The Island Economy: Past, Present and Future

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Acknowledgements

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[1] Introduction

The idea of promoting island-wide economic growth and development has received much coverage in recent years, against the background of the evolving peace process in Northern Ireland. As people on both sides of the border begin to accept that there are likely to be mutual gains to be had from more cross-border interactions and co-operation, there is increased attention directed at identifying and removing any remaining barriers and constraints to promoting island-wide growth.

The Good Friday Agreement, signed on April 10th, 1998, contained a specific Strand relating to North-South institutional co-operative arrangements (Strand Two) which potentially had wide implications for public policy. A joint statement issued on December 18th, 1998 by First Minister David Trimble and Deputy First Minister Seamus Mallon of the Northern Ireland Assembly set out six implementation bodies for joint North-South policy making and designated six further areas for North-South co-operation of a less formal kind. These cross-border bodies are up and functioning and a week seldom passes without reports of Northern and Southern Ministers meeting on matters of common interest. As a result, minds are now becoming much more focused on the practicalities that will be involved if functional areas for North-South co-operation are to be used to greatest mutual economic and social benefit.

Looking back at the negotiations that eventually led to the institutional arrangements contained in Strand Two of the Good Friday Agreement, it is interesting to note that the main Nationalist parties on the island - both in Northern Ireland and in the Republic of Ireland - advocated the desirability of strong North-South links across a broad range of policy areas, in particular those of a business and socio-economic nature. They also advocated the establishment of institutions and structures to develop these links. There were many other undercurrents of influence on the Nationalist parties as they pursued these goals, but business and policy pragmatism were not entirely absent.

In contrast, the Unionist parties within Northern Ireland appeared to be less convinced of the benefits claimed for greater North-South policy and institutional links, often arguing that the economic benefits were likely to be small, if not non-existent. However, it is difficult to establish the extent to which their behaviour was driven by political desiderata as distinct from detailed business and economic analysis. Nevertheless, as we watch the cross-border institutions begin to function, it is gratifying to see pragmatism reasserting itself, political fears begin to fade, and Unionist Ministers engaging actively with their opposite numbers in the South.

Influenced no doubt by the strong performance of the Southern economy over the past decade, recent Unionist thinking on the potential benefits of North-South co-operation in the economic sphere has become more flexible. For example, in an address to the Chamber of Commerce of Ireland in Dublin in 1998, First Minister David Trimble laid down three principles that his party would apply in evaluating cross border bodies:

i. Any new body should have demonstrable advantages both for Northern Ireland and the Republic of Ireland;
ii. Northern Ireland’s ability to develop a vibrant and competitive economy on a sound basis should not be impaired;

iii. Northern Ireland’s identity should not be submerged in a new all-Ireland identity.

The political tensions between differing institutional approaches to the modalities of cross-border co-operation are all too apparent, and the wisdom and salience of such arrangements are vigorously debated within the wider Unionist community. However, the most positive and optimistic viewpoint on the potential of deeper business relations between North and South came in a non-political context from within the Northern business community. This was most dramatically articulated by Sir George Quigley in an address to the Confederation of Irish Industry conference in 1992, when he said that:

"I find no difficulty with the proposition that Ireland is - or should be - an island economy".

This simple and clear statement gave a considerable boost to many in the business community, especially in Northern Ireland, who had been slowly and pragmatically increasing North-South trade and business links on the island. The statement also had an important galvanising impact on how business people, policy makers and academics began to think about the opportunities that a peaceful future might bring to the economies of Ireland, North and South, especially in the context of increasing European integration. The fact that Sir George Quigley's statement was regarded as very avant garde in 1992 indicates just how far thinking has advanced since then. At about the same time, the Joint Business Council of the Confederation of Irish Industry (now the Irish Business and Employers Confederation - IBEC) in the South and the Confederation of British Industry in the North was formed, and has played an important part in encouraging and facilitating significant increases in the level of trade, business contacts, development and co-operation between both parts of Ireland.

It might be thought that there is already an island economy within the context of the Single European Market. After all, both the United Kingdom and the Republic of Ireland are member states of the EU. If there are still problems, what is it about the island of Ireland that makes it different from the mainstream processes of EU market integration, requiring more specific analysis and initiatives in addition to those common to normal cross-border relations in other EU member states?

Policy-making in Ireland prior to 1922 took place in a context where the island as a whole was an integral part of the United Kingdom. The impact of the Government of Ireland Act of 1920 on subsequent policy making in the two regional economies of the island was to create two separate policy regimes. However, traces of the earlier policy legacy in the form of adherence to many UK policy norms also lasted in the South until well into the 1960s. Stormont, on the other hand, never really exploited, developed, or even tested the limits of its regional policy autonomy.

The impact of direct rule after the prorogation of Stormont in 1972 worked towards an even closer integration of Northern Ireland into the UK at the very time when the Republic of Ireland was switching its political and economic focus away from London and towards Brussels. However, Irish and UK membership of the EU after 1973
provided a context for the removal of all tariff barriers between North and South, a process that had got under way as long ago as 1965 with the signing of the Anglo-Irish Free Trade Agreement.\footnote{\textsuperscript{1}} The Single European Market of 1992 was designed to remove all non-tariff barriers between EU member states and hence between the Republic of Ireland and Northern Ireland. Economic and Monetary Union (EMU) has the potential for further policy harmonisation between the Republic of Ireland and the UK, should the UK eventually join.\footnote{\textsuperscript{2}} Thus, political and economic currents have resulted in the North-South policy-making environment today having a high - if less than complete - degree of commonality.

The scope for loss of economic efficiency due to lack of full market completion between Northern Ireland and the Republic of Ireland has diminished considerably with the advent and later deepening of the EU Single Market. However, the completion of the island market still remains unfinished and any adverse effects of lack of completion - such as the UK not joining the euro zone - are compounded by political sensitivities that persist within Northern Ireland, between North and South, and between the UK and the Republic of Ireland. This legacy has served to sustain opposing views on the possible gains to be had from continued market completion and the possible evolution of an island economy, ranging from a conviction that the commercial benefits of further policy co-operation or harmonisation would be minimal (expressed in the writings of the Cadogan Group - a unionist think-tank - as well as those of Paddy Roche, Esmond Birnie and David Hitchins) to the suggestion that there may be many remaining problem areas and barriers specific to the economy of this island, the removal of which would be likely to create more dynamic growth and prosperity (expressed most succinctly by Sir George Quigley).

Although the evolution of the framework of the EU treaties has also diminished the scope for policy mismatch between member states, considerable policy misalignment still remains in areas such as fiscal and monetary policy, taxation, industrial policy, social welfare, education, labour market, infrastructure and agriculture. The extent to which any loss in efficiency and under-performance can be associated with mismatch in public policy needs to be investigated, particularly when the two regions involved share an extended land border and have a relatively high level of inter-regional trade and factor mobility. Although one can draw on wider inter-country EU experience and research findings, a specific focus needs to be directed at the Irish-UK policy interface in the context of the two economies of the island of Ireland since policy regimes in Northern Ireland are almost completely dominated by UK policy norms.

