SM/84/206
Correction 1

CONTAINS CONFIDENTIAL INFORMATION

September 20, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Ireland - Staff Report for the 1984 Article IV Consultation

The following corrections have been made in SM/84/206 (8/22/84):

Page 6, 1st full para., line 12: for "over 19 1/4 percent" read "19 1/4 percent"

Page 7, Table 3, column 1, line 15: for "12.6" read "13.1"
line 17: for "-2.2" read "-6.3"
line 18: for "19.0" read "21.2"
line 19: for "12.5" read "19.8"
column 2, line 18: for "16.5" read "19.1"
column 4, line 16: for "15.1" read "14.7"
column 5, line 16: for "17.0" read "..."
Footnote 6: delete "(excluding first-time job-seekers)"

Page 9, para. 1, line 7: for "119 percent" read "118 percent"
Table 4, line 2: for "Tax revenue" read "Total revenue"

Page 10, last para., lines 1-3: for "that the experience...authorities" read "that it was...progress"
line 17: for "public employment," read "public service employment,"
line 19: for "1984" read "end-1984"

Page 14, Table 6, line 1, columns 3-10: figures revised
line 8, columns 2-4: figures revised; this line is now positioned above heading "(Credit policy years ending February"
Footnote 3: for "Ratio" read "Rate of change in ratio"

Page 15, 2nd full para., line 10: for "about 10 percent" read "about 14 percent"

Page 17, para. 1, lines 7 and 8: for "June 1984" read "the second quarter of 1984 for the majority of employees"

Corrected pages are attached.

Att: (7)

Other Distribution:
Department Heads

Table 2. Ireland: Balance of Payments Summary

	1979	1980	1981	1982	1983	1984 1/
			(In millions of Irish pounds)			
Merchandise exports, f.o.b.	3,395	4,004	4,789	5,592	6,804	8,100
Merchandise imports, c.i.f.	-4,760	-5,346	-6,487	-6,712	-7,278	-8,450
Trade balance	-1,365	-1,342	-1,698	-1,120	-474	-350
Other services and unrequried transfers	339	304	103	-196	-389	-500
Current balance	-1,026	-1,038	-1,595	-1,316	-863	-850
Net recorded capital inflows	816	1,326	1,487	1,638	1,383	...
Nonbank private sector 2/	221	-4	38	127	-168	...
Financial sector	139	425	12	132	592	...
Public sector	456	905	1,437	1,379	959	...
Net residual	-76	59	117	-232	-293	...
Overall balance 3/	-286	347	9	91	227	...
			(In millions of SDRs)			
Trade balance	-2,162	-2,122	-2,323	-1,441	-553	-381 4/
Current balance	-1,625	-1,641	-2,182	-1,694	-1,006	-925 4/
Overall balance	-453	549	12	117	265	...
			(Percent change)			
Memorandum items:						
Volume of exports	8.4	7.9	0.8	7.2	12.3	11.5
Volume of imports	14.4	-4.8	2.1	-3.4	3.0	6.8
Unit value of exports	8.3	8.8	16.1	11.1	8.5	6.8
Unit value of imports	13.6	17.9	18.8	7.3	4.8	8.5
Terms of trade	-4.7	-7.7	-2.3	3.5	3.6	-1.5
Current deficit (in percent of GNP)	-13.7	-11.8	-15.1	-10.9	-6.5	-5.8
Foreign reserves (in SDR millions)	1,693	2,255	2,291	2,389	2,535	2,585 5/
Reserve coverage (months of imports)	2.7	3.2	3.0	3.3	3.8	3.7
Effective exchange rate (1970 = 100)						
MERM	2.6	-0.3	-10.8	-3.1	-6.0	...
Official index	-0.6	-4.0	-8.5	-0.6	-3.3	...
Relative unit labor costs 6/						
Relative to 14 industrial countries	3.3	1.5	-7.1	2.5	-6.1	-5.9 7/
Relative to EMS participants	6.3	8.5	0.5	3.7	-7.6	-4.5 7/

Sources: Central Statistics Office, Revisions to the Balance of International Payments and the National Accounts, May 1984; IMF, Balance of Payments Yearbook and International Financial Statistics; Central Bank of Ireland, Quarterly Bulletin; and data provided by the Irish authorities.

