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in a divided island**



**AN ISLAND ECONOMY OR ISLAND ECONOMIES?
IRELAND AFTER THE BELFAST AGREEMENT**

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ABSTRACT

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This paper examines economic progress in the island of Ireland in the context of its modern history, but with particular emphasis on the post cease-fire and post Belfast Agreement period, inquiring whether or not policy makers and businesses on the island have been able to build a more robust economy, benefiting from cross-border synergies as civil conflict faded into the background. In what way has an "island" economy emerged in the aftermath of internal Northern Ireland conflict, in the sense envisaged by business leaders such as Sir George Quigley and Liam Connellan in the early 1990s? In the absence of a strong "island" focus for the economies of North and South, are the two regions of the island likely to drift further apart and relate to the newly enlarged EU market in different ways? If an island economy does not emerge, has Northern Ireland any future other than as a lagging region of the UK? On the other hand, can Ireland sustain its role as an EU success story in the face of increasing competition from the new member states and from Asia?

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BIOGRAPHICAL INFORMATION

John Bradley was formerly a Professor at the Economic and Social Research Institute in Dublin, and now works as an economic development consultant. His published research explores the impact of the single European market, structural funds, and economic and monetary union on the less developed peripheral states and regions of the European Union as well as the transition of former COMECON countries to EU membership. He has carried out a wide range of international consultancy assignments for the Irish and other governments, the European Commission and other international organizations.

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1. INTRODUCTION

There were three main motivations for this paper. First, a recently compiled set of manufacturing data for the Republic and Northern Ireland covering the 1990s came up with interesting patterns of North-South behaviour that require interpretation (InterTradeIreland, 2003). Second, in attempting such an interpretation, one is aware of the tensions that exist between the two separate areas of economic and business research. Of particular interest is strategic policy design that is relevant to the development and modernization of small open economies and regions such as the Republic and Northern Ireland, where the primary focus is on the important area of industrial policy. Finally, Tannam (2005) has pointed to the paradox of the failure of the neo-functionalism hypothesis of common cross-border economic interests, and this may have links to the economic and business analysis.

In a global economy, with no barriers to the movement of goods, factors of production or capital, small nations and regions are forced to specialize, since they cannot efficiently support a very wide range of different industries (Stigler, 1951). During the nineteenth century, the area that is now Northern Ireland came to specialize mainly in textiles and clothing, ship-building and light engineering.¹ The area that is now the Republic had radically different areas of specialization, almost entirely in agricultural production and associated basic food processing. In the case of Northern Ireland, manufacturing in the region experienced difficulty in diversifying during the twentieth century and still retains a relatively high concentration in sectors like textiles and clothing. However, in the case of the Republic there was a dramatic switch after the 1960s away from the weak, traditional industries that had been fostered behind protective tariff barriers from 1930 to 1960 and towards modern high-technology sectors such as computers, software, pharmaceuticals and chemicals.

Today, both regions of the island of Ireland have a relatively narrow portfolio of sectoral specialization: Northern Ireland to a large extent in mature or declining sectors, the Republic in a range of modern sectors (or, rather, in specific products within such sectors) that are, however, rapidly moving towards maturity and could conceivably soon enter their decline phase. Thus, the perspective provided by industrial strategy frameworks such as Vernon's product life cycle, Porter's diamond of competitive advantage or Best's productivity triad has implications for the economy of the whole island of Ireland that complement the more conventional economic aspects of international cost competitiveness (Vernon, 1966, 1979; Porter, 1990; Best,

¹ For explanations of the late nineteenth century sectoral specialization in Ireland, see Ó Gráda, 1994.

2001). The same may hold for the design of industrial policy in many of the smaller newly liberalized economies of Central and Eastern Europe and for some of the smaller Asian economies (Bradley, 2000b: 22-26).

We can characterize the key challenge of policy making in any small nation or region as that of blending the techniques and insights of the *economic* analysis of what one might call the "outer" business environment with those of the *business* analysis of the middle ground of strategy. These two areas are often studied in isolation from each other by non-overlapping groups of researchers.² When cross references are made between the two areas of research, each separate group tends to focus on the inadequacies of the other's methodology.³ Seldom if ever are the two different perspectives looked at as being entirely complementary and mutually supportive.

The paper is organized as follows. In section 2 we set the context for the present state of the two economies on this island in terms of their previous histories. Our focus is on the manufacturing sector, in particular, since this can be regarded as the "engine" of growth. Section 3 explores the implications of some of the most commonly used industrial strategy frameworks for the island economies, as policy makers in Northern Ireland attempt to address an imbalance in the regional portfolio of businesses caused by declining sectors, and as policy makers in the Republic face up to the likelihood of a rapid onset of maturity and decline of the computer and software sector. The wider challenges faced by policy makers in small peripheral regional economies in competing to attract replacement for maturing sectors are examined, and suggestions made about the role of all-island policy cooperation. Section 4 concludes with a reflection on the island economy of the future.

2. THE HISTORICAL ISLAND CONTEXT

After partition in 1920, the island of Ireland was a striking example of highly uneven industrial development. The south was poor and overwhelmingly agricultural. By contrast, the north—in particular the north-east region centred on Belfast—was heavily industrialized and relatively prosperous. The sectoral distribution of total employment, north and south, in the year 1926 is shown in table 1.

² Economists tend to be the worst offenders, and seldom if ever can bring themselves to acknowledge the existence of the contributions of, say, Vernon and Porter. However, only in his most recent work has Porter acknowledged the economic research on spatial issues and clustering by Krugman and others, and even then inadequately (Porter, 1998). Kay, 1991, is an attempt to synthesize.