We also need to understand the manner in which institutional harmonisation might moderate the effects of barriers and encourage mutually beneficial opportunities for North-South growth and development. Current interest has, understandably, focused on the likely impact of institutional harmonisation in the main sectors of the island economy (i.e. agriculture, energy, trade, transport and communications) where policy-making often involves large publicly-owned, semi-state and privatised organisations as well as government departments and, increasingly, independent regulation. These make up the institutional context described in Strand Two of the \textit{Good Friday Agreement} and form part of the agreement of December 18th, 1998 on Northern government departments, North-South implementation bodies and co-operation.
Harmonisation and co-operation in wider areas of economic life, such as industrial policy, joint planning of physical infrastructure, consumer affairs and approaches to EU policy making, may be important in promoting island-wide growth, but operate mainly through medium to long-term (and often indirect) channels. Social policy aspects of cross-border co-operation are not our main concern but it is also important to understand the full extent to which existing North-South socio-economic differences may have created barriers to mutually beneficial growth and how harmonisation and co-operation in these areas might act to mitigate or remove them. Political and cultural issues also divide Northern Ireland in a way that has implications for the performance of the Northern economy and for North-South business and economic interactions, but it is for others to examine these aspects and prescribe remedies.

Our analysis is designed to investigate the barriers to accelerated growth and development in the island economy of Ireland that arise from what we characterise as partial market completion and the policy mismatch associated with the existence of an international border between the Republic of Ireland and Northern Ireland. As noted above, some of these problems are common to all regions of nation states that have international land borders and are the subject of discussion and analysis at the EU level. However, the Irish situation has some unusual and unique features:

i. A history of mistrust and lack of communication between the two regions that has only recently begun to unfreeze and change;

ii. The geographically peripheral location of both regions with respect to their core markets in Britain, the rest of the EU and elsewhere;

iii. Asymmetries in the roles and power of policy-making institutions in both regions that have made previous North-South co-operation difficult to foster;

iv. Regional economic structures that have evolved in different ways within the island, reflecting among other things their different external relationships - Northern Ireland with London and the Republic of Ireland increasingly with Brussels and Frankfurt.

This essay is structured as follows. Since historical context is all important in developing an understanding of Irish issues, in part 2 we briefly review the background history to the two island economies since we are still - at least to a some degree - constrained by our history. In part 3 we turn to the state of the two economies today and show that one fortuitous consequence of the last decade of fast growth in the Republic of Ireland is that the two economies face each other across the border with a much greater degree of social and economic parity than they have done at any time since partition. In part 4 we direct our attention to the future and engage in some informed speculation about what the island economy might look like in ten or twenty years from now, at a time when we may look back at the Good Friday Agreement as a turning point in the fortunes of our island and a harbinger of peace, stability and prosperity. In part 5 we draw some general conclusions.
[2] The island economy of the past

In his illuminating account of the post-War success of Japan, the economist Mikio Morishima felt it necessary to go back to the fourth century! We do not need to go back quite so far in order to understand how the island economy came to be in its present state, but we do need to revisit some of the consequences of the Act of Union. One such consequence in the late 19th century was the emergence of a North-South divide on the island, into a prosperous industrial North-East and a poor agricultural South. Even after partition in 1920, this divide continued to influence the external orientation and economic possibilities on both sides of the border, and the legacy of the earlier period has only recently been overcome at the end of the 20th century.

Ireland's industrialisation never emulated Britain's generalised economic and technological leap forward. Rather, it involved a few specific sectors (brewing, linen, shipbuilding), and selected locations (mainly Belfast and Dublin), and by-passed much of the rest of the country. What is of interest is that the concentration of the key sectors, linen and shipbuilding, came to be located almost exclusively in the north-east corner of the island. The greater Belfast region took on all the attributes of an "industrial district", i.e., a geographically defined economy characterised by a large number of firms that are involved at various stages and in various ways, in the production of closely inter-related products. Population grew in the area around Belfast, to the extent that, by the year 1911, the population of the Belfast area had outstripped that of Dublin.

The South embarked on a path of political independence after 1922 with an economy that was without significant industrialisation and dependent on mainly agricultural exports to the British market. The North achieved a degree of regional autonomy within the UK at a stage when the perilous state of its strong industrial base was still hidden in the aftermath of the economic boom created by the First World War.

Between 1921 and the early 1960s there were many changes in the North and South, but few of major significance compared with the legacy of the pre-1922 period. The South attempted to construct an industrial base behind a protective barrier of high tariffs. The North's staple industrial specialisations continued to decline, with a temporary period of growth during and immediately after the Second World War. Both regions entered the 1960s in a state where major policy changes were needed, even in a situation where the North had been moderately successful during the 1950s in attracting British investment in the area of textiles, artificial fibres and other petroleum-based products. What was not anticipated was that the outbreak of civil unrest would make this transformation much more prolonged and difficult than it would have been in a period of peaceful economic transition.

The mid 20th century features of the island economy had clear origins in the early and middle of the 19th century. These included a weak island industrial base, other than in the north-east corner of the island; the interaction of population growth with weak economic performance that was to appear as a mixture of unemployment/under employment and emigration; a vicious circle of interaction between emigration and a weak ability to create a national system of innovation; and an almost complete
integration into and dependence on the British economy. Only after a period of national crisis was a sustained effort made in the South to address these problems, beginning with the publication of *The First Programme for Economic Expansion* in 1958. It was to be a long haul, and the fruits of success we not to become available until the 1990s. Parallel efforts made in the North during the 1950s and 1960s produced a rate of Northern industrial-based growth that for a short while exceeded that of Britain. However, subsequent efforts were hampered by a lack of appropriate regional policy instruments and by the effects of the outbreak and persistence of civil unrest that lasted from the late 1960s until the cease-fires of the early 1990s.

[3] The island economy today

Radical transformations have taken place during the past three decades in both economies of the island, introducing dramatic differences in the relative performance of North and South. Overlaying these differences is the civil unrest (or so-called “troubles”) that casts a shadow over the recent economic development of Northern Ireland. A detailed discussion of the reasons for the stronger performance of the South relative to the North in the last decade would require a separate book. Basically five key factors are involved in the South’s dynamic performance: the steady build-up of human capital after the educational reforms in the 1960s; the major improvements in physical infrastructure, particularly since 1989 as a result of the EU Structural Funds; the extreme openness of the economy, export orientation to fast growing markets and products, together with benefits stemming from the completion of the Single European Market and from massive foreign direct investment inflows; the changing demographic structure and the role of inward migration in preventing skill shortages; and the stable domestic macroeconomic policy environment.

The role played by large-scale British financial support in sustaining the standard of living in the North has perhaps served to mask the true nature of the differences in performance between North and South. The situation in the North would appear to be rather less advantageous than in the South for each of the above five factors. The problems associated with the selectivity of the Northern education system and the effective exclusion of many from higher education are beginning to be understood. Economic openness is less beneficial to the North than is the case in the South, since the North’s export orientation is mainly to the slower growing British markets and to more traditional products. The overhang of the large financial subvention and fears about its possible reduction has introduced uncertainty to Northern medium-term economic planning. Northern demographic trends remain out of line with the European norms to which the South has converged. In fact the only exception where the relative position of the North is better than the South is in the state of physical infrastructure, and this is changing rapidly.

We turn our attention now to some of the main features of the economies of both regions as they are today. We first examine the issues of relative standards of living, and then comment on the wider performance of both economies.
3.1: Relative standards of living

Comparisons of the present state of the economies of North and South can be made for a variety of reasons. A simple reason might spring from a desire to rank both regions in a performance league table with a view to deciding which was the more "successful" in some sense yet to be defined. A more pragmatic reason might be to seek to understand better the current and likely future performance of either or both regions with a view to exploiting trade and other business opportunities between them.