1/ Forecasts.
2/ Excluding semistate companies and including other capital transactions.
3/ Including valuation adjustments.
4/ Using average SDR rate over first two quarters.
5/ As at end-May, with gold valued at SDR 35 per ounce.
6/ Adjusted for exchange rate changes (staff estimates).
7/ Exchange rates assumed constant from end of June.

commodity prices remained weak, especially for a period of world recovery, the terms of trade improved by some 3 1/2 percent and contributed to a marked decline in the trade deficit (Chart 3).

A slowdown in direct investment inflows contributed to a worsening of the nonbank private capital balance. However, a turnaround in short-term capital flows, following the Irish devaluation at the time of the EMS realignment in March 1983 was reflected in a large increase (of over £Ir 450 million) in the external capital surplus of the financial sector. Combined with the improvement in the current account, it allowed a significant reduction in net external borrowing by the Government and state-sponsored bodies from £Ir 1.38 billion in 1982 to £Ir 0.96 billion in 1983. Interest payments on the external public debt continued to rise, but as a proportion of exports, fell from a peak of 10 percent in 1982 to 9 1/2 percent in 1983. The debt service ratio also fell to 17 percent from a peak of 19 1/4 percent in 1982 (Chart 3). Official external reserves rose to SDR 2 1/2 billion (equivalent to 3 3/4 months of imports) at the end of 1983.

In effective (trade-weighted) terms, the Irish pound depreciated by about 9 percent during 1983 and was about 3 1/4 percent lower on average than in 1982. This reflected the small devaluation at the time of the EMS realignment, but more importantly the subsequent decline of the Irish pound relative to both the pound sterling and the U.S. dollar (Charts 4 and 5). Since, in addition, unit wage costs fell by 2 percent, as compared to an average increase of 3/4 percent in the trading partners, the competitive position of the manufacturing sector improved by 6 percent to reach its most favorable level in many years (Chart 6). The decline in unit wage costs came about as a result of exceptionally large gains in productivity as manufacturing output grew by over 7 percent, while employment continued to decline by some 6 percent (Chart 7). The increase in average wage earnings at about 11 1/2 percent was significantly higher than in the major trading partners.

Despite a further decline of 2 3/4 percent in domestic demand, real GDP rose marginally in 1983, mainly on the strength of the foreign balance (Table 3). Private consumption fell by 3 1/2 percent, reflecting a further decline in real personal disposable incomes and a small rise in the personal saving ratio. With continued weak demand, low profitability and the curtailment of the public capital program, gross fixed investment fell by 7 1/2 percent, following a decline of a similar magnitude in 1982 (Chart 8). The buoyancy of manufacturing output, stemming from the dynamism of the new export-oriented enterprises, was offset by a sharp fall of output in the construction sector and weak activity in the rest of the economy. Total employment continued to decline and registered unemployment as a proportion of the labor force rose to 16 percent at the end of 1983 from 14 percent a year earlier. The decline in manufacturing unit wage costs and a slowdown in import prices contributed to a marked deceleration in the average rate of consumer price inflation to 10 1/2 percent from 17 percent in 1982, despite increases in indirect taxes in the budget for 1983, which added an estimated 3 1/2 percentage points to the consumer price index (Chart 9).

Table 3. Ireland: Expenditure on GNP

(Changes in percent)

	1976-80 Average 1/	1981	1982	1983 2/	1984 3/
GNP at current market prices	17.8	19.7	14.3	10.1	9.0
GNP deflator	12.8	17.2	15.8	10.9	7.8
Real GNP	4.4	2.1	-1.3	-0.7	1.3
Real GNP adjusted for changes in the terms of trade 4/	3.0	1.5	0.1	1.2	...
Components of demand at constant prices					
Private consumption	5.4	2.1	-4.9	-3.5	1.0
Public consumption	6.0	2.0	4.1	--	-1.5
Gross fixed investment	7.3	6.1	-6.1	-7.7	-1.5
Stockbuilding 5/	...	—	1.2	1.3	—
Total domestic demand	5.4	3.1	-2.7	-2.8	--
Exports of goods and services	9.8	1.8	5.5	10.6	10.5
Imports of goods and services	9.3	2.3	-3.1	3.9	6.3
Foreign balance 5/	...	-0.5	5.1	3.8	2.3
GDP	5.3	2.9	1.9	0.6	2.0
Net factor income from abroad 5/	...	-0.9	-3.3	-1.4	-1.0
Memorandum items:					
Consumer prices	13.1	20.4	17.1	10.5	8.5
Unemployment rate 6/	8.3	10.2	12.4	14.7	...
Real net farm income	-6.3	-5.1	4.0	1.4	-6.9
Nonagricultural wage bill	21.2	19.1	13.2	8.0	8.5
Property income 7/	19.8	18.7	13.4	20.0	20.0
Manufacturing production	5.1	2.2	-1.0	7.1	7.5
Average weekly earnings in manufacturing	15.5	16.4	12.1	11.0	...
Output per man-hour in manufacturing	3.0	5.7	4.4	14.1	...
Unit wage costs in manufacturing	12.8	10.1	9.6	-2.2	...