³ Business researchers tend to disparage as irrelevant the older approaches to trade and growth theory and to ignore the major advances that have been made in recent decades. Economists tend to criticize the lack of formal testing of the validity of business frameworks (Kay, 1983).

Table 1: Sectoral employment, Northern Ireland and Irish Free State, 1926

	Agriculture	Industry	(of which manufacturing)	Services
Irish Free State	54	13	(7)	33
Northern Ireland	29	34	(29)	37

Note: figures refer to percentage distribution by sector.

Source: Munck (1993)

Manufacturing employment in the Irish Free State in 1926 accounted for 7.2% of overall employment and only 13.3% of total employment was in the broader classification of industry (consisting of manufacturing, building and construction and utilities). In contrast, the share of manufacturing employment in Northern Ireland in 1926 was over four times that of the Irish Free State.

The initial state of manufacturing on the island can be examined using data starting from the 1924 census of production for Northern Ireland and data from the 1926 census of industrial production for the Irish Free State, the first such data available (table 2). Such comparisons confirm the dramatic difference between the two regions and serve to establish the full extent that the Irish Free State had to evolve if it was to converge towards the higher level of industrialization and economic welfare of Northern Ireland.

Immediately after independence in 1922, the manufacturing sector in the Irish Free State was not only a tiny part of the total economy, but was almost completely concentrated in the food processing area. Northern Ireland, on the other hand, had three areas of concentration: textiles and clothing, as well as transport equipment (shipbuilding, engineering and metal), which were relatively modern capital intensive sectors; and a less modern food processing sector. Very little fundamental sectoral change took place during the following decade, although the northern textiles and clothing sector declined somewhat, and there was modest growth in a range of other sectors in the Irish Free State.

2.1 Industrial and trade policy in the South⁴

Inward orientation: 1932-60. From the early 1930s to the late 1950s high tariff barriers and a strict prohibition on foreign ownership of firms operating in the Republic were the cornerstone of policies designed to promote growth of indigenous manufacturing from the very low base shown in tables 1 and 2 above. The high tariffs succeeded in stimulating growth in local manufacturing but by the late 1950s it was clear that protectionism had long outlived its usefulness and that few of the so-called infant industries had matured and become sufficiently competitive to generate much by way of exports.

⁴ The material in this section draws selectively from material contained in Bradley (1996); Barry and Bradley (1997); Bradley (2000a).

Table 2: Output in manufacturing, Northern Ireland and the Irish Free State

Sector	1924 £000	Share %	1930 £000	Share %	1935 £000	Share %
<i>Northern Ireland</i>						
Textiles & clothing	32,758	54.1	21,105	41.3	22,466	43.1
Food, drink, tobacco	15,036	24.9	13,876	27.1	16,146	31.0
Boot, shoe and apparel	2,944	4.9	3,458	6.8	2,934	5.6
Shipbuilding, engineering, metal	6,540	10.8	9,601	18.8	7,649	14.7
Paper and printing etc	1,690	2.8	1,656	3.2	1,486	2.8
Timber	761	1.3	699	1.4	761	1.5
Miscellaneous	769	1.3	718	1.4	704	1.4
Total manufacturing	60,498	100.0	51,113	100.0	52,146	100.0
<i>Irish Free State</i>						
Textiles & clothing	1,179	2.4	966	2.2	2,146	3.2
Food, drink, tobacco	38,850	79.3	33,320	76.2	43,398	65.5
Boot, shoe and apparel	1,523	3.1	1,990	4.5	5,607	8.5
Shipbuilding, engineering, metal	1,543	3.1	1,838	4.2	5,283	8.0
Paper, printing etc	1,917	3.9	2,098	4.8	2,947	4.5
Timber	1,347	2.7	1,472	3.4	2,395	3.6
Miscellaneous	2,630	5.4	2,071	4.7	4,444	6.7
Total manufacturing	48,990	100.0	43,754	100.0	66,220	100.0

Note: During this period, the Irish pound and sterling were at a fixed 1:1 parity.

Source: *Report on the Census of Production for Northern Ireland*; *Census of Industrial Production* (various years)

The changes forced on Irish policy-makers by economic collapse in the late 1950s were fundamental and far-reaching. The Control of Manufactures Act, which prohibited foreign ownership, was abolished and replaced by a policy that systematically cultivated inward investment by offering a zero corporate profits tax on manufactured exports (replaced in 1980 by a flat rate of 10% on all manufacturing and now a flat rate of 12.5% on the whole corporate sector). In addition, attractive investment and training grants were offered as well as a complete dismantling of most tariff barriers within less than a decade.

Much of the history of the economy of the Republic during the following four decades can be explained in terms of the rapid growth of export-oriented FDI in manufacturing, from a very low base in the late 1950s to a situation in the late 1990s where two thirds of gross output and 47% of employment in manufacturing is in foreign-owned export-oriented firms (Census of Industrial Production, 1998). US investment was, and remains, at the very core of this process: by the late 1990s, almost one quarter of total Irish manufacturing employment is in US owned firms.

The new era of outward orientation in the Republic. The economic and industrial development dilemma of the Republic was that it was confronted by two conflicting options. One was to stay close to UK economic policy and institutional norms and attempt to track the UK's average performance over the business cycle. However,

Irish policy makers took a strategic decision in the late 1950s that the dominance of the UK market was unlikely to provide a suitable context for Irish development, modernization and faster growth. Tax varying (or, more precisely, tax re-balancing) powers were a crucial element of policy making, especially with regard to the attraction of inward investment, and the centrepiece of the incentive system in manufacturing—initially a zero rate of corporation tax—required continued high rates of personal income tax and indirect taxes to balance the wider public finances. However, equally important were reforms in education, progressive improvement in infrastructure, evolution of social partnership arrangements, enthusiastic embracing of EU initiatives (the European monetary system, the single market, the social chapter, economic and monetary union), and—after many false starts—the creation of fiscal stability.⁵

The systematic reduction of exposure to the UK market as a destination for Irish exports is illustrated in figures 1 and 2. Thus, in the Republic's "world" the United Kingdom now has a much smaller export weight than in the late 1950s—when it was almost 100%—with the rest of the EU having a correspondingly higher weight. With no other changes, a shift in export destinations to faster growing European markets would be expected to ease the constraint on the Irish manufacturing expansion.