We can illustrate some aspects of these issues by first looking at the levels of national output (more precisely, GDP at factor cost) per head in the North and South (Table 3.1).³

Table 3.1: GDP at factor cost per head: Northern Ireland and the Republic of Ireland

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<tbody>
<tr>
<td>NI (£)</td>
<td>6,396</td>
<td>6,930</td>
<td>7,205</td>
<td>7,620</td>
<td>7,974</td>
<td>8,423</td>
<td>8,700</td>
</tr>
<tr>
<td>RoI (£IR)</td>
<td>6,907</td>
<td>7,192</td>
<td>7,545</td>
<td>8,177</td>
<td>8,720</td>
<td>9,703</td>
<td>10,591</td>
</tr>
<tr>
<td>RoI (£)</td>
<td>6,425</td>
<td>6,567</td>
<td>7,313</td>
<td>7,984</td>
<td>8,526</td>
<td>9,863</td>
<td>10,863</td>
</tr>
<tr>
<td>NI/RoI</td>
<td>1.00</td>
<td>1.06</td>
<td>0.99</td>
<td>0.95</td>
<td>0.94</td>
<td>0.85</td>
<td>0.80</td>
</tr>
</tbody>
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Source: Data for Northern Ireland are taken from Table 12.1 of Regional Trends 33, 1998 edition, ONS. Data for the Republic of Ireland are taken from Table 3 of National Income and Expenditure 1997. Conversion of £IR to sterling uses annual average exchange rates taken from the Quarterly Reports of the Central Bank of Ireland. No alteration is made for differences in relative cost-of-living (i.e., purchasing power parity).

Starting off in the year 1990 at about parity in terms of national output per head, and ignoring the anomaly in the year 1991, the trend has been for the Republic of Ireland to move systematically ahead of Northern Ireland in terms of this measure of performance. By the year 1996, the gap between North and South had risen to 20 per cent.

However, although GDP at factor cost is a useful measure of the value of goods produced in each region, and is closely related to employment and investment activity in production, it is not a very good measure of income accruing to the inhabitants of either region since there are leakages of funds out of, as well as inflows into, each region from abroad.⁶ The main outflows from the Republic of Ireland consist of that element of profits made by foreign multinational firms which is repatriated as well as interest payments made to foreign holders of Irish national debt. Inflows arise mainly from payments from abroad made to private citizens as well as from funding associated with the EU (mainly CAP subsidies and Structural Funds). These inflows and outflows are measured in the Irish National Accounts and permit the construction of an aggregate measure of economic activity that more accurately reflects how much income remains within the domestic economy, i.e. GNP or gross national product.⁷

Since research by the Northern Ireland Economic Council has shown that a considerable portion of Northern manufacturing and services is also externally owned, it is clear that there must be significant outflows of profits from Northern Ireland to Britain, the USA and elsewhere. Unfortunately these are not measured officially. On the other hand,
some of the main inflows are recorded and published, and consist of the so-called “subvention” from Britain (by far the largest element) as well as funding from the EU (mainly agricultural (CAP) subsidies, Structural Funds and the Peace and Reconciliation funds), which is a relatively minor consideration.

A better measure of relative welfare North and South that is published in both regions is provided by the level of Personal Disposable Income (PDI) per head of population. PDI measures income of the personal sector (i.e. households, other individuals and non-profit making bodies serving persons), after deduction of all direct taxes on income. Table 3.2 shows this for the years 1990-96, since official data are not presently available after 1996.

Table 3.2: Personal disposable income per head: Northern Ireland and the Republic of Ireland

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<tbody>
<tr>
<td>NI (£)</td>
<td>5,767</td>
<td>6,385</td>
<td>6,839</td>
<td>7,208</td>
<td>7,537</td>
<td>7,960</td>
<td>8,181</td>
</tr>
<tr>
<td>RoI (£IR)</td>
<td>5,196</td>
<td>5,498</td>
<td>5,798</td>
<td>6,119</td>
<td>6,389</td>
<td>6,799</td>
<td>7,165</td>
</tr>
<tr>
<td>RoI (£)</td>
<td>4,833</td>
<td>5,021</td>
<td>5,619</td>
<td>5,975</td>
<td>6,247</td>
<td>6,911</td>
<td>7,349</td>
</tr>
<tr>
<td>NI/RoI</td>
<td>1.19</td>
<td>1.27</td>
<td>1.22</td>
<td>1.21</td>
<td>1.21</td>
<td>1.15</td>
<td>1.11</td>
</tr>
</tbody>
</table>

Source: Data for Northern Ireland are taken from Table 12.7 of Regional Trends 33, 1998 edition, ONS. Data for the Republic of Ireland are taken from Table 9 of National Income and Expenditure 1997. Conversion of £IR to sterling uses annual average exchange rates taken from the Quarterly Reports of the Central Bank of Ireland. No adjustment is made for differences in relative cost-of-living (i.e., purchasing power parity).

Since personal disposable income can be used either for consumption or savings, one would expect that the levels of consumption per head North and South would mirror the levels of income per head, and Table 3.3 shows that this is broadly the case.

Table 3.3: Household consumption per head: Northern Ireland and the Republic of Ireland

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<tr>
<td>NI (£)</td>
<td>6,357</td>
<td>6,916</td>
<td>7,409</td>
</tr>
<tr>
<td>RoI (£IR)</td>
<td>5,732</td>
<td>6,065</td>
<td>6,477</td>
</tr>
<tr>
<td>RoI (£)</td>
<td>5,605</td>
<td>6,165</td>
<td>6,643</td>
</tr>
<tr>
<td>NI/RoI</td>
<td>1.13</td>
<td>1.12</td>
<td>1.12</td>
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</table>

Source: Data for Northern Ireland are taken from Table 12.8 of Regional Trends 33, 1998 edition, ONS. Data for the Republic of Ireland are taken from Table 5 of National Income and Expenditure 1997. Conversion of £IR to sterling uses annual average exchange rates taken from the Quarterly Reports of the Central Bank of Ireland. No adjustment is made for differences in relative cost-of-living (i.e., purchasing power parity).

On the basis of personal disposable income per head, in 1996 the average person in Northern Ireland was about £832 (or 11 per cent) better off than the average person in the Republic of Ireland. The North-South differential in personal disposable income
has declined from a value of £934 per head in 1990 or a percentage difference of around 20 per cent. Since the consumer price level rose in the North by 11.2 per cent more than in the South between 1990 and 1996 (see table 3.5 below), in simple real purchasing terms the PDI differential in 1996 was about £750 per head or just over 10 per cent in the North’s favour. With growth in the South far outstripping that in the North since 1996, it is likely that a further narrowing of the PDI differential has occurred and that, at least according to this indicator of average living standards, the South will probably overtake the North in the very near future unless Northern private sector growth accelerates or unless the per capita subvention rate is increased.

One might be tempted to attribute the differential in favour of Northern Ireland to the superior economic performance of the Northern economy, and in a certain highly qualified sense this is true. However, if we define regional performance net of external transfers, then a rather different picture emerges. The “subvention” paid by the UK government to Northern Ireland in recent years (i.e. the difference between revenue raised in or attributed to Northern Ireland and public expenditure) amounted in 1995 to just over £2,000 per person. The fact that Northern Ireland is politically a region of the UK means that it attracts this subvention automatically from being part of the UK fiscal union. However, such a high level of subvention is needed for Northern Ireland only because – as demonstrated by UK regional research - without the subvention its economic performance has been and remains poor compared to the other ten standard UK regions.

The Republic of Ireland, on the other hand, attracts no such subvention, but does receive generous investment aid from the EU under the Structural Funds (or Community Support Framework), as well as agricultural subsidy payments through the CAP. However, depending on whether or not one includes the CAP subsidy payments with the CSF for the case of the Republic of Ireland, these are between 5 times (including them) and 9 times (excluding them) smaller per person per year than the NI subvention. With the winding down of Structural Funds between 2000-2006, the ratio is now even bigger.

