Britain can learn from Ireland's economic success

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It's a pleasure to be in Dublin, where I have come to study the Irish economy at first hand, and also to be at UniversityCollege's Smurfit School, which was the first MBA school in Europe. Today it occupies a pivotal role in Irish and indeed international business life, with a thousand students graduating every year, and alumni occupying positions of influence in every sector and many overseas countries.

I find myself here on the same day that in 1455 the Gutenberg Bible was published. As the first book printed with moveable type, it heralded a revolution in information technology – just as firms like Google are doing now. And today I want to talk about the challenges that we will face in the future, and about what we need to do to prepare our economies.

Like the changes that followed the arrival of the printing press, we are living through a period of rapid change. Cheap transport and even cheaper internet communication are making the world a smaller place. Over the next ten years, two billion more workers will become connected to the new global economy for the first time – that's a third of the world population. These changes have already meant that many low-skill, low-wage jobs have moved abroad. But with four million new graduates per year around the world, increasingly the high-skilled, high value added jobs are going to places like China, India, Vietnam and Brazil too.

These changes have already had an enormous impact. Emerging economies have bid up the price of commodities like oil and gas, while at the same time pushing down the price of manufactured goods like T-shirts and cars. Markets for services are increasingly international, as JP Morgan have shown by moving 30% of their global back-office toBangalore. And even success in the new global economy raises questions of how to ensure that everyone benefits from the fruits of prosperity.

To respond to these enormous challenges, we need a new approach to economic policy. In a world in which skills and capital can flow across borders, the only way to stay competitive in business and technology is with the most highly skilled workforce. Our markets must be flexible to cope with the changes that we cannot avoid, so that we can make the most of the opportunities that the new global economy presents. And we must ensure that through education, tax reform, and infrastructure those opportunities are available to everyone in our economies without allowing anyone to get left behind.

As two open economies with strong links in both Europe and America, Britain and Ireland have strong similarities. So in asking how we should respond to the challenges of the new global economy, it is right that we should learn from each other.

In the mid-1980s, Ireland looked to Britain's new found freedoms and self-confidence, as we opened up our markets, and chose to begin down the same path. And instead of halting reform in the 1990s, Ireland continued to prepare herself for the new global economy, and continues to reform today. Perhaps that is why, having been lower throughout history, real incomes in Ireland are now 20 per cent higher than in the UK, and are growing twice as quickly too. Productivity, the "fundamental driver of economic performance", has grown over three times as quickly over the last decade.

Today I have visited Google and the new Irish Financial Services centre because I think that Britain can learn from how Ireland is prospering in the new global economy, and from how it is preparing its economy for the future.

So what are the lessons that we in Britain can learn from the Irish experience? Let us start by looking at Ireland's recent achievements.

Those achievements are impressive. Output has doubled over the past decade. In some years income growth exceeded ten per cent. And real income per person is fourth in the world, behind Luxembourg, Norway and theUnited States.

This growth has not been achieved at the expense of prudent management of the public finances. Following a run of very large government deficits in the early and mid-1980s, the deficit was reduced to a manageable level by 1990, and between 1998 and 2002 was in surplus. Today the deficit is no more than 0.3 per cent of GDP – a tenth of the British level – and national debt stands at only 30 per cent.

For a student of recent British debates on political economy, it is striking to note that this fiscal discipline co-existed with healthy rises in government spending to meet the aspirations of a steadily more prosperous Irish society. In the ten years to 1995, government spending on public services almost doubled. In the next ten years, to 2005, it doubled again. But the economy grew faster – much faster. Government expenditure was equivalent to over 60 per cent of GNP in 1985, but that had fallen to 44 per cent in 1995, and 39 per cent last year. Rapid economic growth was accompanied by a substantial easing of the tax burden. I don't think that was mere coincidence. And along side the reductions in tax has been an expansion of public services. Not only does Ireland now have lower business and income taxes than the UK, but there are also twice as many hospital beds per head of population.

And at around the same time, efforts were made to deregulate the Irish economy. For example, restrictions on operating commercial flights between Dublin and London were relaxed, enabling a small firm called Ryanair to begin flying the route. Twenty years later, Ryanair was the most profitable airline in the world.

These are policies we can learn from.

Indeed, there are similarities to some of the policies we Conservatives have set out so far. As I said in January, we view stability as the first pillar of international competitiveness, so we must put economic stability before tax cuts. Sorting out the public finances must be our priority. And when it is responsible to do so, we will share the proceeds of growth between increased spending on public services and reductions in tax. That combination: of fiscal responsibility and sharing the proceeds of growth, seems to me to be exactly what Ireland has done over the past twenty years.

But sharing the proceeds of growth has been just one element in Ireland's improved international competitiveness. We have set up the Tax Reform Commission to report on how we must reinvigorate the tax system with simpler, flatter, lower, and fairer taxes to respond to the challenges of an increasingly competitive world. And we have set up the Competitiveness Policy Group to look into supply side changes that we must make to enhance the dynamism of the British economy. Today I will write to them to recommend that they look to the Irish example in drawing up their reports.

To prosper over the long term, a modern European economy has to be able to compete internationally in three main ways.

First, it must attract talent, which in our globalised world is increasingly mobile. Ireland has done that, in a spectacular reversal of long-established migration patterns. On one estimate, Ireland endured net emigration of over 2.5 million people in the century up to 1991. But in 1992 that trend reversed itself, and Ireland is now a clear winner in what is sometimes called the 'war for talent'. It's not just Irish expatriates returning, either; aspiring young people from Eastern Europe have flocked here too; so much so that Dublin now has a Lithuanian-language school, and its main evening paper carries a Polish-language supplement.