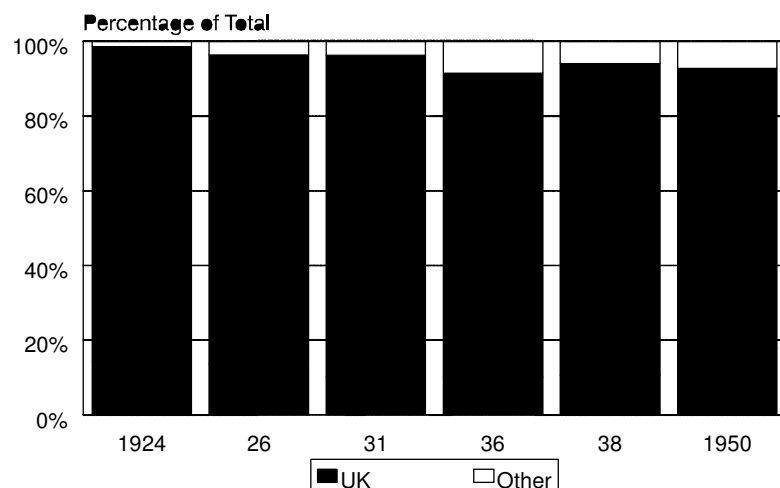


Figure 1: Export destinations, Irish Free State and Republic of Ireland, 1924-50

⁵ Unfortunately, the one EU initiative that Ireland could not adopt was the Schengen Agreement, since the UK opted out, and Irish participation would have required the re-establishment of border controls between Ireland and Northern Ireland.

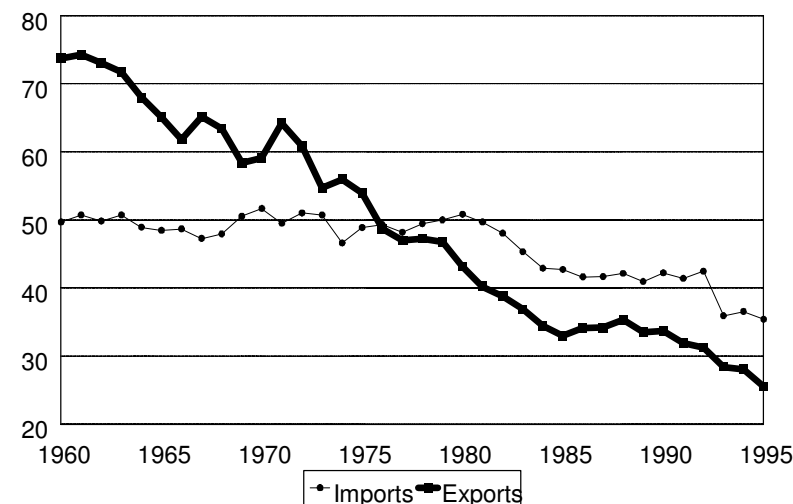


Figure 2: UK share of Republic of Ireland exports and imports, 1960-95

Where did the inward investment come from? The detailed census data for manufacturing classified by nationality of ownership for the year 1996, the height of the high technology boom, are shown in table 3. Although only 16% of local plants were foreign owned, they produced just over two-thirds of gross output and made up nearly half of total manufacturing employment. The importance of the US connection is illustrated by the fact that almost 40% of the foreign plants are US-owned, with 16% British and 13% German.

A striking difference between locally owned and foreign owned plants is that the indigenous ones exported on average just over one third of their output, while the foreign-owned ones exported almost 90%, rising to above 95% for US-owned plants.

Table 3: Total manufacturing: general characteristics, 1996

Nationality of ownership	No. of plants	Total persons engaged	Gross output (£m)	Materials purchased: % imported	Gross output % exported
Irish	3871	120,224	12,188	25.1	34.0
Other EU	344	37,114	4,765	65.2	70.5
(of which UK)	117	12,283	1,960	52.9	53.5
(of which German)	98	10,684	855	80.3	93.3
Non-EU	384	69,296	19,343	65.7	93.9
(of which US)	286	54,167	15,814	61.6	95.3
Total foreign	728	106,410	24,108	65.6	89.3
Total	4599	226,634	36,296	47.0	70.7

Source: *Census of Industrial Production*, 1996.

Thus, by the late 1990s the domestic market was of little or no significance to the owners of foreign plants. They located in the Republic to produce for export. It was and remains the competitive characteristics on the supply side of Irish manufacturing that attract inward investment: corporate tax rates, labour costs, skill levels, infrastructure.

There are some further differences between foreign and indigenous plants, illustrated in table 4. Foreign plants tend to be larger (measured in terms of gross output, or in numbers employed, per plant); they are more productive (measured in terms of net output per person engaged); and consequently they are more profitable since they face similar wage costs to local firms. In terms of these proxy measures, US owned plants are over 17 times larger than indigenous owned plants, over five times as productive, and almost eight times as profitable.