Hence, in any comparison of the economies of Northern Ireland and the Republic of Ireland, policy differences that arise due to differences in governance must be kept in mind. Simplistic and unqualified comparisons of economic indicators tend to be misleading and generate fruitless debate. More detailed comparisons can be more informative if the objective is to explore the ability of the regional private sector to compete in external markets and to lessen the dependence on external public finance. However, one should not be too dogmatic about the conclusions since the welfare as well as the political issues are complex. Nevertheless, the implications of severe regional imbalances in public finances and their consequences for the relative sizes of the public and private sectors in a region eventually lead to problems of dependency. In nation states they either lead to policy feed-backs that restore balance to the public finances or, in the absence of appropriate policy responses, they can ultimately lead to loss of economic sovereignty.
3.2: North-South strengths and weaknesses

As a prelude to consideration of how matters might improve, it is useful to summarise the strengths and weaknesses of both economies as they are today. In the case of Northern Ireland, a series of structural weaknesses in the economy are to some extent a legacy of the past industrial strength of the region, and have three main characteristics. First, there is a continued dependence on the traditional sectors like textiles, shipbuilding, clothing and footwear, which are particularly vulnerable to low-cost competition and changing demand. Second, there is a deficit in education levels (particularly at the middle and lower ends) that contributes to low productivity and high structural unemployment. Third, a structural dependence on the public sector to sustain employment has emerged as a consequence of an inability to attract high quality foreign direct investment in sufficient quantity to offset the decline in domestic traditional industry.

The difficulties experienced by policy-makers in attempting to address these problems are reasonably well understood. There has been an unwillingness (or inability) of the Northern Ireland authorities to make a break with previous areas of specialisation. There is only very limited degree of policy autonomy within NI, which effectively prevented the emergence of region-specific policy variations from national policies designed to address region-specific structural problems. Finally, the disruption caused by violent conflict – together with related problems of increased labour market segmentation and discrimination – made it much more difficult to mobilise resources of both private capital and labour to bring about fundamental changes.

A very different pattern of behaviour has been experienced in the Republic of Ireland. Here, the main background factors underlying present growth could be summarised as follows. Exercising its policy autonomy, there was a dramatic break with protectionist policies from the late 1950s, and much of the artificially sustained inefficient indigenous industry was subsequently allowed to fail. A tax-based competitive environment was created that was attractive to foreign direct investment, while simultaneously working to improve the level of domestic physical infrastructure and human capital. This policy, after a slow start in the 1960s, eventually proved to be spectacularly successful by the mid-1990s, to the extent that about 60 per cent of manufacturing output in the Republic of Ireland is now produced by foreign-owned multinational enterprises. Finally, the economy of the Republic of Ireland was largely untouched by the destructive and disruptive aspects of the Northern violence. Where costs associated with conflict-related spillovers had to be borne, they were containable and mainly in the areas of increased security in border areas.

A period of peace is necessary to facilitate structural reform and change, and should permit the Northern Ireland economy to accelerate its growth and development. However, the existence of two economies on the island of Ireland is likely to impose constraints on this process unless barriers are identified and removed. We now turn to consideration of barriers that arise due to market failure and policy mismatch.
The island economy of the future

4.1: Strategic issues

In a wide strategic context, the two regions of the island appear to be characterised by very different economic policy environments as they plan for their futures. In the case of the Republic of Ireland, its strategic policy orientation towards the future is relatively benign at present and could be characterised in terms of five key issues. First, the continued creative use of its modest but significant scope for national policy-making autonomy against a background of a progressive ceding of elements of macroeconomic fiscal and monetary policy autonomy to the institutions of the EU. Second, a continuation of the crucial policy orientation of the past decades concerning openness to inward investment using a mainly tax-based system of industrial incentives and associated improvements in physical infrastructure and human capital. Third, further modernisation of the industrial base through targeted foreign direct investment in high technology areas as well as through steady expansion of indigenously-owned industry. Fourth, a likely continuation of the process of “decoupling” of the economy away from the earlier heavy dependence on the UK as a result of its sustained systematic and pro-active orientation towards participation in EU policy initiatives. Fifth, the pursuit of steady improvement in economic performance with the aim of converging systematically towards the standard of living of the wealthier core economies of the EU as well as bringing about greater social equity.

The strategic policy context for Northern Ireland is more difficult to characterise with any degree of precision since the region has only recently experienced a sustained period of peace and is in the process of designing and implementing major changes to its system of political and economic governance. Nevertheless, from a strategic point of view the region faces major policy challenges and will have to address some potentially serious issues. First, the continuation into the medium term of a situation where the region has limited regional policy-making autonomy combined with a lack of political consensus as to the wisdom of seeking out and using greater policy autonomy in the context of the Good Friday Agreement. Second, the continued use of a range of policy instruments (particularly in the area of indiscriminate grant-based industrial incentives) that have not proved particularly effective in the past. Third, difficulties in modernising its manufacturing base away from its traditional specialities, e.g. textiles and clothing towards higher value-added products. Fourth, a continuing dependence on Britain as the main external sales destination, with potentially undesirable consequences in terms of slow and erratic growth in the longer term and with the UK remaining outside EMU for the present at least. Fifth, economic peripherality within the UK, one of the lowest standards of living among the UK regions, combined with the possible perpetuation of dependence on external financial aid in the form of the "subvention", with consequential lack of dynamism in the regional economy (i.e. a Mezzogiorno problem)

The fact that the Northern and Southern strategic policy orientations are so out of alignment is likely to have disruptive consequences for planning and executing moves towards the completion of the island market economy. While there are likely to be many positive aspects to the evolution of North-South relationships over the coming years, there will be negative aspects as well. In very general terms, the strategic policy
environment of the Republic of Ireland would appear to be more favourable at present than the situation facing Northern Ireland. There remains the possibility that, in the absence of explicit and concerted North-South co-operative initiatives, there will be a tendency for a continuation of the previous process of essentially separate development of the two regions and an inability to complete the island economy, even as conventional North-South trade continues to expand. In the absence of appropriate island-wide policy making forums, there is likely to be a lack of focus and urgency in addressing the related problem and consequences of policy mismatch. There may be a tendency to accept the continuation of the economic isolation and internal peripherality of the immediate cross-border regions, in particular the north-west region centred on Donegal and Derry, the central region of Armagh, Fermanagh, Sligo, Monaghan, Leitrim and Cavan, and the east border region of Down and Louth, centred on Newry and Dundalk.

In the light of the differing strategic policy making contexts of North and South, we need to understand how the process of market completion is progressing on the island. Guided by the mainstream EU material from the Cecchini (1988) and the Monti (1997) programmes of Single European Market (SEM) research, it is possible to isolate three main areas of the island economy where market completion continues to be hindered due to the presence of the border.

(i) The first (and most direct) involves the direct spatial disruptive impacts of the physical presence of the border itself.

(ii) The second concerns the emergence of different industrial structures in Northern Ireland and the Republic of Ireland.

(iii) The third follows directly from structural mismatch in the industrial area and involves the consequential distorting impact of the border on conventional North-South trade.

4.1: Physical border problems

An obvious barrier to the full market completion of the island economy is, of course, the physical existence of the border itself since 1922. The Single Market in the EU has now removed all remaining non-tariff barriers that were border-related, and goods and services can now pass through the border with little or no disruption other than problems related to security whenever violence resurfaces within Northern Ireland. However, this does not mean that the border has ceased to be of any significance for economic development on the island.

A continuing legacy of the border is that the development of physical infrastructure on the island is a long drawn out process and the disruptive impact of the border is therefore likely to endure for a long time. The physical infrastructure of the island for most of this century was developed within each region in isolation from the other, with little or no account taken until recently of how it could be best co-ordinated to maximise all-island business and economic developmental needs. Moreover, the border has created areas of internal peripherality and cut regions off from their natural economic
hinterlands, e.g. the north-west region (centred on Derry) and the north-east region (straddling the border between Newry and Dundalk).

