Politicians, Bureaucracy and the Economy – Then and Now

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Abstract:

Many of the institutional innovations that would give birth to the modern Irish economy emerged over the course of the 1950s. The Industrial Development Authority and Córas Tráchtála – a forerunner of today's Enterprise Ireland – took shape at the beginning of the decade. The origins of our low corporation tax regime lie in the export profits tax relief introduced in 1956. Discussions on trade liberalisation reached fever pitch in the late 1950s, triggered by the imminent establishment of the European Free Trade Association (EFTA). Economic policymakers of the time faced a diversity of viewpoints from within the bureaucracy. The Departments of Finance and Industry & Commerce offered distinct sets of policy choices, and politicians rarely adopted policies that had not been advocated by – or garnered the support of – one or other of these camps. The bureaucracy of the time, furthermore, guarded its independence jealously. This is in sharp contrast to the situation that prevailed in the build-up to the present crisis, as revealed by recent reports into the performance of the Central Bank, the Financial Regulator and the Department of Finance. These reports document the deference and diffidence of the modern bureaucracy and its vulnerability to 'groupthink'.

Pressures from vested interests can be so intense that, as Garret FitzGerald memorably noted, many government decisions operate against the interests of society as a whole. The independence of the bureaucracy – as provider of policy advice, the role focussed upon here – is a crucial line of defence against such pressures.

Many of the policy errors committed over the boom period were driven by political calculations rather than advocated from within the bureaucracy. The Department of Finance was opposed to the property tax incentives that helped to fuel the construction boom, and the Wright Report into the Department's performance judges that its advice on the stance of fiscal policy was generally appropriate, even if voiced too quietly. The problem that the report identifies was that the Department's calls for caution were overwhelmed by spending processes emanating from within the political arena, with Social Partnership and the Programmes for Government singled out for particular mention.

The bureaucracy was certainly devoid of blame for the fiasco of decentralisation, as announced in Budget 2003. Several Secretaries General roundly criticised the policy at the first publicly available opportunity – their retirement dinners.

The bureaucracy can be criticised however for surrendering much of the independence that characterised its policy advice in the past, and specifically – for present purposes – in the 1950s, the bleak decade from which emerged the institutional innovations that gave birth to the modern Irish economy.

Since 1932, the Departments of Finance and Industry & Commerce had been engaged in a battle for supremacy over economic policy, with Finance restrictive and Industry & Commerce expansionist. Finance emerged victorious under T.K. Whitaker at the end of the 1950s, but only after it had robed itself in Industry & Commerce's developmentalist mantle. The two departments offered distinct sets of policy choices, and politicians – on matters of economic policy – largely confined themselves to choices that would have the backing of one or other of the two camps.

This is not to underestimate the importance of the political decision-making process. On these political decisions the direction of the entire economy turned. In the 1930s Fianna Fáil's protectionist vision accorded with the policies advocated by Industry & Commerce throughout the tenure of the previous government, whereas Cumann na nGaedheal's perspective was more aligned with that of the Department of Finance. In the late 1950s Lemass did not switch allegiance completely from his old department – he had been Minister for Industry & Commerce for most of the period since 1932 – but he found elements of the new blend on offer from Finance appealing. In each case, options appeared on the menu only if they had succeeded in gaining the support of at least one of the major economic departments of state.

Conventional wisdom today portrays the Department of Industry & Commerce of the time as antediluvian, remaining wedded to protectionism long after its sell-by date. But many of the crucial institutional innovations of the period were the fruits of victories that it scored over its rival. The low corporation tax regime is one. Córas Tráchtála (forerunner of today's Enterprise Ireland) is another.

The origins of the other major institutional innovation – the Industrial Development Agency – are more complex. Though it was staffed by officials from Industry & Commerce, the board of the IDA – as established by the first Costello government in 1949 – was independent of the department. Neither Industry & Commerce nor Finance were initially happy about this, though the IDA soon proved itself a useful ally to the former. According to Alexis FitzGerald, Costello's son-in-law and economic advisor, the idea that the board should be independent of the department came from a private businessman, Eustace Shott, who was a partner in Craig Gardners. The logic, FitzGerald recalled, was that 'it involved a complete regearing of industrial policy, something difficult for a Department which had been going along a particular line – the protection of industry.'

Its independence would prove to have consequences of the utmost importance. When Lemass returned to power as Minister for Industry & Commerce, he *requested* the IDA 'to concentrate all their activities on an examination into the possibilities of establishing factories' for a list of import-substituting goods that he presented to them. The IDA's independence allowed it to effectively ignore this list and concentrate on the possibility that it had recently stumbled upon, of attracting foreign export-oriented firms to Ireland. To put the requisite policies in place would require defeating the Department of Finance at cabinet. This would take a further few years to achieve.