Since the foreign-owned manufacturing sector is so large in the Republic, it has economy-wide as well as sectoral implications. Thus, the overall health of the economy has come to depend on the performance of this sub-sector. However, the mainly tax-based industrial incentive system, and the fact that the Republic features as a production platform rather than as a market, means that opportunities exist for transfer pricing. A much larger distortion concerns profit repatriation, since foreign firms tend not to reinvest a high proportion of their profits in the local economy. The resulting outward flows of profits show up in the Irish balance of payments statistics where there is a large deficit on net factor income. This introduces a wedge of some 10-12% between gross domestic product (GDP) and gross national product (GNP).⁶

Table 4: Manufacturing plants: characteristics by ownership, 1996

Plant ownership	Gross output per plant (£000)	Net output per person engaged (£000)	Destination of exports (percent)			
			UK	other EU	USA	rest of world
Irish	3,149	34.6	42.2	32.2	8.2	17.3
Other EU	13,851	65.3	36.8	46.8	6.8	9.6
(of which UK)	16,750	87.4	74.3	10.9	5.4	9.3
(of which German)	8,724	35.9	12.3	72.7	6.4	8.6
Non EU	50,372	166.7	19.9	50.6	11.4	18.1
(of which US)	55,293	177.9	20.1	52.5	9.5	17.9
Total foreign	33,115	131.3	22.6	50.0	10.7	16.8
Total	5481	80.0	25.7	47.1	10.3	16.9

Note: all values in Irish pounds.

Source: *Census of Industrial Production*, 1996.

⁶ Hence, although Irish GDP per head has now exceeded that of the UK, GNP per head—a more accurate measure of performance—is still somewhat less than that of the UK.

The balance sheet. The Irish experience has been that a crude erection of trade or other barriers in order to “protect” weak regions was ultimately damaging to economic welfare. A blind belief in competition policy and the forces of market liberalization was never tried, but was also feared as inadequate. Reviewing the ways in which poorer regions can seek to accelerate their growth rate in order to catch up, Krugman (1997) suggests that the Irish experience is essentially a working out of Marshallian externalities:

1. An initial clustering of similar industries (often foreign owned and in the high technology areas such as computer equipment, software and pharmaceuticals) supported by local suppliers of specialized inputs subject to economies of scale.
2. These clusters generate a local labour market for skilled workers which further facilitates the growth of the cluster. At this stage, the training and human resource policies of the EU structural funds were crucial aid in ensuring elastic labour supply.
3. Spillovers of information further encourage growth in the high technology sectors and provide the basis for additional clustering effects, often in traditional areas that can benefit from new technologies in their supply chains (such as food processing). Here, the improvements in physical infrastructure and in the productive environment supported by the structural funds were crucial.
4. Finally, a consensual process of social partnership needs to be put in place to ensure that there are as few losers as possible in the economic restructuring that accompanies such a virtuous circle, with the result that growth is less likely to be choked off by industrial unrest.

However, Krugman also draws attention to some of the risks to which a country like the Republic is exposed, as it follows this growth process. First, the dynamic foreign manufacturing base is concentrated on a narrow range of technologies that can quickly move through maturity and into decline, an issue that will be taken up again in section 3. Second, the policy initiatives that ensured that the Republic enjoyed an advantageous “first mover” status in the early 1960s may not be sufficient to guarantee success in making the transition to the next wave of technological inward investment when the key electronics, software and pharmaceutical sectors enter their maturity and/or declining phase. Indeed, the Irish industrial incentive package may not even be able to retain the original maturing sectors, which may move to lower cost locations.

2.2 Industrial and trade policy in Northern Ireland⁷

Although radical changes have taken place in Northern Ireland manufacturing during the past three decades, in some important ways these developments can be seen as a continuation of an historical evolution that started after the first world war. The first annual census of production taken in 1924 in Northern Ireland showed that

⁷ In this section we draw selectively on material from Bradley and Hamilton (1999) and Bradley (2001).

one sub-sector of manufacturing (textiles, including textile products) accounted for 64% of total manufacturing employment and produced 54% of gross output. At the start of the outbreak of civil unrest in 1969, the share had declined to 41%. A similar census taken just before the Belfast Agreement (for the year 1996) showed the continued important role of textiles, which still accounted for about 23% of total employment in manufacturing.

The evolution of an index of aggregate Northern Ireland manufacturing employment over the three decades from the 1960s to the end of the 1980s (the period of major civil unrest) is shown in figure 3, in comparison with indices for the aggregate UK and for the Republic. A large element of the northern manufacturing decline can be put down to the inability of the North to attract inward investment to anything like the extent of Scotland or the Republic of Ireland due to the uncertainty and disruption of the conflict as well as world economic conditions.

While Northern Ireland tracked a wider decline in UK manufacturing, it did not experience the parallel strong growth of private services that occurred in the more prosperous core regions of southern England. A rigorous analytic study by Borooh and Lee (1991) interpreted the northern decline in manufacturing employment over the 1970s and early 1980s simply in terms of a systemic loss of regional cost competitiveness, and showed that growth of total factor productivity in Northern Ireland during the 1960s and 1970s was at a rate substantially below that of the UK, but at the same time wage rates in Northern Ireland converged rapidly on the UK average.

