CHAPTER 2

Falling over the Competitive Edge

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In the Celtic Tiger years of the 1990s, Ireland apparently rode the roller coaster of freewheeling capitalism towards the information society. A boom in high technology industry was said to be fuelled by a new entrepreneurial class competing in free markets, and driven forward by private investors motivated by low tax rates. Ireland was unusual too in that it turned to international investors as the source of economic change. Foreign investment in high technology was intensely promoted, stressing Ireland's attractions: a skilled English-speaking labour force, access to the EU market and, above all, low corporate tax rates. The untrammelled market remained the road to a coveted place in the brave new information economy.

This belief would have been all too familiar to Karl Polanyi, who wrote in the 1940s of the dangers of the 'liberal creed' that elevates markets above all other social relationships.[1] While markets can be important and useful institutions, creating a 'market society' that prioritises markets over relationships of community and social solidarity will ultimately lead to social fragmentation and even economic decline. Sustainable economic growth must remain embedded in social relationships – as markets

[1] K. Polanyi, *The Great Transformation*, Boston: Beacon Press, 2001 [1944].

themselves tend to undermine the relationships of co-operation that are essential to social life and economic development. After World War II, many advanced capitalist countries, in Polanyian fashion, embedded market relationships firmly within national welfare state institutions and international controls on trade and capital flows. Since the 1970s, however, these social and political institutions have been under attack from a new, virulent form of the 'liberal creed', which advocates widespread deregulation, privatisation and reduced public spending.

A blind faith in the global market had come early to Ireland, with the turn to foreign investment and free trade in the 1950s. After the economic disasters of the 1980s, globalisation appeared kinder to Ireland in the 1990s with the Celtic Tiger boom. In 2002, however, the economy slowed, inflation rose, foreign investment rates declined and unemployment began to increase. Nonetheless, faith in the market society persisted. The widespread solution offered to these dilemmas was the restoration of cost competitiveness by reining in public spending and controlling wages. The barriers posed to market action by the public sector, social welfare and the demands of community and solidarity were to be stripped away.

On the road to the post-industrial economy

Both the diagnosis and the cure for the Irish economy stated above are mistaken. Clearly, a boom in foreign investment did drive the rapid expansion in growth and exports in the late 1990s. But many of the best-known foreign firms were simply moving goods through their Irish operations to take advantage of low tax rates, creating an entrepôt economy that provided an illusion of growth and development. Significant elements of the Celtic Tiger were a mirage.[2]

[2] P. Honohan, B. Maitre and C. Conroy, 'Invisible Entrepôt Activity in Irish Manufacturing', *Irish Banking Review*, Summer 1998, pp. 22-36.

Nonetheless, alongside this conjuring trick of the global economy, and often in the same firms, significant transformations occurred in the capabilities of the Irish economy. Spending on research and development increased, new forms of team production were adopted, the labour force became increasingly professionalised and productivity improved. Irish-owned firms grew and a number became important international companies: exporters and overseas investors in their own right.[3] Most significant were changes in the labour market: as employment rose dramatically, female labour participation increased, unemployment declined and mass emigration was reversed. As it turns out, these transformations were rooted in new sets of social institutions and alliances between groups within the state and society rather than in individual entrepreneurial action supported by freewheeling markets for money, labour and technology. If the Celtic Tiger was a mirage, it was also a surprisingly concrete set of changes in economic life and new social and organisational capacities for knowledge creation emerged.

Although the most high profile parts of the Irish economy are in high tech manufacturing, it is important to recognise that all manufacturing only accounted for approximately 18.6 per cent of total Irish employment in 2001 and for 14.5 per cent of the growth in employment between 1987 and 2001. The employment growth, which was the most impressive feature of the Irish economy in the decade to 2002, was only partly based, therefore, on transformations in manufacturing. It was also rooted in expanding social services employment and expanding local demand for business, retail, construction and personal services.

The Irish labour force has clearly undergone a structural shift since the 1970s, with a marked trend towards a 'post-industrial' workforce. In the 1990s, even as agricultural employment continued its steady decline, manufacturing

[3] S. Ó Riain, *The Politics of High Tech Growth*, Cambridge: Cambridge University Press, 2004.

grew at 3.6 per cent annually, while social services grew at 4.4 per cent and market services grew at 5.7 per cent.[4] The transformation looks more dramatic when we focus on key sectors such as insurance, finance and business services (incorporating financial services and software) and health and education: the only sectors to record steady employment growth in every decade since the 1970s. Taken together with the unprecedented employment creation of the 1990s, Ireland has undergone a rapid shift towards a post-Fordist economy and a post-industrial workforce – driven in large part by high tech manufacturing, producer services and social services.

