact not just because it is an EU obligation, but because the rules make good sense in themselves. Sound public finances are essential to underpin business confidence, investment and sustained economic growth. As I indicated earlier, the benefits of budgetary stability have been very real in Ireland over the last 15 years. In 2003 the interest on the National Debt was 1.6 % of GNP: the corresponding figure in 1987 was 10.2 %.

Regulatory reform

Ireland has also benefited from the EU's economic structural reform agenda. Ireland is now recognised by the OECD as one of the most 'lightly' regulated economies in the world. However this wasn't always the case. Before joining the EU, Ireland's economic tradition included both protectionism and large domestic monopolies.

On joining the EU, the policy bias toward producer interest began to be balanced by consumer interests and competition. Initiatives at EU level to open telecoms, energy and transport markets have also played a significant role in increasing competition in Ireland and have led to significant cost reductions for both businesses and consumers. Given our geographical location, transport costs are particularly important for Irish competitiveness and much progress has been made in this area over recent years. Taken together all these developments have significantly improved our competitiveness.

Regulatory reform is also helping Ireland to manage the consequences of rapid growth and to build new capacities to sustain growth in the future. At EU level, our belief in the importance of good quality regulation has led to the launch of the recent Four-Presidency Initiative by the Irish Presidency, the Netherlands, Luxembourg and the UK. Our aim is, through a concerted and co-ordinated effort, to drive the regulatory reform agenda forward over the next two years.

Closing Remarks

I hope that I have been able to contribute to the evaluation of the role which the Financial Perspectives, through the designation of pre-allocated Structural and Cohesion Funding, have played in the development of the Irish economy.

A key factor in this evaluation is the extent to which the Funds interacted with domestic policies and the other forces in play to bring about the recent transformation of the Irish economy.

The EU financial transfers have been extremely important but so too has the consistent pursuit over a protracted period of time of a credible set of stability-oriented macroeconomic policies, supported by broad-based social consensus and, more recently, a determined approach to microeconomic reform.

The EU which we joined in 1973 has evolved significantly. We believe we have not just been passive beneficiaries – we have played our part in supporting the EU's ongoing development. We are continuing this approach during our Presidency, not least in helping to process the Financial Perspectives dossier in a manner which will lay the ground for the tabling by the Commission of its legislative proposals this summer.

Thank you for your attention.