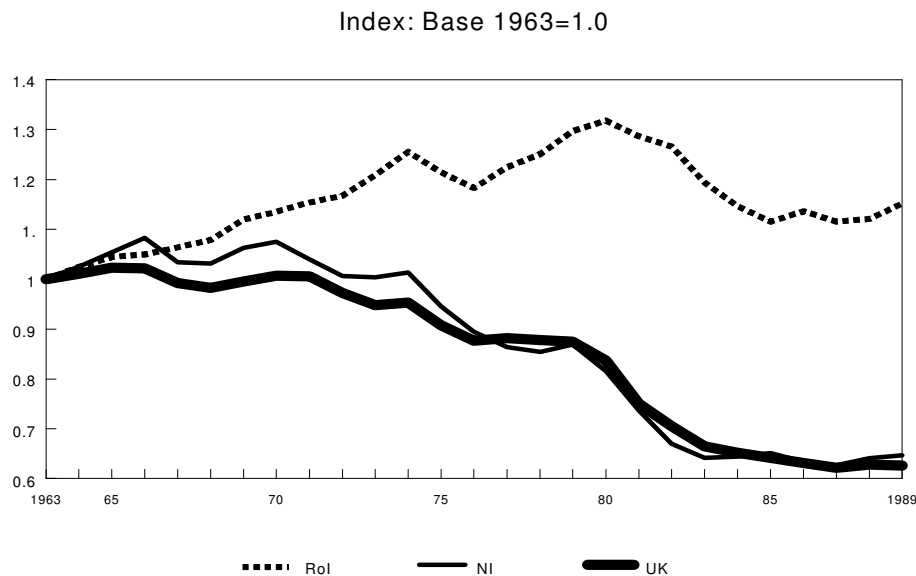


Figure 3: Evolution of manufacturing employment, 1963-89

Recent industrial strategy in Northern Ireland. The most recent major report on industrial strategy in Northern Ireland—*Strategy 2010*—was published in March, 1999.⁸ The debate around industrial strategy in Northern Ireland has paralleled the experience of the Republic. The overriding emphasis in strategy from the mid-1980s was the need for improved competitiveness as the key driving force behind industrial policy, with a consequential reduction in the level of financial subsidization of industrial activities. However, the necessary changes in policy were only implemented to a very limited extent (Northern Ireland Economic Council, 1999). There seems to have been a clear lack of success on the part of the agencies in Northern Ireland, whether due to implementation difficulties or reluctance to wean industry away from high levels of subsidization. For example, the average rate of financial support to industry in 1996-98 made up 5% of manufacturing GDP and more than 20% of manufacturing investment, values which are very high in comparison with other UK regions and the rest of the EU (*Strategy 2010*, 1999: 113).

Strategy 2010 correctly identified the rapid globalization of economic activity as the primary factor that will set the future context for accelerated growth and restructuring of manufacturing in Northern Ireland. Although the opportunities offered by globalization are obvious, with international trade growing at over twice the rate of local GDP, these benefits can only be realized if the local economy can obtain access to export markets by having a high degree of competitiveness, measured in the very widest sense. For a regional economy like Northern Ireland, a local concern for the health and dynamism of the external economy will always have two distinct but complementary aspects:

1. How external markets are going to sustain buoyant demand for exports from Northern Ireland, and
2. Where foreign direct investment (FDI) into Northern Ireland is likely to come from.

In a short to medium-term perspective, the list of dominant export destinations and sources of foreign direct investment are unlikely to switch dramatically from the position today. Consequently, the British market must continue to be of central concern for Northern Ireland producers, since it is the destination of over half of external sales and is the source of the bulk of inward investment.

The size and persistence of the British Exchequer financing (the so called subvention) serves to influence and colour every aspect of the northern economy. The subvention directly supports employment in the northern public sector, which makes up about 33% of total employment, compared with 22% in the UK as a whole (and about the same in the Republic). The subvention also directly supports incomes of the unemployed, the retired and the sick, as well as providing a high level of public

⁸ Although *Strategy 2010* came under fierce criticism from the media, from the Northern Ireland Economic Council and from academics (including the present writer), it was never revised, has a life after death, and appears to continue to supply whatever strategic logic there is to northern industrial strategy (Bradley and Hamilton, 1999).

housing, health and education (over and above direct public employment aspects). These might be termed the primary impacts of the public sector.

However, secondary impacts of Northern Ireland's public sector activity on the structure and behaviour of the local manufacturing and market service sectors are of equal, if not greater, importance relative to the above primary impacts. For example, subvention finance sucks in imports, and explains much of the buoyancy of the retail sector.⁹ Northern manufacturing has come to be made up predominantly of small firms, oriented mainly to supplying the domestic market, which is in turn sustained to a great extent by direct and indirect demand arising from public sector activity. For example, the fact that the northern economy emerged relatively unscathed from the last British recession of the early 1990s was due in the main to the large size and cushioning effects of automatic and discretionary public expenditure stabilizers. The buoyancy of activity in the northern manufacturing sector relative to Britain was also largely due to the much higher level of subsidies and grants, and, therefore, almost certainly had little to do with local competitiveness in any underlying sense.

Diagnosing the reasons for Northern Ireland's performance. Perhaps the greatest success of the northern economy was that it functioned in a relatively normal fashion in spite of prolonged and severe disruption from civil unrest. In part, this can be explained by the availability of financial transfers to boost public sector activities so that the negative consequences of the inevitable decline of private sector activities were mitigated. In the 1950s and 1960s, Northern Ireland had attracted a substantial level of foreign direct investment to replace the shrinking (but still important) textiles and heavy engineering sectors (Farley, 1995).¹⁰ This investment was predominantly in sectors where the North already had a comparative advantage, such as artificial fibres. Unfortunately, this advantage effectively vanished with the onset of the oil-price rises of the 1970s, and a wide range of labour intensive industries across northern Europe in general migrated to the low cost centres of southern Europe and Asia..