Typically, this transformation is seen as being driven solely by foreign investment. But this ignores the growing sophistication of foreign firms in Ireland, and the ability of the local economy to absorb new forms of work and technology. Furthermore, a set of indigenous industries has emerged that is only partly driven by links to foreign investment in Ireland – most significantly, the software sector. In these industries, the role of local entrepreneurs was clearly important and this entrepreneurship was deeply embedded in the set of surrounding institutions that shaped and moulded it. Firms that received state grant aid did not seek the easy road of surviving on grants, but grew faster, exported earlier and were more likely to be involved in innovative activities and alliances. Private investment was remarkably unadventurous in supporting Irish high tech firms in the 1990s; the state was the risk-taking investor in these crucial early years, and private investment capital only flowed into indigenous high technology when the returns were relatively certain.

Furthermore, since the 1980s, a network of semi-public institutions had emerged (funded and sponsored by the Irish state and the EU and often linked to the universities) that supported innovation and research. Innovation centres,

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4 National Economic and Social Council (NESC), *An Investment in Quality: Services, Inclusion and Enterprise*, Dublin: NESC, 2002.

programmes in advanced technology, technology centres and other institutions were an important collective set of supports for individual technologists and business people. Indigenous firms emerged where these institutions existed to enable local actors to take advantage of the connections to foreign investment and foreign markets. Indeed, it seems highly likely that the foreign investment boom of the late 1990s was itself encouraged by the growing sophistication of the innovative capacities of the Irish economy.

If export competitiveness has driven Ireland part of the way down the road to the informational economy, it has gone hand-in-hand with public sector expansion of social services employment. Together, these twin drivers of economic development have generated huge local demand (since around 1994) resulting in rapid increases in employment in sectors such as personal services and construction. In any overall explanation of the dramatic expansion of employment in Ireland, we need to focus not only on foreign investment or even general export competitiveness, important though these have been, but on the interaction of those sectors with the rather more unfashionable public sector, where job expansion was instrumental in creating patterns of local demand that generated further employment increases. Ultimately, the significant transformations in the Celtic Tiger are not driven so much by freewheeling market capitalism, as by a set of politically constructed and institutionally supported state–society alliances, extending across institutions of innovation and social partnership. In many cases, these institutions have emerged despite the official ideology of the efficiency of market mechanisms and the moral superiority of individual entrepreneurship.

The competitiveness obsession and the threat to the Celtic Tiger

As growth and exports slowed dramatically in 2002 and unemployment began to rise, the airwaves were filled with calls to restore competitiveness in the Irish economy.

Indeed, competitiveness has been institutionalised as a national policy priority with the establishing of the National Competitiveness Council, which monitors almost any aspect of social and economic life for its implications for firm competitiveness. The focus of the competitiveness agenda has been the reduction of costs, and the policy mechanisms of choice to achieve this goal are wage restraint and reduced public spending.

Casting the problems of the Irish economy in terms of competitiveness inevitably leads to calls for a crackdown on excessive public spending and wages. But the Celtic Tiger years have made competing on costs an increasingly precarious proposition for Irish firms, as reflected in recent job losses in the traditional sectors of the economy. The agenda for the Irish economy must be one of upgrading, learning and innovation. The current economic difficulties in Ireland fundamentally reflect the dilemmas of managing a transition from a low wage to a high wage economy, and industrial upgrading has become not just a motor of development, however incomplete, but a necessity.

Wage competitiveness is, in any case, of uneven importance in the Irish economy. The most dynamic high tech sectors either rely more heavily on tax breaks than low wages or have seen rapidly rising wages, outside the scope of the national social partnership agreements. On the other hand, wages have remained all too low in many services sectors and it is perverse to call for further restraint. Where wage restraint has been most important is in the least sophisticated sectors of Irish industry and in managing the public sector pay bill to assist in reducing public debt. Calls for wage restraint do not address the complexities of the variety of upgrading strategies required in different sectors and the politics of balancing these sectoral differences within the national political economy.

Indeed, focusing on wage restraint directs policy attention away from investing in labour, learning and improved training, and long-term career development and security. A neo-liberal economic strategy, focused on a narrow concept of cost competitiveness, will seriously undermine this necessary upgrading: potentially generating a vicious circle of declining investment, rising inequality and ultimately the weakening of co-ordination capacities and the social basis of the knowledge economy. Nonetheless, this is the strategy that the Fianna Fáil and Progressive Democrats coalition government has pursued: cutting back on public spending (already at a remarkably low level compared to other countries) and in the process undermining the very institutions that had important developmental impacts in the Celtic Tiger years.

Similar problems arise in relation to cutbacks in public spending and low levels of long-term public investment; such policies are damaging Ireland's capacity to evolve as an information society. The education system is suffering as the decline in the numbers of young people in the population is seen as an opportunity for cost cutting in education rather than a chance to implement smaller class sizes and other forms of pedagogical best practice. Reduction in funding for research has threatened long-term organisational development in the universities, just as a new set of research institutions was being established. More broadly, students in primary and secondary schools have walked out of their classes to protest at the deteriorating physical condition of their school buildings. There is a perversity in a system that lauds the knowledge economy and society, while failing to support the very educational institutions – from primary to third level – that are crucial to building them.