The IDA's first interim report called for tax relief for exporters and the establishment of an Irish export board. Similar proposals had been made several years earlier by Industry & Commerce but had been withdrawn in the face of objections from Finance. The prevailing dollar shortage in post-war Europe, however, strengthened the hand of Industry & Commerce, not least through the establishment of a number of new agencies and bodies that would support key elements of its agenda. The Dollar Exports Advisory Committee, established in 1950 and chaired by the Secretary of Industry & Commerce, was one such body. Its membership included representatives of various government departments and a substantial number of businessmen, including Eustace Shott. The reports of the Committee, issued in rapid succession over the course of that year, reiterated the recommendations of the new Authority.

The decision to establish an export board was taken before the Inter-Party Government left office. With Finance defeated on the matter, Lemass duly established Córas Tráchtála (the Irish Trade Board) in 1952. Its successor would merge with a number of other agencies in the 1990s to form Enterprise Ireland, the body now tasked with the development of Irish indigenous industry. Córas Tráchtála in turn added its weight to the calls for export profits tax relief, in the face of continuing opposition from Finance and the Revenue Commissioners.

The latter camp argued that such relief would represent a windfall gain for existing exporters, that it would open the door to other demands for special treatment – making it even more difficult to bring farmers into the tax net – and that any concessions offered should in any case be in the form of subsidies, loans or grants, which could be effectively measured.

In 1956 Costello, in his second period as Taoiseach, took the momentous decision to overrule Finance, siding with Industry & Commerce and the development agencies. Thus was instituted Ireland's low corporation tax regime – which Padraic White, a long-serving Managing Director of the IDA, refers to as 'the unique and essential foundation stone of Ireland's foreign investment boom'.

The Department of Finance continued to snipe at the policy for years afterwards, particularly when Fianna Fáil abolished all profits tax on qualifying exports. 'Nothing we can do', Whitaker wrote to one Minister with reference to a particular Danish proposal, 'will relieve the Danes of *all* tax on their income… A double taxation agreement would secure that they paid only *one* tax – and that tax to the *Irish* Exchequer. The exports tax concession will secure that they pay one tax – but to the *Danish* Exchequer.' 'Department of Finance concerns regarding the policy remain', he wrote elsewhere, 'and remain the same.'

These defeats at the hands of Industry & Commerce triggered a change of strategy on the part of Finance. By May 1957, as Ronan Fanning notes, Whitaker was urging his Assistant Secretaries that it was desirable 'that this Department should do some independent thinking and not simply wait for Industry & Commerce or the IDA to produce ideas'. Joe Lee, and indeed Garret FitzGerald in a contemporary article for the *Irish Times*, interpreted Whitaker's *Economic Development* as manifesting, in part at least, a desire to reestablish the supremacy of the Department of Finance in economic policymaking.

Finance seized the initiative by adopting elements of its rival's developmentalist agenda. The contrast between Whitaker's understanding of the role of the Department of Finance as expressed in two articles in *Administration*, one in 1953 and the other in 1961, could hardly be starker. 'Our function', the earlier paper states, 'is not to select the most meritorious (departmental proposals) and clap them on the taxpayer's back but, rather, to see that as few as possible emerge as new burdens on the community'. By 1961, he was reporting that the Department 'has now, as an integral part of its organisation, a special division (the Development Division) whose responsibility is to seek out ways and means of advancing economic growth and to develop ideas and projects to the point at which they can be placed with the appropriate Department or agency.'

The new developmentalist agenda of the Department of Finance revolved around productive capital spending, though Lemass did not always take heed. *Economic Development*, which the department produced, argued for a reduction in direct taxation and a shift in public investment from social to productive areas. The government's *First Programme for Economic Expansion* followed suit. It proposed reducing capital spending on local authority housing and hospitals, implementing significant income tax reductions and keeping the rate of increase in wages and salaries below that of Britain.

The outcome over Lemass' tenure as Taoiseach proved to be very different. The reductions in capital spending were short lived; Irish nominal wages expanded far more rapidly than in the UK, and income taxes increased significantly. *Economic Development* helped the government out of a political difficulty however. Its publication under

Whitaker's name provided cover for the government's U-turn on economic policy. As Joe Lee notes, 'the de-politicisation of "planning" was too useful an asset to be wantonly surrendered to the capricious vagaries of Dáil debates.'