Current policy proposals on manufacturing incentives have focused on the perceived need to rebalance and reform priorities for financial support. Unfortunately, with regard to the provision of incentives for inward investment, current thinking is still very conservative. With regard to direct financial assistance, it is suggested that "the existing grant regime for inward investment should be maintained unless and until new measures become available" (Strategy 2010, 1999: 168-169). Moreover, the possibility of targeting grants at specific sectors or that differential rates of assistance be decided on a sectoral basis were ruled out, for reasons that were not made explicit. Rather, grant prioritization was recommended based on a series of specific company characteristics, such as commitment to research and develop-

⁹ The existence of the subvention finance means that Northern Ireland households can enjoy a very high rate of consumption spending without this causing any problems for the current account of the balance of payments. The balance of payments constraint only matters at the UK national level, and not for its constituent regions. It is this latter constraint that can operate to constrain consumer spending in a sovereign state like the Republic of Ireland.

¹⁰ See Bradley (2006) for a more extended treatment of the Northern Ireland clothing and textiles sector.

ment or export orientation. This would seem to be a continuation of what is understood to be the existing situation and, moreover, raises serious questions as to how the necessary rebalancing of industry from low to high value added activities can take place. For example, with regard to attempting to match the Republic's low rate of corporation tax, Northern Ireland has no policy-making powers in fiscal matters and must implement UK-wide rates.¹¹

Policy making for promoting and sustaining inward investment in Northern Ireland needs to be based on a comprehensive, critical and realistic evaluation of the present endemic lack of underlying competitiveness of the region, as documented—for example—in the regular Department of Trade and Industry publications on *Regional competitiveness indicators*. The faster growth of manufacturing output and employment in Northern Ireland relative to Britain is sometimes presented as a sign of underlying competitiveness rather than as an indication that very high grant rates serve to attract a certain type of labour intensive low profit manufacturing and service activities to Northern Ireland before it leaves the UK and the EU for lower wage locations in Eastern Europe and elsewhere.¹² This is likely to deceive nobody, least of all analysts of global economic issues upon whom multinational companies rely for advice on their future investment strategies. These issues are further examined in two case studies elsewhere (Bradley, 2006).

3. STRATEGIC MARKETING AND FUTURE IRISH INDUSTRIAL STRATEGY

Past and present industrialization on the island of Ireland has displayed a curious asymmetry. In the late nineteenth century, the north-east region—centred on Belfast—displayed phenomenal growth in a range of what were then modern high technology industries (ship-building, engineering and textiles), while the rest of the island stagnated. Almost exactly one hundred years later, the southern part of the island—centred to a large extent on Dublin—displayed phenomenal growth in a range of high technology industries (computers, software, chemicals and pharmaceuticals), while the northern part of the island displayed little or no dynamism and retained a dependence on declining industries.

Explanations for this behaviour require economic as well as business perspectives. Research suggests that development is most active where two conditions hold:

1. A sufficient degree of policy autonomy is available that permits freedom of action to address local problems;
2. Economic and business policy are designed and implemented in tandem: the first to design an attractive environment for business to flourish; the second to recog-

¹¹ We return to the issue of corporate tax harmonization in the concluding sector.

¹² Data presented in the *Strategy 2010* working paper on the textiles and clothing sector (unpublished) show that wage rates in Northern Ireland are almost nine times higher than in Estonia (for textiles) and nine times higher than in Romania (for clothing). The ratios for Bangladesh and Vietnam are in the region of thirty times higher.

nize and exploit profitable opportunities where they exist, and to feed back information to policy-makers where problems and obstacles are identified.

Must the success of one region of the island of Ireland always be at the expense of the other? In what follows, we examine issues related to business and policy cooperation on the island.

3.1 Industrial policy in regions and states

At various times in the life of a country or region, often when the economy is performing particularly poorly or is facing major new challenges, state and regional governments and agencies carry out in-depth reviews and re-evaluations of economic and business strategy. To the extent that the focus is on problems and challenges that are regarded as “strategic” rather than “tactical” in nature, such policy reviews are only carried out infrequently, and have a medium or long-term orientation. The ability of such reviews to improve economic and business performance depends both on the extent and quality of the review of past policies and future options as well as the extent to which any policy prescriptions are systematically implemented.

The key differences in policy emphasis as between states and regions are summarized in table 4. In the case of a state (like the Republic), there is a primary focus on economic policy, since states have considerable freedom of action in setting policies in the fiscal and monetary areas. A region (like Northern Ireland), on the other hand, has little or no freedom in this area, and its policies derive from the larger state (in this case, the UK) of which it is a part. When it comes to business policy, regions have—or at least usually seek—some freedom of action which they can attempt to use to differentiate their business environment from other regions of the state. In the case of Northern Ireland, an example of business policy differentiation has been the use of higher rates of grant aid than apply elsewhere in the United Kingdom. States also need to focus on business policy initiatives, but in the wider context of institutional and regulatory arrangements that promote greater efficiency of their firms as they compete within the international marketplace.

States can use economic policies to attempt to influence the environment within which businesses can function efficiently, even though their freedom of action has diminished as supranational organizations like the European Union take on more power as a result of policy harmonization. Regions have far less power, and must take most aspects of the economic policy environment as set externally by the state to which they belong.

Table 4: Policy focus in regions and states

	Region	State
Economic policy	Derivative focus	Primary focus
Business policy	Focus on differentiation	Institutional and regulatory focus

But regions are not completely powerless when it comes to policy making, and can use business policies to distort conditions in their favour relative to the other regions of their state. Nevertheless, policy makers in regions still need to understand how national economic policies affect them differentially, even though there is little that they can do to influence policy other than to call for some form of “compensation” to offset actual or perceived disadvantages. Unfortunately, such “compensation” often comes in the form of financial transfers from the core regions to the periphery regions that can blunt competitiveness and engender dependency.¹³

The dilemma facing regional policy makers requires them to strike a balance between the knowledge that national policies can have regionally asymmetric negative impacts, and the extremely constrained scope for designing off-setting region-specific policies within the context of the nation state.¹⁴ Thus, regional policy has a built-in tendency to become inward-looking that is sometimes difficult to counteract. National policy-making, on the other hand, tends to be more outward looking and is constrained only by the more complex, political and diffuse rules of the global marketplace as it seeks to optimize local gains from policy initiatives.