A recent manifestation of the peripherality of Donegal arose in connection with the troubled *Fruit of the Loom* plants there. An (unpublished) report prepared for the IDA stated:

> “Despite our efforts, few companies have chosen to locate in the North West region. Our experience of dealing with clients who have located elsewhere has shown us that poor access by air and road, Northern troubles, limited sub-supplier capacity and small urban structure have made the region unattractive in comparison with other locations” (*Irish Times*, August 17th, 1998).

The consequences of these distorting processes – legacies from a time when cross-border co-operation and policy co-ordination were largely absent - are aspects where the cross border implementation bodies dealing with transport, the environment, waterways, tourism, EU programmes and urban and rural development are likely to initiate major improvements in the nature and quality of social and commercial relationships in the immediate border areas as well as further afield.

4.2: Industrial structure

Overall manufacturing employment shares in Northern Ireland and the Republic of Ireland are fairly similar, though the South has a far higher concentration in high technology industries. The Southern situation reflects the much more significant contribution of foreign direct investment, which has raised productivity and profitability substantially. Indirect information on the indigenously owned sectors suggests greater similarity, North and South.

Table 4.1 shows the manufacturing employment shares for the main UK regions as well as for the Republic of Ireland, disaggregated into three broad sub-sectors: Food, Drink and Tobacco; a traditional sector consisting mainly of textiles, leather and wood products; and the remainder, which consists broadly of modern industries. The similarities between Scotland and the Republic of Ireland are apparent, where both have a higher than average concentration of employment in Food, drink and tobacco and a share of modern manufacturing employment that lies between that of England and Wales (at the high end) and Northern Ireland (at the low end).

| Table 4.1: Traditional and modern industry – 1996 employment percentage shares |
|---------------------------------|----|----|----|----|----|----|
|                                 | UK | England | Wales | Scotland | NI | RoI |
| Food, drink and tobacco         | 11.7 | 11.0 | 10.5 | 17.9 | 18.6 | 20.5 |
| Traditional                     | 16.4 | 16.0 | 14.4 | 17.6 | 29.8 | 15.0 |
| Modern                          | 71.9 | 73.0 | 75.1 | 64.5 | 51.6 | 64.5 |
| Total                           | 100 | 100 | 100 | 100 | 100 | 100 |

4.3: Trade patterns

A key relationship between the economies of Northern Ireland and the Republic of Ireland involves North-South trade. The ability to sell outside a regional economy requires the ability to produce a range of goods and services that are in demand elsewhere. Our characterisation of the Northern and Southern productive structures - with the South having a more modern industrial base - has important implications for trade and we now turn to these issues.

Table 4.2 shows the export proportions of Southern trade with the North, Britain and the rest of the EU for the year 1997. Table 4.3 shows similar data for imports.

| Table 4.2: Republic of Ireland: Export shares by destination, 1997 |
| Exports to NI | Exports to Britain | Exports to rest of EU |
| 2.9% | 21.4% | 45.0% |
| Source: Trade Statistics, December 1997, CSO. |

| Table 4.3: Republic of Ireland: Import shares by origin: 1997 |
| Imports from NI | Imports from Britain | Imports from rest of EU |
| 2.8% | 30.9% | 24.2% |
| Source: Trade Statistics, December 1997, CSO. |

Data for external sales shares for the North are shown in Table 4.4. Unfortunately, data on imports by the North are not available since regional data are not collected in the UK.

| Table 4.4: Northern Ireland: External sales by destination, 1996/97 |
| Sales to Britain | Exports to RoI | Exports to rest of EU |
| 50.7% | 9.6% | 20.6% |
| Source: Made in Northern Ireland Sold to the World, NIERC/DED/IDB, 1998 |

These tables show that exports from the South to the North account for about 3 per cent of total Southern exports, while exports from the North to the South account for almost 10 per cent of total external sales. In other words, the South is over three times more important as an export market for Northern firms than the North is as an export market for Southern firms. On the other hand, Britain is over twice as important a market for Northern firms than it is for Southern firms, which are more oriented towards trade with the rest of the EU. However, Britain is more important for the South as a source of
imports than it is as a destination for exports, i.e., the South runs a trade deficit with Britain. However, the South runs a trade surplus with the North, which totalled about £IR 300 million for the year 1997.

To explore the details of bilateral North-South trade we can make use of the detailed trade statistics produced by the Irish Central Statistics Office. Table 4.5 shows Southern exports to the North, to Britain and to the entire EU, disaggregated using the Standard Industrial Trade Classification (SITC), with specific details of some subdivisions. The table highlights some striking facts. Exports from the South to the North are heavily concentrated in SITC 0 (Food and Live Animals), accounting for 24.5 per cent of total Southern exports to Northern Ireland. For the same product category, this compares with 17 per cent of total exports to Britain and only 11 per cent of total exports to the EU as a whole.

There is a very high concentration of Southern exports in categories SITC 7 (Machinery and Transport Equipment) to Britain and the EU as a whole, accounting for over a third in each, but only 12 per cent of total Southern SITC 7 exports to the North. More notably, for the important category of SITC 75 (Office and ADP machines), almost 25 per cent of Southern exports to Britain and to the EU fall into this category but less than 2 per cent of total exports to the North.

The situation for SITC 5 (Chemicals and related products) is also anomalous, but not quite as dramatic as the previous cases, with 24 per cent of total exports to EU in this category, 16 per cent to Britain, but only 9 per cent to the North. One should note a residual category – “Other” – which makes up 15 per cent of total Southern exports to the North, and is negligible to anywhere else. This category consists of goods whose trade volume is at too low a threshold to be accurately recorded, and almost certainly consists of traditional rather than high technology products.

Table 4.6 gives the corresponding data for shares of Southern import from the North, from Britain and from the EU as a whole. It is clear that Southern imports from the North are very heavily concentrated in SITC 0 (Food and live animals), accounting for 25 per cent of total imports, compared to 9 per cent from Britain and the EU.

The importance of Southern imports from Britain and from the EU in SITC 7 (Machinery and Transport Equipment) is clear, with one third of the total from each, but only 8 per cent from the North. In SITC 75 (Office and ADP machines) and 77 (Instruments), Southern imports from the North have a very low share of the total of imports from the North. This pattern is repeated, though less dramatically, for SITC 5 (Chemicals).

If one defines “traditional” products as SITC sections 0, 6, 8 and “Other”, then about 73 per cent of total Southern imports from the North fall into this category. The corresponding figure for Southern imports from Britain and from the EU are only 46.1 and 41 per cent, respectively.
Table 4.5: Republic of Ireland export shares by SITC sections: 1997

<table>
<thead>
<tr>
<th>SITC</th>
<th>Exports to NI* (percentage of total)</th>
<th>Exports to Britain* (percentage of total)</th>
<th>Exports to EU* (percentage of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>24.5</td>
<td>16.9</td>
<td>11.3</td>
</tr>
<tr>
<td>1</td>
<td>6.6</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td>2</td>
<td>2.8</td>
<td>2.2</td>
<td>1.8</td>
</tr>
<tr>
<td>3</td>
<td>1.1</td>
<td>1.0</td>
<td>0.6</td>
</tr>
<tr>
<td>4</td>
<td>0.0</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>5</td>
<td>9.3</td>
<td>15.9</td>
<td>24.4</td>
</tr>
<tr>
<td>6</td>
<td>17.4</td>
<td>5.6</td>
<td>4.4</td>
</tr>
<tr>
<td>7</td>
<td>12.1</td>
<td>36.8</td>
<td>35.6</td>
</tr>
<tr>
<td>(54)</td>
<td>0.8</td>
<td>4.2</td>
<td>(5.6)</td>
</tr>
<tr>
<td>8</td>
<td>12.0</td>
<td>14.8</td>
<td>15.0</td>
</tr>
<tr>
<td>9</td>
<td>0.0</td>
<td>3.1</td>
<td>3.9</td>
</tr>
<tr>
<td>Other</td>
<td>15.3</td>
<td>1.8</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Source: Trade Statistics, December 1997, CSO.
Note: Totals of shares may not add to 100 due to rounding