The decision on whether or not to apply to join the European Free Trade Association (EFTA) when it was established in 1960 was effectively settled over the course of an exchange of civil service memos in late 1959. These largely pitched Whitaker at Finance against MacCarthy, his opposite number at Industry & Commerce, and were intended especially for the eyes of Lemass, who had become Taoiseach earlier that year. EFTA membership would have exposed Irish industry to strong competition. Whitaker argued that the discipline of tariff reduction would increase efficiency and reduce costs, enhancing the prospects for increased exports not just to EFTA but to other countries as well. EFTA membership, he suggested, would also draw further export-oriented foreign investment to Ireland. MacCarthy, on the other hand, insisted that the increased industrial competition would be catastrophic.

The debate was ultimately resolved by an intervention from the Department of Agriculture which suggested that EFTA membership would most likely require Britain to extend equivalent agricultural access to other EFTA member states and that Irish interests would therefore be best served by seeking a Free Trade Area arrangement with Britain alone. Whitaker wrote to the Secretary of the Department of Agriculture to signify his acceptance of this thesis and the decision not to pursue membership of EFTA was effectively settled.

What we see in each of these episodes is the importance of the bureaucracy's role in vetting proposals, in analysing their costs and benefits, and in offering policy options to government. Only the proposal to establish the IDA as an independent body breaches this pattern. Crucially, the suggestion – even though it came from a private businessman and was supported neither by Finance nor Industry & Commerce – was untainted by rent-seeking behaviour.

The Central Bank maintained a rigorously independent voice and was frequently – if not permanently – at loggerheads with government over the 1950s and beyond. Its historian, Moynihan, records that ‘so far as the Bank’s views generally are concerned, (de Valera) insisted at all times that they were held in good faith, but (in common with Mr. Lemass and, no doubt, almost all the members of Dáil Éireann) he was unwilling to accept them as a basis for public policy’.

The Bank’s report on the economy for 1950-51 proved to be of particular significance. As one contemporary account put it, ‘seldom since the Communist Manifesto has a slim volume produced such a medley of heat and noise’. The Labour Party condemned the opinions of the Bank as ‘Victorian and reactionary’. Lemass, Moynihan notes, was determined ‘once and for all, to rid himself and the Government of the incubus of any responsibility for the views of the Central Bank’. So hostile were both government and opposition to the independent stance adopted by the Bank that its Governor resigned rather than give way.

Contrast this with the more recent experience described by the Honohan Report of 2010 into the performance of the Central Bank and Financial Regulator in the years leading up to the current crisis. As to why the Bank did not warn more aggressively of the risks of the inflating property market, Honohan writes that ‘although some initiatives were taken, deference and diffidence on the part of the CBFSAI led to insufficient decisive action or even clear and pointed warnings’. And later he concludes that ‘”rocking the boat” and swimming against the tide of public opinion would have required a particularly strong sense of the independent role of a central bank in being prepared to ‘spoil the party’ and withstand possible strong adverse public reaction.’

Similar criticism of excessive diffidence on the part of the Department of Finance is made in the Wright Report of the same year. ‘It did provide warnings on pro-cyclical fiscal policy and expressed concern about the risks of an overheated construction sector’, the report notes. ‘However, it should have adapted its advice in tone and urgency after a number of years of fiscal complacency. It should have been more sensitive to, and provided specific advice on, broader macroeconomic risks’. And again later, ‘after several years of fiscal action well above that clearly recommended by the Department, one would have expected the tone, and shape, of advice on the risks of this path to increase vigorously. We would have expected more initiative to make these points in new ways. This did not happen.'

The catastrophic failure of banking regulation, and the failure to recognise – until after it was too late and the Bank Guarantee of September 2008 was in place – that the banking crisis was one of solvency rather than liquidity, have been ascribed by the Nyberg Report to a lack of professional scepticism, inadequate understanding of stability issues, and leadership failures across the bureaucracy.

Closed and rigidly hierarchical bureaucracies are clearly more vulnerable to 'groupthink' and less likely to exhibit professional scepticism. The Irish public service seems to have regarded it as a virtue to remain insulated from outside influence. Ronan Fanning describes the Secretary of the Department of Finance as being incensed at the 'heresy' committed by an academic economist who suggested in 1939 that discussion of the sterling link should not be 'confined to anonymous bureaucrats'. A decade later, the Department interpreted the suggestion that the IDA should have an independent board as impugning the integrity of the civil service.