These policy dilemmas have been summarized by Kenichi Ohmae as follows:

The world economy today represents a simultaneous shift of power from the traditional national government down to region-states, and up to super-national economic blocs. Governments in tune with this change will seek economic stability through the latter, and prosperity by means of the former (Ohmae, 2000).

With the recent regional devolution measures affecting Northern Ireland, Scotland and Wales within the UK, power is beginning to pass from the centre (London) to the regions (Belfast, Edinburgh and Cardiff). Simultaneously, increasing integration tendencies within the European Union is resulting in some powers that were previously the prerogative of nation states passing to supranational agencies like the European Central Bank and the European Commission. In certain respects, the policy environment of regions is coming to resemble that of small states, while the policy environment of small nation states is coming to resemble that of regions. Indeed, according to Ohmae, the world economy has become a series of interacting regions, where national boundaries have lost much of their previous economic and business significance (Ohmae, 1996).

At the risk of oversimplification of what are very complex issues, perhaps what the comparison between the Republic and Northern Ireland shows is that the intelligent

¹³ 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 (Commission of the European Communities, 1993).

¹⁴ A recent example of an asymmetric shock that negatively impacted on Northern Ireland relates to the refusal of the UK government to join the European Monetary Union at its inception in January 1999. The subsequent strengthening of sterling relative to the euro had a more serious impact on the weaker Northern Ireland economy than on the more prosperous and strong core British regions, particularly due to the trade exposure to the Republic, a euro zone member (Bradley, 1998).

combination of economic policy and business strategy can generate huge synergies in terms of rapid national growth and convergence. To achieve these synergies requires a degree of economic policy autonomy that can be used to protect workers who lose their jobs in declining sectors and who require extensive retraining for other occupations. But more importantly, policy autonomy can be used to address weaknesses shown up by frameworks such as the competitiveness diamond of Michael Porter or the capability triad of Michael Best. Regions simply do not have sufficient economic policy autonomy and are heavily restricted in the extent to which they can intervene to support individual sectors and sub-sectors.¹⁵

3.2 Wider strategic policy issues on the island of Ireland

In a wide strategic context, the two regions of the island appear to be characterized by very different economic policy environments as they plan for their futures. In the case of the Republic, its strategic policy orientation towards the future is relatively benign at present and could be characterized in terms of five key issues.

1. 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.
2. The 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.
3. Further modernization of the industrial base through targeted foreign direct investment in high technology areas as well as through steady expansion of indigenously-owned industry (see Bradley (2006) for an extended treatment of this issue).
4. 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.
5. The pursuit of steady improvement in economic performance with the aim of building on the recent rapid convergence in order to sustain a standard of living equal to that of 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 characterize with any degree of precision since the region has only recently experienced a sustained period of peace and is mired in a protracted process of designing and implementing

¹⁵ An example of the limits to discretionary policy making in Northern Ireland is the case of the high level of aid promised to a Taiwanese textiles plant (Hualon), which sparked off protests from rival textiles companies in England and had to be adjudicated (in favor of Northern Ireland) by the European Commission. In the event, Hualon changed its plans and never came to Northern Ireland.

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.

1. 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 Belfast Agreement.
2. The continued dependence on a narrow range of policy instruments (particularly in the area of indiscriminate grant-based industrial incentives) that have not proved particularly effective in the past.
3. Difficulties in modernizing its manufacturing base away from its traditional specialties, such as textiles and clothing, towards higher value-added products (see Bradley, 2006, for an in-depth treatment of this issue).
4. A continuing dependence on Britain as the main external sales destination. Although this has been a benefit during the past few years, when the major economies of the EU suffered slow growth, it may prove to be potentially undesirable in the longer term if the UK remains outside the euro zone.
5. Economic peripherality within the UK, a relatively low standard 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 (that is, a *Mezzogiorno* problem).

The fact that the northern and southern strategic policy orientations are so out of alignment is likely to continue to have disruptive consequences for planning and executing any desire to “complete” the island’s 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 would appear to be somewhat more favourable at present than the situation facing Northern Ireland. There remains the possibility that, in the absence of explicit and concerted North-South cooperative 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.

3.3 Industrial structure and North-South business links

Overall manufacturing employment shares in Northern Ireland and the Republic are fairly similar, though the South has a far higher concentration in high productivity, high technology industries. This reflects the much more significant contribution of foreign direct investment, which has raised productivity and profitability substan-

tially. Indirect information on the indigenously owned sectors suggests greater similarity between the two island economies.

A key relationship between the economies of Northern Ireland and the Republic 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. The characterization of the northern and southern productive structures—with the South having a more modern industrial base—has important implications for internal trade.

Table 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 sub-divisions. 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% of total southern exports to Northern Ireland. For the same product category, this compares with 17% of total exports to Britain and only 11% 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% of total southern SITC 7 exports to the North. More notably, for the important category of SITC 75 (office and ADP machines), almost 25% of southern exports to Britain and to the EU fall into this category but less than 2% of total exports to the North.¹⁶

Table 5: Republic of Ireland export shares by SITC sections, 1997

SITC section	Northern Ireland	Great Britain	Rest of EU
0	24.5	16.9	11.3
1	6.6	1.7	1.6
2	2.8	2.2	1.8
3	1.1	1.0	0.6
4	0.0	0.2	0.1
5	9.3	15.9	24.4
(54)	(0.8)	4.2	(5.6)
6	17.4	5.6	4.4
7	12.1	36.8	35.6
(75)	(1.8)	(25.1)	(23.8)
(77)	(1.9)	(5.9)	(6.4)
8	12.0	14.8	15.0
9	0.0	3.1	3.9
Other	15.3	1.8	1.3

¹⁶ The situation for SITC 5 (chemicals and related products) is also anomalous, but not quite as dramatic as the previous cases, with 24% of total exports to EU in this category, 16% to Britain, but only 9% to the North. One should note a residual category—"other"—which makes up 15% 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.