Sources: Department of Finance, Economic Review and Outlook; Central Statistical Office, Revisions to the Balance for International Payments and the National Accounts, May 1984; Central Bank of Ireland, Quarterly Bulletin; IMF International Financial Statistics; and data provided by the Irish authorities.

1/ Four-year compound annual average.
2/ Provisional.
3/ Forecast.
4/ By deflating exports of goods and services by the deflator of imports of goods and services.
5/ Contribution to growth in GNP.
6/ Registered unemployed as percent of labor force.
7/ Trading profits, professional earnings, interest, dividends, and rents.

The upturn in economic activity, which started in late 1983 is expected to gather some pace in 1984, leading to real GDP growth of 2 percent. Exports continued to show buoyancy in the first five months of 1984 and for the year they are again projected to increase strongly in volume terms. Although import demand is expected to pick up as the recovery proceeds, the foreign balance is likely to remain the main source of output growth. Real personal disposable income is projected to decline marginally, but with an expected reversal of the recent increases in the personal savings ratio, private consumption is projected to stage a modest recovery after three years of decline. However, with declining investment and public consumption, domestic demand is forecast to remain stagnant.

The rate of unemployment has leveled off in the second quarter of 1984, but this is believed to be a temporary development, and probably reflects increased emigration rather than an upturn in employment. Manufacturing employment is projected to continue falling, although at a slower pace than in the recent past, and the rate of registered unemployment could reach 17 percent by the end of 1984.

The deceleration in the rate of inflation was interrupted in late 1983, mainly as a result of the depreciation of the Irish pound, but the downward trend is expected to be resumed during 1984 and for the year inflation may average about 8 1/2 percent. The external current deficit is projected to stabilize at its 1983 level in terms of Irish pounds, but fall relative to GNP to about 6 percent.

The outlook for 1985 will clearly be influenced by, inter alia, the outcome of the negotiations in the wage round currently under way, the stance of fiscal policy in the budget for 1985, and the degree to which the recovery in foreign markets is sustained. On the technical assumptions of no changes in the personal saving ratio and the effective exchange rate from their present levels, a neutral budget for 1985, and no significant slippage from the official pay guidelines, domestic demand would probably show a modest recovery, with some further strengthening of personal consumption and a pickup in gross investment. Exports are likely to continue to provide the main stimulus to growth, and real output may grow somewhat faster than in 1984. The rate of inflation is projected to decline further. Despite stronger growth in imports and possibly a marginal fall in the terms of trade, the trade deficit is likely to decline, but with continued growth in net factor payments abroad, the current account deficit as a percent of GNP will probably remain broadly unchanged from its 1984 level.

IV. Policy Issues

The policy discussions with the Irish officials focused on a review of the experience in implementing the current strategy, the appropriate pace of further adjustment in the period ahead and the scope for action to alleviate the costs of adjustment on output and employment.

1. Fiscal adjustment

The Irish officials acknowledged that only limited progress has been achieved so far in the efforts to shift more of the burden of fiscal adjustment from taxation to current expenditure restraint. The rapid growth of interest payments on the public debt constituted an important element of rigidity in budgetary management. The legacy of successive years of large exchequer borrowing had led to one of the largest public debts in relation to GNP among industrial countries (over 118 percent in 1983) and, with recent high nominal interest rates, had pushed up debt service charges to the equivalent of more than a third of total tax receipts. Moreover, because of the influence of demographic factors and rising unemployment on transfer payments, it has proven difficult to make progress in restraining the noninterest component of current spending. As a result, the fiscal correction has so far relied heavily on increased taxation and reductions in public capital spending (Table 4).