Table 4.6: Republic of Ireland import shares by SITC sections: 1997

<table>
<thead>
<tr>
<th>SITC</th>
<th>Imports from NI (percentage of total)</th>
<th>Imports from Britain (percentage of total)</th>
<th>Imports from EU (percentage of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>24.7</td>
<td>9.2</td>
<td>9.1</td>
</tr>
<tr>
<td>1</td>
<td>7.2</td>
<td>0.9</td>
<td>1.7</td>
</tr>
<tr>
<td>2</td>
<td>2.4</td>
<td>0.9</td>
<td>1.5</td>
</tr>
<tr>
<td>3</td>
<td>1.2</td>
<td>5.8</td>
<td>3.4</td>
</tr>
<tr>
<td>4</td>
<td>0.0</td>
<td>0.6</td>
<td>0.5</td>
</tr>
<tr>
<td>5</td>
<td>8.2</td>
<td>13.6</td>
<td>15.4</td>
</tr>
<tr>
<td>(54)</td>
<td>0.6</td>
<td>(2.7)</td>
<td>(2.6)</td>
</tr>
<tr>
<td>6</td>
<td>25.5</td>
<td>17.0</td>
<td>15.7</td>
</tr>
<tr>
<td>7</td>
<td>8.5</td>
<td>31.8</td>
<td>34.7</td>
</tr>
<tr>
<td>(75)</td>
<td>(2.2)</td>
<td>(7.5)</td>
<td>(8.4)</td>
</tr>
<tr>
<td>(77)</td>
<td>(1.2)</td>
<td>(9.0)</td>
<td>(7.7)</td>
</tr>
<tr>
<td>8</td>
<td>10.5</td>
<td>15.3</td>
<td>13.0</td>
</tr>
<tr>
<td>9</td>
<td>0.0</td>
<td>1.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Other</td>
<td>11.8</td>
<td>3.7</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Source: Trade Statistics, December 1997, CSO.
Note: Totals of shares may not add to 100 due to rounding

Thus, the composition of bilateral trade between the North and the South is very different from bilateral trade between Britain and the South, as well as between the EU as a whole and the South. North-South trade – both ways – is predominantly in traditional, low technology products with an exceptionally high weights for SITC 0 (Food, Drink and Tobacco). Perhaps surprisingly this phenomenon has not received the attention it deserves, but of course simply reflects the underlying industrial structure in
Northern Ireland compared with the Republic of Ireland. We saw earlier in this section that the two industrial structures are very different: the South having a concentration in modern high technology sectors, and the North specialising in more traditional sectors. However, the most important dynamic promoting increased intra-EU trade in the Single Market of the EU is associated inter-firm trade in similar product areas rather than trade in finished consumer goods. This two-way trade simply cannot easily take place between North and South, given the contrasting production structures.

4.4: The future of North-South trade

With an improved political situation in the North, recent experience shows that the previous reluctance of individuals and groups to travel freely between both regions is declining. Greatly increased North-South tourist flows, and the pressure on the limited capacity of the Belfast-Dublin road and rail links, bear testimony to this process of North-South development. However, there remain other important reasons for continued market segmentation related to such issues as the very different industrial structures, different fiscal and monetary/exchange rate regimes, the separate and parallel functioning of public sector development agencies like the IDA and Enterprise Ireland in the South and the IDB and LEDU in the North, with their obvious implications for higher business transactions costs when working in both markets.

It is heartening to note that rapid progress is being made in addressing the problem of North-South market segmentation. Trade literature in the South is now targeted at disseminating information on Northern marketing opportunities. An ambitious joint initiative of An Bord Tráchtála (now Enterprise Ireland) and the Northern Ireland Industrial Development Board, supported by the International Fund for Ireland, has resulted in the publication of a detailed marketing guide to fifteen key product areas, facilitating greater North-South trade penetration as well as providing opportunities for import substitution. Joint promotions of Irish products overseas have been organised, and strategic alliances are being encouraged between Northern and Southern firms. The distribution system on the island, which has tended to deal with the North as part of the UK and with the South as a separate region, is gradually being integrated on an island basis. In the longer term, the development of strategic transport links on an integrated all-island basis would be a powerful force for removing North-South market segmentation. Finally, the recently agreed North-South Implementation Bodies include a major initiative on Trade and Business Development.

The potential gains from greater North-South trade interaction, given existing Northern industrial activity, may be modest relative to the potential gains from greater penetration into wider world markets, including British markets. Nevertheless, there are gains to be made from intra-island trade in circumstances that will assist in strengthening the competitive performance of all businesses on this island. North-South trade improvement on this island is not an alternative to East-West trade improvement, but is entirely complementary to it. It is a transitional process that will produce gains in the short term and, by strengthening its supply side, will help to position the island economy to make further advances in world markets. North-South trade will reach its potential if and only if the structure of manufacturing in Northern Ireland can be modernised and brought into line with that of Wales and Scotland.
4.5: The euro and North-South economics

As in the case of fiscal policy, the North has no scope for an independent monetary policy. Hence, the impact of monetary policy mismatch on cross-border interactions must also be viewed in the light of the UK-Republic of Ireland policy interface. At present, this comes down to the decision of the South to participate in EMU and the decision of the UK to stay out, at least from the start-up phase.

The potential benefits of any currency union consist of reduced transactions costs, lower interest rates, increased price transparency and (if the European Central Bank does its job properly!), lower inflation. Potential costs consist of transitional expenses (cash registers, ATMs, accounting arrangements and price displays); the possibility that so-called “core” regions will gain at the expense of “peripheral” regions; the fact that more of the costs of adjustment to adverse shocks will have to be borne by the labour market in the absence of a national exchange rate; the prospect that some sectors may be hit more than others; and (importantly for the peace process), the evolution of North-South business interactions on this island may be hindered by the non-membership of the UK.

Why is there a regional dimension to EMU within the UK? After all, the Maastricht criteria only have meaning at the national level and regions of the UK already share a common currency. But if decisions on EMU are taken with “national” criteria in mind, the consequences for the regions are unlikely to be uniform. Regional economies within nation states can be and are very heterogeneous. Regions tend to specialise (the financial sector in London; engineering in the English midlands; textiles in Northern Ireland), creating the possibility of what economists call “asymmetric” shocks. The regions of the UK can have very different trading relations with other regions and with the rest of the world. For example, the North is more heavily oriented towards the South than is any other UK region. Regional labour markets differ in their degree of “flexibility” and in the mobility and skills of the labour force. Finally, national fiscal and monetary policies impact differently on regions, with the more prosperous regions of the south of England contributing to the welfare of the less prosperous regions of the north and west of the UK.