Note: Totals of shares may not add to 100 due to rounding

Source: Trade Statistics, December 1997, CSO.

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 weight for SITC 0 (food, drink and tobacco). Of course, this phenomenon simply reflects the underlying industrial structure in Northern Ireland compared with the Republic. 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.

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 (including British) markets. Nevertheless, there are gains to be made from intra-island trade in circumstances that could assist in strengthening the competitive performance of all businesses on the island. North-South trade improvement 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 modernized and brought into line with that of Wales and Scotland.

4. CONCLUSION

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 subsidized by public funding and is mainly concentrated in the low technology sectors of traditional industries such as food processing, textiles and clothing. The situation in the Republic is somewhat healthier, but industrial development there has been heavily driven by foreign direct investment, which does not always lay down the full range of developmental roots in the domestic economy that are usual in locally-owned firms. As time passes, a range of key interconnections and spillovers between related firms and industries are taking place, but this remains an area of concern for policy makers.

How might this situation be improved? Both regions are individually small, with populations of only 1.6 and four million. Northern Ireland 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, Northern Ireland is almost never central to strategic planning by British firms, and risks becoming both geographically and economically peripheral to Britain. However, recent improvements in access transport and a more positive political situation should help to alleviate this over time. But Northern Ireland 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 economically peripheral to Britain. In contrast, there is less geographical or economic logic to Northern Ireland remaining peripheral within the island of Ireland.

The logic in favour of deepening North-South supply-side links, thus making the two Irish regional economies 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 negative side), and partly political (since deeper North-South economic links might aid the consolidation of peace and political stability within Northern Ireland and greater North-South trust and harmony).

The situation in the Republic, relative to the countries that provide the bulk of its foreign direct investment (predominantly the US, but also Britain and the rest of the EU), has some analogues with the position in Northern Ireland. For example, just as Northern Ireland is not strategically central to externally owned (mainly British) firms located there, neither is the economy of the Republic always central to the strategic planning of many of its (mainly US-based) plants. Rather, the Republic is often seen merely in terms of a highly profitable location for production of goods 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 Republic 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 (Best, 1990; Porter, 1990). This is a major preoccupation of Irish policy-makers.

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. It might be suggested that in order to upgrade the four Porter competitiveness factors on the island, policy-makers in the two regional economies should not plan for separate development as two competing regions, but should facilitate a coming together in order to build on natural island economic strengths and remove barriers and weaknesses so that genuine synergies can be realized for the mutual benefit of both economies. 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.¹⁷

¹⁷ An interesting European case is the recent decision of Peugeot to relocate out of Britain to Slovakia. Bidding for the plant was intense, in particular between Slovakia, the Czech Republic and the Polish region of

The unfortunate reality is that both North and South are attempting to improve their competitive advantages largely in isolation from each other (*Strategy 2010; Enterprise 2010*). 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 or Best-type strategy would have demanded levels of cooperation that were never realistically going to be politically feasible as long as the conflict in Northern Ireland continued.

However, what of the post-Belfast Agreement period? During the 1990s I had been of the opinion that North-South market imperfections were a serious constraint on cross-boarder cooperation, and that this was restricting the development potential of both regions (Bradley, 1996). It might appear that many of these imperfections have been addressed, and that cross-border institutions are now in place. But as Tannam (2005) notes, cross-border business cooperation has remained at a rather narrow level that has left the underlying development processes of both regions untouched. Tannam went on to ask whether this is due to the short time that has elapsed since the institutions were put in place, or whether the wrong kind of institutions came out of the Agreement negotiations, and concludes that this is not a fruitful way to examine the situation.

My own views, based on economic and business research, are now considerably more pessimistic than they were in the 1990s. Not only have I come to believe that the economic and business cross-border institutions of the Agreement were a negative, grudging, minimalist concession to an "Irish" dimension of the inter-communal problems of Northern Ireland that fundamentally rejected the concept of an island economy, but I find it impossible to envisage any politically acceptable process through which the economy of Northern Ireland can break free of the constraints of being a peripheral region of the United Kingdom.

Remaining as part of the UK under direct rule will very likely doom Northern Ireland to play out the process of continued industrial decline, stagnation and dependency that we described above.¹⁸ Devolved government, even under the most optimistic of circumstances, is unlikely to be more beneficial to Northern Ireland than it is at present to Scotland, where the local administration finds it difficult to design and implement distinctive, Scottish development policies (see Coyle, Alexander and Ashcroft, 2005). There do not yet appear to be any other options that would command the enthusiastic support of both communities in Northern Ireland and their political representatives. I fear that future generations will look back on the Belfast Agreement as a missed opportunity to put history behind us. This was not—as the neo-functionalists claim—due to a failure of the political elite to react to pressures emanating from the business communities. At a deep psychological level, both business communities are probably happy to function in their separate spheres, and

Dolnoslaskie (Lower Silesia). Slovakia won, but the adjoining Czech, Slovak and Polish regions are becoming a cluster within the automotive sector.

¹⁸ Northern Ireland's economic dependency is presently, of course, of the comfortable variety, since the British subvention ensures that living standards do not fall too far below national levels.

far from urging greater action on the politicians, I believe that they colluded with them to prevent the Agreement from encroaching on the economic tranquility of their lives.

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