Table 4. Ireland: Fiscal Adjustment Profile

(Changes from preceeding year, in percent of GNP)

	1982	1983	1984 Budget Proj.
EBR	-0.2	-2.9	-1.1
Total revenue	2.5	1.8	0.7
Total expenditure	2.3	-1.1	-0.4
Current	3.4	1.4	0.4
(of which interest payments)	(2.0)	(0.8)	(0.3)
Capital	-1.1	-2.5	-0.8

Source: Data provided by the Irish authorities.

In 1982 and 1983 the authorities had expressed a commitment to eliminating the current budget deficit by 1987. The Irish representatives noted that a technical exercise which was unavoidably based on a number of simplifying assumptions suggested that substantial real reductions in the noninterest component of current expenditure would be needed to achieve this target. Assuming no change in the ratios of tax revenue and interest payments to GNP from their present levels, the required reductions in real expenditure (excluding debt interest) over the next three years would range from 17 percent (if average annual real GNP growth in 1985-87 were to be 1 percent) to 10 percent (if real GNP growth were to average 4 percent). Clearly, even sharper cuts in spending would be necessary if fiscal equilibrium were to be achieved at reduced levels of taxation.

The status of the commitment to eliminate the current budget deficit was at present uncertain. The National Planning Board, an advisory body set up by the Government, had recently recommended that only the structural component of the deficit, which it estimated to be equivalent to just under 4 percent of GNP, should be eliminated by 1987. The Irish officials noted that the proposals of the Board were being examined by the Government in the context of the preparation of a National Plan for 1985-87. They emphasized, however, the practical difficulties in distinguishing between the structural and cyclical components of the deficit.

The Irish authorities believed that the 1 percent of GNP reduction in the EBR budgeted for 1984 was adequate to maintain the balance between, on the one hand, bringing the growth of the public sector under control and, on the other, avoiding excessive deflation of the economy. The mission noted that the slowdown in the pace of reduction of the EBR implied that more severe measures might be needed over the next few years to restore order in the public finances and stressed the importance of ensuring that the 1984 budgetary targets were met, if necessary through appropriate mid-year measures. The Irish representatives judged that, on the basis of the current trends in revenues and spending, the budget targets would be met without any mid-year adjustments. If deviations from targets were to emerge, the authorities intended to act quickly to ensure that the fiscal goals set for the year would be achieved.

The Irish officials agreed that it was difficult to make significant further progress in cutting back on current spending in the absence of hard political decisions on the question of the level of public services and welfare that the nation could afford. In the six years to 1983 transfer payments had increased by a cumulative 62 percent in real terms of which only about 15 percentage points was accounted for by the increase in unemployment. The rest had resulted from extensions of assistance schemes and large increases in real rates of benefits. Despite a recent slowdown in the fertility rate demographic pressures on public spending were expected to continue over the medium term. The largest component of current spending--public consumption--had climbed from 19 1/2 percent of GNP in 1979 to over 22 percent of GNP in 1982, but the upward trend has since been arrested (Table 5). The adoption since 1982 of a tight employment policy for the public sector whereby only one of three vacancies is filled has made an important contribution to the progress in containing public consumption. As a result of this policy, public service employment, excluding the education and police services, is expected to fall by a cumulative 6 percent over the three-years to end-1984. Relative restraint in public service pay has also been a factor.

factor contributing to this progress. In addition, the authorities allowed interest rates to rise in real terms and intensified their efforts to sell government paper to the nonbank sector by broadening the range of instruments available to the market. Exchequer receipts from small saving schemes also rose significantly. The Irish representatives stressed that the authorities were continually exploring new means to improve the marketability of public debt instruments, but the scope for increasing debt sales through improved marketing techniques alone was limited. During 1984, the competition for funds between the Government and state-sponsored bodies increased as the latter were reducing their foreign borrowing and meeting their needs largely in the domestic market. This was putting upward pressure on interest rates which the authorities were inclined to resist. In view of this and the general uncertainty about interest rate prospects, both domestic and international, the uptake of government securities by the nonbank public declined sharply in the first half of 1984 and most of the EBR in that period was financed by monetary means.