Since regional issues appear to be potentially significant, and since there are likely to be regional winners and losers in EMU (whether or not the UK eventually joins), what is the broad context of regional policy? The advent of the Single European Market has already greatly restricted national policy autonomy. EMU simply continues this trend and some countries like this more than others! However, regions have begun to emerge as “natural economic zones”, which can be regions within a single nation state as well as zones of cross-border co-operation between regions in different nation states. Purely region-specific policies (in the industrial, educational and social spheres) tend to operate on the supply-side of the regional economy. With recent moves towards more regional devolution within the UK, the optimum degree of regional policy autonomy has become a live issue and debate, particularly in Scotland. And finally, since regions will always have a lesser degree of formal policy autonomy than the nation as a whole, there is need for innovative regional mixtures of public and private sector initiatives and collaboration that are perfectly compatible with being an integral part of a nation state.
As a peripheral region of the UK, there are effectively two “domestic” markets for Northern Ireland to trade in: its own local market and the wider British market. Exchange rate fluctuations will not directly affect Northern Ireland’s intra-UK relationship. However, there are indirect factors to be considered which will impact differently on the local and the national economy. Thus, the high sterling rate against the euro has made UK-produced goods less competitive in the domestic UK market to the extent that there are euro-priced competing goods in that market. Since many Northern-produced goods appear to be sold as intermediate inputs to other British firms before being exported as final goods, the North’s crucial intra-UK trade is unlikely to be protected for long from sterling’s strength against the euro. Of course, the opposite would hold if sterling were to weaken against the euro. This is a serious matter for the North since about 80 percent of manufacturing employment is domestically (or UK) oriented.

We conclude with some remarks on the effect of EMU on North-South economic interactions. The peace process that emerged during this decade, and that has culminated in the Good Friday Agreement, has been associated with rapid growth and deepening of North-South business and economic ties. The mutually beneficial nature of these developments is widely acknowledged, even if there are different priorities and agendas for future progress. The key question at issue for the immediate future is whether the non-participation of the UK in EMU will erect barriers to increased North-South interactions in the economic and business sphere? We can illustrate just one small aspect of this issue by drawing attention to the finding that small firms in Northern Ireland (i.e., with a turnover of less than £500,000 in 1990 or employing less than 50 people) who sell outside the UK do so predominantly to the Republic of Ireland. Given their characteristics, such firms are also most at risk to EMU-induced loss of competitiveness should sterling strengthen relative to the Euro. Indeed, they are already suffering in this way.

With the UK out of EMU, the North-South border will take on the role of a European policy “fault line”. Just as with geological fault lines, policy fault lines are going to make it more difficult to encourage the deepening of North-South linkages and structures, and will continue to distort the vulnerable and underdeveloped economies of the immediate cross-border region. More generally, Northern Ireland will be buffeted in the backwash of the consequences of UK non-participation in EMU. In the Republic of Ireland, these negative consequences will tend to be offset by other positive benefits of EMU membership.
4.6: The island economy of the future

Industry in Northern Ireland has yet to develop dynamic, self-sustaining characteristics, especially in terms of clusters of related and supporting industries. It remains heavily subsidised by public funding and is concentrated in the low technology sectors of traditional industries such as textiles and clothing. The situation in the South is somewhat healthier, but because industrial development has been so heavily driven by foreign direct investment, which tends not to lay down the full range of developmental roots in the domestic economy, the key interconnections between related firms and industries have yet to take place fully.

How might this situation be improved? Both regions are individually small, with populations of only 1.6 and 3.8 million respectively. The North is not only separated geographically from Britain, but, importantly, also appears to be very weakly integrated into the supply side of the British economy, even when demand for Northern output is driven by the British market. For example, the North is almost never central to strategic planning by British firms and is, therefore, both geographically and economically peripheral to Britain. However, recent improvements in access transport and a more positive political situation should help to alleviate this situation over time. But the North is unlikely ever to be placed on a par with the rest of the British economy, at least from the supply side perspective. Rather, it is likely to remain the case that the North will remain economically peripheral to Britain. In contrast, however, there is less geographical or economic logic to the North remaining peripheral to the South.

The logic in favour of deepening North-South supply-side links, thus making the two Irish regions less peripheral to each other, is partly economic (dealing with cross-border policy externalities and spillovers), partly geographic (close proximity and land borders have a unique and inescapable logic of their own), partly cultural (although this aspect is not without problems), and partly political (since deeper North-South economic links might aid the consolidation of peace and political stability within the North and greater North-South trust and harmony).

The situation in the South, relative to the countries that provide the bulk of its foreign direct investment (i.e. predominantly the US, but also Britain and the rest of the EU), has strong analogues with the position in the North. For example, just as the North is not strategically central to externally owned (mainly British) firms located in Northern Ireland, the economy of the South is not central to the strategic planning of many of the (mainly US-based) firms located there. Rather, the South is seen as a highly profitable location for production of products mainly designed, developed, tested and marketed elsewhere, and a location where a very high quality labour force is available at reasonable cost. As already argued, the branch plant nature of foreign firms located in the South tends does not always encourage the establishment of strong economic performance built on competitive advantage. Heavy dependence on foreign investment is less likely to generate the type of cumulative self-sustaining indigenous growth that is a characteristic of successful European regional economies such as Emilia-Romagna in northern Italy and Baden-Württemberg in Germany.
The Harvard-based business strategist Michael Porter has suggested that four interacting characteristics are essential for competitive success: factor conditions, demand conditions, related and supporting industries, and firm strategy, structure and rivalry. First, with regard to *factor conditions*, there is clearly much that could be done to improve the level and quality of education, training, infrastructure and technology on an island basis, in much the same way as the South has managed to do over the past decade by itself. As Porter emphasises, improved factor conditions do not come about automatically, but as the result of government and companies bringing them about and subsequently sustaining them.

Second, *demand conditions* are a clear example of how island-based activity and policy could bring significant economic improvement. What is required is the creation of sophisticated and demanding local buyers who put pressure on companies to meet high standards in terms of product quality, features and services. There is clearly substantial scope for development on this front, even in the South where industrial success is still tightly focused around the activities of multi-national companies. There seems to be some evidence that foreign plants are beginning to source more inputs locally and that indigenous industry is responding to the challenges that they demand. However, there is certainly potential for further development. The turnaround in performance, documented by ESRI economist, Eoin O'Malley, and the increased cross-border trading activity of Northern small and medium-sized businesses suggest that circumstances are already changing for the better.

The third determinant of the competitiveness diamond is the need for *related and supporting industries*. In effect, this is the complement of demand conditions and involves the development of a critical mass of competitive suppliers of specialised components, machinery and services. The relevance of the island economy is that Porter emphasises the importance of geographic proximity and close working relationships for the promotion of the key issue of innovation, involving information flows, technical interchange and the opportunities that exist for sharing. It is in this respect that he presents the case for the importance of *clusters* of related industrial activity, with strong forwards and backwards linkages, both within and between industries.

Fourth is the importance of *firm strategy, structure and rivalry*. Again, the two economies, North and South, would still seem to lack much of what Porter argues for in this regard. For example, he states that companies rarely succeed abroad unless there is intense competitive rivalry at home. In the North, competition is limited and cushioned by high levels of public subsidisation. In the South, foreign industry does not compete locally and indigenous industry, at least until recently, operated in partially sheltered markets due to the element of non-traded goods being produced for home consumption. Intra-island trade on the island has increased in recent years, but there again remains substantial scope for further growth of high technology two-way trade.

What is required to upgrade the four Porter competitiveness factors on the island is not for the North and South to develop separately, as two separate and competing regions, but to facilitate their coming together, building on strengths and eradicating weaknesses so that genuine synergies can be realised for the mutual benefit of both North and
South. Such synergies would ultimately be reflected in the formation and development of deeply embedded, inter-connected and supportive island industrial activity. This would be seen in the emergence of industrial clusters of firms and industries feeding backwards and forwards off each other, industrial districts centred around specific industries in specific geographic regions and with the potential to increase local sourcing, and industrial networks involving the exchange between firms and industries of mutually-supportive information and knowledge.