An anecdote from Seán MacBride further illustrates the point. When he became Minister for External Affairs in 1948 he decided to recruit an economic advisor from outside the civil service and settled on Louis Smith, later professor of economics at UCD. Smith was appointed via a cabinet order in the face of hostility from both Finance and MacBride's own department. After six weeks or so, MacBride was notified that Smith's services had been dispensed with because he had failed to pass an Irish language exam!

In the lead-up to the 2008 Bank Guarantee, the Department of Finance hired in external consultants from Merrill Lynch to provide policy advice but it was by then too late as they did not have sufficient time – nor was it part of their mandate – to analyse the solvency or otherwise of the Irish banks. But it has since emerged that senior officials in the department had prevented dissenting junior officials from alerting government and the public over the preceding years that a collapse of the property bubble could expose the banking sector.

Ironically, many issues of pertinence to the findings of the Nyberg Report were extensively discussed in the period immediately following the institutional innovations of the 1950s. The need for a more professional and specialist bureaucracy was emphasised by writers such as Basil Chubb and T. J. Barrington. The recruitment of a cadre of trained economists, as suggested by the Wright Report, however, is unlikely to be sufficient to overcome the deficiencies highlighted by the crisis. The large coterie of professional economists employed at the Central Bank, for example, did not prove sufficient to prevent the failures evident in that organisation over the run-up to the crisis.

Paddy Lynch, one of Costello's key advisors, diagnosed the problem of the civil service as far back as 1956 as one primarily of organisational culture. 'The most striking thing that I remember about the civil service', he wrote, 'was its lack of morale (and) sense of studied disenchantment'. He advocated a greater delegation of responsibility, which he argued would increase the sum of authority and responsibility, establish and sustain an intellectual and professional tradition, boost morale and leave the heads of departments with more time for thought.

Crucially, this would allow for a greater diversity of voices to be heard, the benefits of which we have seen here through the dialectical processes played out between the Departments of Industry & Commerce and Finance.

In a number of recent papers the present author has advocated that policy advice be subjected to the same kind of scrutiny that allows progress to be made in science, medicine and other fields. Presentation before expert audiences with diverse opinions ensures that ideas are tested and challenged. 'A more competitive marketplace for ideas', it is pointed out, 'offers the opportunity for good ideas to drive out bad ones.'

Conclusion

The 1950s witnessed some of the key institutional innovations that gave birth to the modern Irish economy. The bureaucracy of the time bore primary responsibility for weighing up the costs and benefits of new proposals and for deciding whether and in what form they might be put forward for political consideration. Even the later example of Donogh O'Malley's surprise announcement of the introduction of 'free education' was based on plans already well advanced within his department.

By contrast, many of the schemes which led to the current collapse were introduced directly by politicians, occasionally at the behest of identifiable interest groups, without being vetted or supported by the bureaucracy. The bank guarantee scheme of September 2008 was not the preferred option of Merrill Lynch, who were acting as advisors to government at the time. It is clear that the private banking lobby furnished misleading information to government, which had an influence on the final outcome. Senator Seán Barrett, the TCD economist, suggests that the only government support that should have been forthcoming that night was the offer of the government jet to allow the bankers put their requests directly to the European authorities!

Should private lobbyists be required to work through the civil service if they wish to have their proposals considered by government? Related proposals for distancing policymakers from vested interests are emerging from a range of sources. A recent book from MIT Press, *Guardians of Finance*, suggests creating an outer layer of regulators to stand 'sentinel' over the financial regulatory authorities in order to guard against regulatory capture and political influence. This extra layer would have no direct interaction with the banks but would have full access to information to scrutinise the actions and decisions of the regulators. Similarly the Mahon Tribunal recommends the establishment of an independent Planning Regulator, among whose tasks would be to investigate when the policy decisions of elected officials appear grossly at odds with the professional and managerial advice of the bureaucracy.

The independence of the bureaucracy of the 1950s stands in contrast to the reticence of its successors. The culture of the public service may have been affected by the intimidatory tactics of Charles Haughey and his disciples. A relevant example is provided by the Beef Tribunal, which reported that 'there is no doubt whatsoever but that the Government … wrongfully and in excess of their powers … directed the (Industrial Development) Authority to remove "the performance" clause from the Grant Agreement being negotiated between the IDA and the Goodman Group and that this direction was made either at the instigation of the then Taoiseach or the Secretary to his Department.'

But recall too that, as Whitaker noted in a 1987 interview, independence is compromised when even the most senior civil servants become dependent on others for future appointments. A UK inquiry into the Iraq War recommended that a particular key post should never again be held by anyone other than an official 'who is demonstrably beyond influence and thus probably in his last post'.

References

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