As an operational target in pursuit of their monetary policy objectives, the authorities announce a guideline for the expansion of credit to the private sector. In 1983, reflecting the weakness of activity, the growth of bank credit to the private sector slowed down and was comfortably within the official guideline of 11 percent. DCE also decelerated markedly, although at about 25 percent, it still remained high (Chart 10). For 1984, DCE is expected to decelerate to around 20 percent and M3 growth is projected at around 9-10 percent. A guideline for the growth of total bank credit to the private sector of 10 percent, broadly equal to the projected change in nominal GNP, has been set. However, increased flexibility has been introduced in that this is now an indicative guideline for the banking system as a whole, rather than a target for individual banks, as was the case earlier. The growth of bank credit to the private sector remained sluggish during the first half of 1984, but because of the large monetary financing of the EBR, DCE decelerated only modestly to 12.2 percent compared with about 16 percent during the corresponding period of 1983. On a year-to-year basis, the rate of growth in M3 was about 6 percent in mid-1984, practically the same as at the end of 1983 (Table 6). After rising somewhat in early 1984, short-term interest rates fell back by end-June to about their end-1983 level. However, they increased sharply in July following the continuing firming of Euro-dollar rates and a steep increase in U.K. short-term rates (Chart 11).

External borrowing by the pubic sector declined markedly in 1983 to about £Ir 960 million (7 percent of GNP), resulting in some slowdown in the rate of increase of the external public debt. However at over £Ir 9 billion (68 percent of GNP) at end-1983, external debt remained, in relative terms, among the highest in the industrial world. Despite some reduction in interest rates, interest payments increased in 1983 to about £Ir 750 million (5 1/2 percent of GNP), reflecting in part a switch toward dollar-denominated debt. Amortization payments are spaced out fairly evenly over a long period of time, but are inevitably large in absolute terms. 1/ The Exchequer's

1/ Data on private nonbank external debt are not available. The net external liabilities of financial institutions increased by about £Ir 600 million in 1983 to £Ir 2,189 million.

Table 6. Ireland: Monetary Survey

(End of period data)

	1984 May 1/	1981	1982	1983 1/	1983 Feb.	1983 May	1983 Aug.	1983 Nov.	1984 Feb. 1/	1984 May 1/
	In millions of Irish pounds	Percentage changes from the corresponding period in previous year								
Net foreign assets 2/	-868	0.8	1.4	-4.2	1.0	...	...	...	3.2	1.3
Domestic credit, net	9,939	18.0	12.9	11.2	13.2	18.8	15.0	13.6	5.2	6.0
To government	2,267	11.0	20.0	11.3	20.0	46.1	18.8	4.5	-0.5	-0.7
To nongovernment	7,672	19.9	11.2	11.2	11.3	11.9	13.9	16.4	6.8	8.2
Narrow money (M1)	1,730	8.2	7.1	8.6	8.8	12.8	10.0	9.3	9.6	3.9
Broad money (M3)	7,808	17.4	12.9	5.6	11.7	13.8	11.4	8.9	5.4	5.8
Memorandum items:										
Velocity of circulation (M3) 3/		1.7	1.9	4.8	...	...	...	...	...	...
Domestic credit expansion 4/	1,579	40.3	31.0	24.7	...	...	...	...	...	21.4
		(Credit policy years ending February)								
Private sector credit										
Central Bank guideline	...	13.0	15.0	14.0	14.0	...	...	...	11.0	...
Actual outcome	7,672	13.4	15.6	10.2	10.2	...	...	...	8.4	...
Broad money (M3)	7,808	25.0	15.1	11.7	11.7	13.8	11.4	8.9	5.4	5.8

Source: Central Bank of Ireland, Quarterly Bulletin.

1/ Based on new money and banking statistics. Data under old format was discontinued in December 1983.
2/ Change in NFA as percent of M3 in corresponding period of previous year.
3/ Rate of change in ratio of GNP to average broad money stock.
4/ Change in net domestic credit plus net external financing of the Exchequer, as percentage of M3 in corresponding period of previous year.

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net foreign borrowing target for 1984 has been at £Ir 640 million, representing a 20 percent fall compared to the amount raised in 1983. This target has already been met. The Irish representatives indicated that, as a matter of prudent financial planning, some additional loans might be arranged in the remainder of 1984 for use in 1985.