Second, a modern European economy must attract capital in a world with ever more diverse investment opportunities. Ireland has done that, too. By 1996, foreign-owned firms had come to account for nearly half of manufacturing employment, and nearly two-thirds of manufactured exports. A quarter of Europe's computers are made in Ireland, and much of its Viagra. And leading global firms like Apple, Google, Intel, and Microsoft have chosen to locate their European operations here.

Third, a modern European economy must produce goods and services that succeed in the international marketplace. In other words, it has to be able to export. And here too, Ireland's record is impressive. In 1987, and for 15 consecutive years thereafter, Ireland's export volumes grew at a higher rate than the trade-weighted import flows of its trading partners, as Irish firms won market share. And last year, whilst some British theorists posited that slow growth in the EU was an acceptable excuse for low economic growth in Britain, Ireland – which sends nearly two-thirds of its exports to the EU – posted export volume growth of

8.8 per cent. That was better than Britain and better than the OECD average.

So what can we learn from Ireland's success?

Some in Britain believe that Ireland's economic success is illusory, or based on an unfair advantage, due to the transfer payments it has received from the European Union. It is certainly true that these have been significant. Net EU receipts, which peaked at 6.2 per cent of GDP in 1991, were undoubtedly a benefit and helped to support government investment during that period of strict fiscal discipline.

But the contribution of the EU can be exaggerated. From that 1991 peak, net EU receipts fell steadily to only 0.6 per cent of GDP last year, but rapid economic growth continued. The OECD concluded that EU transfers have added at most half a percentage point to the Irish growth rate. In contrast, being able to trade freely in the European Single Market is estimated to have added a full percentage point. So Irish growth cannot be explained away on account of EU aid.

Nor do I believe that membership of European Monetary Union explains Ireland's success. The improvement inIreland's performance began before the euro existed, and its emphasis on fiscal balance predates the Maastrichtrules for euro-entry. The strong foundations of Ireland's economic success were laid before the euro.

Over the past two decades, sustained high levels of business investment has generated more and better jobs. With its well-educated, English-speaking labour force, its common law traditions and institutions, its excellent education system, its high levels of R&D, and its attractive tax regime, Ireland is well positioned to encourage investment.

Let us look at these drivers of Ireland's success.

One of the most important factors is high quality skills and education. Ireland has an excellent reputation for the quality of its education system and the skills of its workforce. And studies suggest that the reputation is deserved. The World Economic Forum ranks Ireland third in the world for the quality of its state education system. That is a huge achievement. Britain is in 33rd place. Ireland is ranked 21st internationally for the teaching of science in schools; Britain is in 53rd place. Ireland ranks 18th for employee training and tenth for retention of well-educated skilled workers; Britain is 40th on both counts. Irish workers are 20 per cent more productive than their British counterparts. In a world in which education is the key to long-term prosperity, Ireland is showing Britain the way. That is why the current reforms of the UK secondary education system are so important.

In terms of innovation, Ireland is showing the way too. Research and development is the backbone of the knowledge economy, and is the activity on which the comparative advantage of economies increasingly rest. But in Britain, R&D spending is actually falling. The OECD ranks Britain 6th out of the G7, and recently described our innovation performance as 'mediocre'. Ireland, in contrast, registers substantially more patents – 46 per thousand researchers per annum, compared with Britain's 31. And Ireland's intellectual property legal environment ranks 13th in the world, compared with Britain's 31st place.

Ireland's R&D record has been stimulated by its tax code. No tax is paid on revenue from intellectual property where the underlying R&D work was carried out in Ireland - regardless of whether or not the patent is itself is Irish. This is clearly a major attraction for the overseas technology and pharmaceutical companies that have established significant operations here, where some 40 per cent of inventions are made in foreign owned firms.

And more broadly the business tax regime has played a major role in its response to the realities of the new global economy. In a recent survey of OECD and leading economies, Ireland's 12.5 per cent business tax rate was the lowest, and its effective rate, which takes allowances and calculation of taxable income into account, is lower than all but a handful of countries. In Britain, the 30 per cent corporation tax rate was five years ago the tenth-lowest among the 30 OECD economies. Now it is tenth from highest.

Instead of driving business abroad, Ireland draws it in. So the low business tax rates generate strong revenues for the Irish exchequer, from the added prosperity and higher income tax paid on the more and better jobs. That in turn encourages the formation of 'clusters' of industrial expertise which stimulate progress and innovation in those industries, leading to more economic growth. And in a world that is increasingly knowledge-driven, that kind of growth is absolutely fundamental to long-term prosperity.

Faced with the extraordinary rise of emerging economies like China, India, and Brazil, many European governments seem to have accepted that we will not be able to compete. In Britain we are in danger of following their lead. Our Chancellor's response to globalisation is to block much-needed reforms, and give us an ever rising tax burden, and an ever growing welfare state. But that path leads to decline and is wedded to the past.

To stick to it today represents a failure of ambition. Instead we must prepare ourselves for the future, through education, benefit and tax reform, new infrastructure, more research, and renewed innovation. That is what Irelandhas done. That is why companies like Google, Intel, Apple, and Oracle have all chosen to locate their European operations in Ireland not Britain.

Ireland stands as a shining example of the art of the possible in economic policy-making. With its vision of a highly-educated, innovative, open, dynamic, low-tax economy, and relentless focus on the long-term drivers of prosperity,Ireland's economic miracle has shown that it has the right answers to the challenges of the new global economy.

That new global economy offers us great challenges, and also great opportunities. Ireland has shown the world that wise economic policy-making can produce outstanding results that surpass all expectations, so that we can meet our potential, achieve our goals, and share rising prosperity in an increasingly competitive world. We in Britain would do well to listen and learn from our Irish neighbours.