The unfortunate reality, as we have already argued, is that both North and South have attempted to improve their competitive advantages in isolation from each other. Given the political climate of the last few decades, this process of separate development is easy to understand. The type of public and private sector planning and consultation needed to build a Porter-type strategy would have demanded levels of co-operation that were never realistically going to be politically feasible as long as the conflict in the North continued. However, the changing and more positive political situation offers many opportunities for development, which to a large degree are already being taken by the business sectors, through the CBI in the North and IBEC in the South.

[5] Conclusion

The Northern and Southern economies face very different challenges in the years ahead. For the North these could be summarised as follows. There is the question as to how big the “peace dividend” is likely to be and how it will affect the structure and performance of the economy. There is a need for economic restructuring, involving expansion of the private sector (manufacturing, market services and agriculture) and shrinking the public sector (at least as a share of the total economy. Within manufacturing there is also a need for restructuring, involving growth of the modern high technology sectors and reducing dependence on the traditional sectors, particularly textiles. After three decades of violent conflict, labour markets have become segmented both geographically and along religious lines. The result has been the perpetuation of differential unemployment rates regionally and between the two main communities.

A series of rather different challenges face the South. There is a need to address capacity constraints (particularly in the labour and housing markets) after an extended period of fast growth. It would be prudent to try to balance the dependency on foreign direct investment with growth in the indigenous sector to ensure the continued success of the Irish economy as part of the global economy. It is also necessary to proceed rapidly with deregulation of public utilities (telecoms, electricity, etc.) to ensure lower costs to the exposed trading sectors of the economy. Finally, there is a need to address regional imbalances and problems associated with the relatively poor performance of the immediate cross-border areas.

As policy makers North and South face these challenges, the progressive centralisation of macroeconomic and monetary policy-making in Brussels and Frankfurt will result in a greater focus on the differential performance of regional rather than national economies within the EU. The difference between national success and failure will come to depend increasingly on the ability of regional economies to mobilise their
resources and policy making powers to improve their competitive performance. Regions that do not already have such devolved powers within their own nation states, or who do not seek them, are likely to be at a severe handicap relative to regions that have extensive devolved or federal policy making structures and are prepared to use them wisely and creatively.

In terms of decreasing importance, the following are the main forces driving economic growth and development, North and South. First, the continuation of peace and the full implementation and operation of the new institutions that arose from the political settlement. Will peace unleash the suppressed potential for faster growth or merely prevent further decline? Second, the need to continue to embrace globalisation and economic openness. Third, the search for locally focused policies to improve the level of human capital and physical infrastructure. Fourth, developments in the local policy-making environment concerning increased autonomy (in the case of Northern Ireland) and progressive ceding of authority to EU institutions (in the cases of the UK and the Republic of Ireland).

The goal in both regions is to raise the level of GDP or GNP per head, thereby increasing local standards of living. In the words of the First Minister, David Trimble, speaking about Northern Ireland:

The key task is to develop a stronger core of highly productive firms which can support a high standard of living for all of our people. In the long term we would wish this to become self-sustaining, requiring only modest levels of subsidy.

In identifying different options for economic governance we have paid particular attention to one aspect of the problem: namely, the nature of North-South relationships. In doing so, we are suggesting that the North-South axis is as important as another obvious alternative, namely the East-West axis. A concentration on a North-South axis is perfectly consistent with the fact that the major external markets and sources of inward investment for both regions presently lie, and will continue to lie, outside the island. It is also consistent with the fact that even in the hypothetical situation of a single economy on the island, it would still be one of the most open economies in the world. But openness in terms of trade, in a situation where island production is dominated by foreign multinational branch plants, is not a position of strength.

We suggest that resolution of economic problems on the North-South axis may be a necessary condition for encouraging growth of strong indigenous firms, including Irish multinationals. The separate Southern market of 3.8 million consumers, as well as the Northern market of 1.6 million, are probably too small to be able to nurture and encourage any high level of local entrepreneurship in isolation from each other. In addition, Northern policy makers lack the required degree of policy autonomy to compete on an equal footing with Southern initiatives such as the low rate of corporation tax, but are further disadvantaged because of their peripherality within the wider UK market. Perhaps this dilemma could be termed Northern Ireland’s “Southern” problem. To put it very bluntly, the North needs the South more than the South needs the North.
Another misunderstanding of the idea of a island economy is that, quite literally, it seems to advocate an inward-looking insularity. However, Sir George Quigley’s characterisation of the island economy challenges us to widen our understanding of the role of small regions and small states in the increasingly integrated global economy. The Japanese business strategist, Kenichi Ohmae, wrote:

"Economic activity is what defines the landscape on which all other institutions, including political institutions, must operate" (Ohmae, 1996).

On the global economic map, the lines that now matter are those defining "natural economic zones", that represent no threat to the political borders of any nation. The defining issue is that each such zone possesses, in one or other combination, the key ingredients for successful participation in the global economy. Far from advocating insularity, this is effective and relevant global thinking.
References


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Murphy, Anthony and David Armstrong (1994). *A Picture of Catholic and Protestant Unemployed*, Belfast: CCRU.


Endnotes

1 For an account of the reduction of tariff barriers affecting North-South trade that was carried out during 1956-62 prior to the Anglo-Irish Trade Agreement, see Kennedy (1998).

2 At the time of writing - October 2000 - the weakness of the euro has driven the Irish pound to an all-time low against sterling.

3 Bardon, 1992 provides an account of the political, social and economic aspects of the rise of linen and ship-building in mid and late 19th century Belfast.

4 For a full treatment of the recent Southern growth experience, see Bradley et al., 1997 and Barry (ed.), 1990.

5 GDP at factor cost is a measure of the income of all the factors of production (labour as well as capital) that has been generated by domestic productive activities. It excludes taxes on expenditure such as excise duties and VAT, but includes subsidies. It also excludes financial flows from outside the domestic economy that occur (for example) through the current account of the balance of payments, such as profit repatriation by externally owned firms and inflows of financial aid such as the UK subvention to NI or EU Structural Fund aid.

6 The value of GDP in the Republic of Ireland can be distorted by the possibility of transfer pricing by foreign multinationals as they seek to locate as much profit as possible in Ireland through understating input prices. Of course, most of these profits subsequently flow out of the country.

7 In the year 1997, total GNP at current market prices was 13.1 per cent lower than GDP at current market prices in the Republic of Ireland.

8 It has been claimed by the Department of Economic Development that the cost of living in Northern Ireland is some 10 per cent below that of the UK as a whole, and that the UK and the Republic of Ireland have similar costs of living (Irish Times, December 10th, 1998). However, since there are no reliable published regional price indices for the UK, it is difficult to evaluate this claim.

9 For data on the subvention, see Hutchinson (1998). In the year 1995 the subvention was just over 24 per cent of GDP at factor cost (see below).

10 Of course, Northern Ireland has Objective 1 status and is also in receipt of investment aid from the EU as well as CAP subsidies. However, these are small compared to the level of the overall “subvention”. The North received around £1 billion from the EU Structural Funds for the period 1994-99, i.e. around £200 million per annum over the five year period or 5 per cent of the annual subvention assuming complete additionality. The figures in the main text ignore these EU receipts.

11 Total net transfers from the EU to the Republic of Ireland amounted to about 4 per cent of GDP in 1995, and to 2.25 per cent if one excludes subsidy payments under the CAP. For details, see Bradley et al. (1997, p.44).

12 The Mezzogiorno region of southern Italy has given its name to a phenomenon of underdevelopment and dependency that arose originally when the much richer northern Italian regions gave generous long-term income transfers to the south, which had an unintended side
effect of locking the south into a low efficiency, low productivity, low entrepreneurial dependency (CEC, 1993).

13 Technically sales by Northern firms to Britain are not “exports”, but are classified as “external sales”.