The staff's illustrative medium-term external debt scenario indicates that, under the assumptions made, the debt service ratio would decline somewhat to 15 percent in 1990 from 17 percent in 1983 (Table 8). The projections allow for a recovery in activity from 1984 onwards and a corresponding pickup in the demand for imports; however, they also assume continued gains in export market shares, albeit at a lower rate than in the recent past, and thus a progressive reduction in the current account deficit in relation to GNP. Alternative scenarios of lower export growth and higher interest rates also imply a decline in the debt service ratio to around 16 percent by 1990.

3. Competitiveness

The Irish representatives agreed that the sharp improvement in competitiveness as measured by conventional indicators recorded in 1983 had to be interpreted with caution. Apart from the usual caveats related to the lack of strict international comparability of the data, the overall figures in 1983 had been influenced markedly by exceptionally large productivity gains (Table 7). These gains reflected the ongoing shift in manufacturing output toward new capital-intensive industries but also heavy labor shedding in the traditional labor-intensive industries where many firms had a weak competitive position. Moreover, the substantial decline in real average disposable wage incomes--about 14 percent in the four years to 1983--had not been reflected in a commensurate improvement in profitability and the incentive to hire labor, since it has resulted mainly from tax increases rather than a containment of nominal wage inflation.

Table 7. Ireland: Competitiveness 1/

(Changes in percent)

	1975-81 Cumulative	1982	1983	1984 2/ Forecast
Relative hourly earnings	21 1/2	4 1/2	5 1/4	3
Relative productivity	7 1/4	1 1/2	8 1/4	5 1/2
Relative unit labor costs in local currency terms	13 1/4	3	-3	-2 1/4
Effective exchange rate	-21	-1/2	-3 1/4	-3 3/4
Relative unit labor costs in common currency terms	-10 1/2	2 1/2	-6	-6

Source: Staff calculations.

1/ Changes relative to a weighted average of 14 trading partner countries.

2/ On the assumption of unchanged exchange rates from end-June levels.

Table 8. Ireland: Illustrative Medium-Term External Public Debt Scenario 1/

(In percent)

	1983	1984	1985	1986	1987	1988	1989	1990
	Actual	Projections						
Current account balance, (in percent of GNP)	-6 1/2	-6	-6	-6	-5	-4	-3	-2
External public debt (in percent of GNP)								
Gross	68 1/4	69	72	73	74	73	72	70
Net 2/	53	54	56	56	56	54	53	50
Debt service payments, in percent of exports of goods and services	1[illegible]	19	17	17	16	17	17	15
Of which:								
Interest payments	9 1/2	10	10	9	9	8	8	7

Source: Staff estimates.

1/ The main assumptions underlying these simulations are as follows. The projections for 1984 are in line with the forecasts discussed in the text. For the rest of the decade, real GNP in industrial countries is assumed to grow on average by 3 1/4 percent per annum, with the inflation rate stabilizing at 5 percent. The interest rate in world financial markets (LIBOR) is assumed to fall gradually from 11 percent in 1984 and 1985 to 10 percent in 1986-87 and to 9 percent during 1988-90. Exports of goods and services are assumed to increase by 9 percent per annum, reflecting, besides the growth in export markets, the expected further increase in export capacity. Real domestic demand is assumed to grow at 2 1/2 percent per annum, resulting in an average increase in the volume of imports of goods and services of about 8 percent per annum (elasticity of import demand with respect to total aggregate demand is assumed at 1 1/2). Import and export prices and the GNP deflator are assumed to grow in line with the prices in industrial countries. Capital inflows by the private sector, including the inflows by financial institutions, are assumed to amount to £Ir 100 million per year throughout the period. External public sector borrowing covers the deficit on the current and private capital accounts and allows for maintenance of official reserves at the equivalent of 3 months of merchandise imports. About 40 percent of the debt outstanding at the end of 1983 is at fixed interest rates averaging about 7 percent. All new borrowings are assumed to be at floating interest rates, repayable within 10 years, including four years of grace.

2/ Net of gross official reserves.

