‘Ireland and the United Kingdom: The Changing Economic Relationship and its Relevance in the Context of Possible Changes in the UK’s Links with the European Union.’

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Abstract: In 2011 Ireland exported more goods to Belgium than it did to Great Britain. Trade in goods and services (both exports and imports) with the UK now amounts to only 18% of Ireland’s aggregated trade. As Irish exports have soared in recent decades there has been a considerable diversification of its trade away from the UK. Furthermore in absolute terms there was a fall in Irish exports to the UK of €8 billion between 2002 and 2011. Has Ireland, under a new economic geography, significantly de-coupled from the UK thereby greatly reducing Ireland’s economic concern of the UK (with or without Scotland) changing its economic relationship with the European Union?

John Donne remarked that ‘no man is an island’. This is even more so for an island economy. No island economy can remain as an isolated economic island. While Ireland, from a geographic perspective, is an island on the periphery of Europe there have been considerable changes, at the trading, technological and constitutional levels that have re-structured and re-located the Irish economy. The Irish jump from a ‘donkey and cart’ agrarian economy to a post modern high tech economy, one that did not involve the intervening process of traditional industrialization, has re-located Ireland, from a trading perspective towards the centre of a global technological revolution and constitutionally towards the countries of the European continent. In the process the traditional economic relationship between Ireland and the UK has undergone a profound transformation, one that risks becoming even more profound, if the UK’s economic position towards Europe undergoes a further constitutional change. This paper sets out to examine some of these changes and the potential implications for Ireland of a UK decision to distance itself further the European Union.

Traditionally, since independence, the Irish economy, notwithstanding an ‘economic war’ in the 1930s, has been very strongly linked to the UK economy. The vast bulk of exports and imports was with the UK, labour moved freely between the two economies as did capital aided by the one-to-one parity of the Irish pound to the pound sterling. However, from the 1970s there were significant changes that dramatically changed the traditional economic relationship. These changes were at two levels (1) the constitutional and (2) the technological.

Initially, after the decisions of both Ireland and the UK to join the European Economic Community in 1972, it appeared that both countries were harmoniously moving towards greater economic integration with Europe. However, divergences quickly appeared as Ireland increasingly committed itself to greater monetary integration with Europe, whereas the UK decided not to embark fully on this path. This became quickly evident when the Irish decision to join the exchange rate mechanism of the European Monetary System led to the de-coupling of the one-to-one parity between sterling and the Irish pound in March 1979. The paths further diverged during the exchange rate crisis of 1992 when the UK decided to leave the European Monetary System and allow sterling to float. Ireland stayed in the EMS committing itself to future European Monetary Union by fully signing up for the Maastricht Treaty. By 2002 euro notes and coin were the legal tender in the Republic of Ireland while sterling remained the legal tender of the UK. These developments meant that Ireland had moved away from a quasi-monetary union with the UK to becoming a founding member of the European Monetary Union. From a constitutional perspective this represented an increasing Irish commitment to Europeanisation, whereas the UK, though prepared to sign up for the European Single Market, was unwilling to go further and maintained its monetary independence.

The Irish commitment to further Europeanisation was part of a strategy to improve Ireland's attractiveness as a centre for foreign industrial investment. Combining with the

Ireland's low corporate tax regime it was hoped that the fact that Ireland was the only English speaking country committed to European Monetary Union would further increase its attractiveness.

While these constitutional changes were taking place Ireland's trading performance was enormously changed by the emergence of a major technological revolution in the U.S., primarily based around Silicon Valley in California. This high tech revolution centred on computers, information technology, telecommunications and pharmaceutics, shifted the US's economic tectonic plate closer to Europe enabling Ireland to serve as a trading pontoon between the US and the European Union. US companies in these sectors attracted by low corporate taxes, a young, well educated and English speaking labour force, and a country that was constitutionally fully committed to European Monetary Union, significantly increased their investment in Ireland. From 1994 onwards Irish exports soared (goods exports increasing from €29 billion in 1994 to €92 billion in 2012), employment grew and a new phenomenon of net immigration appeared. By 2000 a golden age seemed to have arrived with economic growth reaching 9%, unemployment falling to less than 4%, the budget moving into surplus and the national debt as a percentage of GDP falling below 40%. It is not the purpose of this paper to describe the subsequent collapse of the Irish economy. Donal Donovan and myself have written *The Fall of the Celtic Tiger: Ireland the Euro Debt Crisis* that will be published by OUP this month which attempts to explain this collapse.