Commercialisation and cutbacks have also undermined the network of innovation institutions that were important to the upgrading that took place in the 1990s. The Centre for Software Engineering (CSE) at Dublin City University has played an important and widely acknowledged role in promoting quality in software engineering. However, reduced public funding in recent years and cutbacks in funding to Dublin City University have left the CSE in deep financial trouble and facing closure or management buy-out. Despite wide university and industry recognition of the important role played by the CSE in developing the software industry, a critical part of the institutional infrastructure of this industry is being undermined by the priority put on cost containment over collective investment.

Ultimately, competitiveness measures have threatened industrial upgrading and innovation by weakening the social foundations of labour and learning. Costs have to be managed, but there is little evidence so far that market liberalisation has been successful in that area. Furthermore, just when sustained public investment in the long-term development of collective capabilities is more necessary than ever, it is undermined by reduced public spending and the blind implementation of market liberalisation.

The Celtic Tiger was a missed opportunity. The creation of innovative capacities in the Irish economy could have gone much further, but was limited by weak investment in social institutions of learning. Those institutions that did promote innovation in the Irish economy emerged in the gaps and spaces left by those institutions purely focused on attracting foreign investment. Rising inequality could have been tackled more decisively through a redistributive approach to tax and welfare and, more significantly, by building a more inclusive set of institutions to support learning and innovation. The economic growth of the 1990s offered the opportunity for creative social democratic politics, with the possibility of narrowing the gap between the working and middle classes while still rewarding the middle classes. However, the opposite occurred: while most groups in society saw significant improvements in their situation through the Celtic Tiger years, policies consistently favoured the middle classes over the working classes and contributed to increased inequality.

The institutions that were built in the 1990s to support innovation and promote social solidarity were always threatened by the official story of the Celtic Tiger as a market-driven economy – the Irish version of Polanyi's 'liberal creed'. During the boom years, these tensions were papered over by rapid growth and booming tax revenues. But, when tougher times hit, the choice between free markets, and innovation and equality was posed more starkly: will the information society in Ireland be unequal and based on low wage competition, or will a more egalitarian, deeper system of innovation be created? The contemporary obsession with competitiveness threatens the very institutions that made possible the most significant changes in the Celtic Tiger years. Nonetheless, the opportunities to tackle inequality and build a structure of indigenous innovation remain – if the process of building social and political institutions can be sustained in the face of the narrow competitiveness agenda.

Ireland and Finland on the road to the information society

Is it simply wishful thinking to believe that we can have an economy that combines export competitiveness with equality and that can sustain investment in a sophisticated innovation system and a developed, universalist welfare state? No, it is not. Finland provides an example of just such a state. Finland, which experienced a similar boom to Ireland in the late 1990s, has in many respects a more sophisticated information economy and is clearly more egalitarian than Ireland.

The generous and universalist Finnish welfare state helps maintain the skilled and healthy population that sustains the information economy, while the information economy helps pay for the welfare state. Sustained by significant and long-term public investment policies to support innovation and vibrant communities of technology developers, Finland has combined growth and equality, and is one of the most competitive economies in the world.[5] The Scandinavian economies also attract large amounts of foreign investment despite high tax rates and a strong welfare state – indeed

5 M. Castells and P. Himanen, *The Information Society and the Welfare State: The Finnish Model*, Oxford: Oxford University Press, 2003.

the investment they attract is much more sophisticated than that lured to Ireland by the promise of low taxes and transfer pricing alongside a skilled labour force.

Ultimately, the lessons of the Irish and Finnish cases are the same. Developing a successful information economy requires significant investment in the labour force as well as in the institutions that support learning and innovation. Informational capitalism rests firmly upon social institutions, even if those who benefit most from the informational economy fail to recognise the significance of those institutions. However, the chimera of the market remains stubbornly in place. Belief in the market is crucial to the new elites in defending their moral claim upon the rewards of the informational economy, but that ideology ultimately threatens the foundation of the economy itself.

The development of informational capitalism is not necessarily linked to rising social inequality. However, a better political and economic choice would be to create an egalitarian information society – by developing both strong social institutions of innovation to support business activities and strong welfare states and egalitarian economic structures to support the population. The competitiveness agenda of restricting public spending, restraining wages and liberalising markets will eventually undermine competitiveness. Whereas Ireland's competitiveness has fallen, Finland has made gains. Investing in education and welfare, directing resources towards the excluded and exploited, taking away the low wage/low skill options within the economy and democratising workplace institutions will not destroy competitiveness, but will enhance it – even as inequality is tackled.

Institutions developed in the Celtic Tiger years contain the seeds of an information society based on social innovation and egalitarianism. It is only when these institutions of innovation and social partnership are supported by sustained and universalist public investment that the promise of the information society can be realised. If Ireland is to build on the transformations of the Celtic

Tiger era, and not miss the opportunities it offers a second time around, it will have to break fundamentally with the neo-liberal policies and ideologies which have come to shape the Celtic Tiger's self-definition, but which ultimately threaten it.