The authorities, conscious of the limitations of any one indicator of competitiveness, have emphasized that in order to generate sustainable increases in employment over the medium-term, it was necessary to ensure that increases in earnings were in line with those in the trading partner countries. They continue to regard wage restraint as the main vehicle for restoring and maintaining competitiveness in the production of traded goods and services. For the current wage round, which began in the second quarter of 1984 for the majority of employees, the authorities have recommended a pay pause of seven months, followed by increases of not more than a few percentage points in agreements lasting at least 18 months. In contrast to the previous centralized agreements, the current negotiations with the public sector unions were on a union-by-union basis, and given that there had already been delays in reaching settlements, the authorities were hoping to achieve a de facto pay pause. In the private sector, wage settlements reached so far in 1984 cover only a small proportion of the work force; they provide for wage increases of of about 10 percent for a 12-month period and without a pay pause. The Irish representatives noted that these settlements were mainly in industries which could well afford to pay, and the average size of settlements was likely to decline as the pay round progressed. They were inclined to discount some signs of discontent from the labor unions and were generally confident that given the reduction in the rate of inflation and the high level of unemployment, the growth in earnings would continue to decelerate in 1984 and, as a result, competitiveness would at least be maintained.

The authorities continue to believe that devaluation is not a viable alternative in the Irish context. Irish officials reiterated the view that with low price elasticities of trade and the rapid pass-through of exchange rate changes into prices and wages, devaluation would only have transitory beneficial effects on trade performance and lasting adverse effects on the rate of inflation. There was also concern that devaluation might be interpreted as a soft option and lead to a weakening both in the authorities' determination to correct the fiscal imbalance and in the willingness of labor to accept wage restraint. Accordingly, exchange rate policy is aimed at keeping the external value of the Irish pound as stable as possible so as to help reduce inflation. Movements of non-EMS currencies are taken into account in formulating policy on the position of the Irish pound in EMS realignments.

4. Supply-side policies

The authorities have placed increasing emphasis on measures to improve the supply performance of the economy and enhance both price and nonprice aspects of the competitiveness of industry. In view of the acute problem of unemployment, they have introduced schemes aimed at mitigating the short-term consequences for the unemployed; however, these have emphasized mainly training and work experience for younger people. In order to encourage entrepreneurial effort and establishment of small firms, the Enterprise Allowance Scheme has been introduced with the aim of assisting unemployed persons in setting up production units by using funds which would otherwise be used for unemployment benefit payments.

The authorities have also extended tax benefits designed to encourage profit-sharing in industrial units with the intention of improving the industrial relations climate.

An active industrial policy, centered around capital grants and tax relief, has played a crucial role in the structural transformation of Irish industry over the last two decades and has contributed to a rapid growth of manufacturing output and exports, even in the face of depressed markets abroad. However, most of the output gains have been concentrated in a few high-technology sectors, dominated by foreign multinational firms, and the associated growth in employment has tended to be offset by heavy job losses in long-established indigenous industries, such as textiles, clothing and footwear. The latter have been affected adversely by the rapid increase in domestic labor costs, growing competition from newly industrializing countries and trade liberalization. Moreover, interindustry linkages between the new dynamic sectors and domestic suppliers of raw materials and intermediate inputs have been weak.

The Government has recently announced a reformulation of its industrial policy. The new policy envisages a shift in government assistance from fixed capital grants to grants for the acquisition of technology and for marketing development. Greater selectivity in industrial assistance is to be sought by confining aid to firms producing goods and services primarily for sale on overseas markets and those supplying intermediate inputs to internationally trading firms. Industrial policy will continue to reflect a liberal attitude towards foreign investment but relatively higher grants will be given to firms which perform key business functions, such as research and development and marketing, in Ireland (for details see Chapter I of the RED paper). Although the cost of grants and tax incentives provided to attract investment in industry is substantial (£Ir 750 million in 1983), undue support to declining industries has generally been avoided. Only firms with clear prospects for profitability within a period of 12 to 18 months are statutorily entitled to state assistance, and the spending by the State Rescue Agency was only about £Ir 25 million in 1983.

5. Trade and aid policies

Ireland's trade policy is determined by the common commercial policy of the European Communities. The Irish representatives noted that, with respect to the nonfarm sector, Ireland had taken a liberal approach in discussions of trade policies within the EC and had argued for increased access to the EC market for newly industrializing countries, despite the fact that Ireland was adversely affected by increasing competition from this source in areas such as textiles. They acknowledged, however, that in the area of trade in agricultural goods, Ireland took a relatively more restrictive stance than many other EC countries. This position was in their view dictated by the major role of the agricultural sector in the Irish economy.