These changes may be clearly seen in the transformed trading performance of the Irish economy. By 2012 the aggregated Irish trading performance in terms of exports and imports of goods and services was €314 billion, nearly double the Irish GDP. This made

Ireland one of the most open economies in the world. This trading performance with the global economy may be contrasted with the trading performance *vis-à-vis* the UK:

Table 1

<u>Irish Goods and Services (2012) € billion</u>

	World	**UK**
Exports of Goods	92	15
Imports of Goods	49	16
Exports of Services	90	15
Imports of Services	87	10
Total Goods and Services	318	56

Table 1 shows that trade and services with the UK amounted to €56 billion or just 18% of the total in 2012. It is quite evident that there has been a huge diversification in the Irish trading performance. The UK which was once the dominant market for Irish exports and imports now appears to have an increasingly less important role to play in Ireland's economic activity. Exports of goods to the UK which amounted to 24% of total exports ten years ago are now down to 17%. The statistics for the exports of goods indicate that, in 2011, Belgium (€13.8 billion) had become a greater market for Irish merchandise exports than Great Britain (€12.9) and that Ireland was exporting more goods to Switzerland than to France. Additionally, over the last ten years, there has been a disquieting absolute fall in Irish exports to the UK of over €8 billion, a decline of 37%! In 2012 the US was the major outlet for Irish merchandise exports (€18.2 billion).

An initial impression suggests that Ireland has (1) produced a remarkable export performance (exports of goods along have increased from €21 billion to €92 billion in the last twenty years) and (2) been highly successful in diversifying its international trade in goods and services rather than relying on the traditional UK market. It could be concluded from this impression that Ireland has become increasingly successful in de-coupling from the UK economy and that even if the UK (with or without Scotland) leaves the European Union the impact on the Irish economy will not be of paramount importance.

Is this really the case? Considerable care needs to be taken in any such interpretation of the data presented above. It is important to decompose the Irish trading performance in greater detail in order to clarify the extent to which the statistical representation of trade really represents the underlying performance.

It is relevant to break down the really sizeable elements in Ireland's trading performance for 2012 in Table 2:

Table 2

Irish Exports of Goods and Services

	€ billion			
Exports of Goods	92			
		Of which:		
			Chemical Exports	55
Exports of Services	90			
		Of which:		
			Computer Services	37
			IFSC	23

The above shows that chemical exports (most notably pharmaceuticals) accounted for 60% of total goods exported. On the services side, computer services and those provided by the IFSC constituted 66% of total service exports. Overall these three items produced nearly two thirds of Ireland's exports of goods and services. These statistics clearly indicate that Ireland has a dual economy incorporating a high tech sector and the more traditional economic sector. The high tech sector has driven export led growth, most notably in the golden years of the first phase of the Celtic Tiger between 1994-2000 and hopefully it may serve to produce a third phase for the Celtic Tiger, after the disastrous second phase driven by builder/developers and bankers that finished up with the financial crisis of the last five years.

However, extreme care needs to be taken in the interpretation of the export statistics of the high tech sector because they do not reflect the real value added to these exports in Ireland itself. There is obviously a considerable amount of transfer pricing taking place in the areas of chemicals and computer services and a great deal of churning with respect to the activities of the IFSC. These activities are distorting both the amount of value embedded in Irish exports and are also showing an artificial rather than real diversification of Irish exports. Apropos the latter point it may be noted that in the case of chemicals, Ireland's largest export sector, one third of chemicals exported go to two small countries, Belgium (€12 billion) and Switzerland (€5 billion) thereby explaining why Ireland apparently exports more goods to Belgium than to Great Britain, and more goods to Switzerland than to France.

Exports to the UK of traditional sector goods such as agricultural products (€3 billion) or a services sector, such as tourism (€1 billion), are dwarfed by high tech exports such as chemicals. Yet, agriculture and tourism are sectors that are labour intensive and have significant links to the UK market.

From the Irish side the debate about the future of the UK in the European Union may therefore start off from a false premise that suggesting that Ireland has significantly de-coupled its economic future from the UK. An initial analysis of the trade statistics might indicate this but further analysis suggests that most of this de-coupling has been due to MNC activity in Ireland. What might happen, if for example, changes in taxation at the European or US levels, led to MNCs in the chemical and computer sectors leaving Ireland and the IFSC shutting down? Such an action would reduce Irish exports from €182 billion to €67 billion. The impact of such a change would be dramatic and show the still strong reliance of the traditional sector’s links with the UK economy. Any move on the part of the UK to leave the European Union, depending on the re-configuration of the trading and financial links between the UK and the European Union, could have considerable effects on the traditional sector in Ireland. Ireland has therefore every incentive to encourage and assist in discussions between the UK and the European Union to ensure that such an eventuality does not arise.