During the 1960s, real GDP per capita in Ireland increased by 38 percent; during the Seventies it rose by 35 percent; in the course of the Eighties it grew by 28 percent, but in the Nineties it skyrocketed by 90 percent, from $15,084 in 1990 to $25,622 in 1999. The high economic growth rates in the 1990s—which earned Ireland the title Celtic Tiger—were driven by large inflows of foreign investment into the electronics, software, medical appliances, and pharmaceutical sectors. By the early twenty-first century, however, the Celtic Tiger started to linger. Growth rates tapered off to 3 to 4 percent, some TNCs in the electronics industry started to leave the isle, and unemployment was on the rise again.

In this chapter I argue that the impressive growth rates of the 1990s were the result of the dynamic interaction of Ireland’s location-specific assets, TNCs’ strategic needs, and the nature of the global competitive environment. Changes in these three key factors have led to a new critical juncture for Ireland in the late 1990s and have given rise to a whole new set of development challenges facing Ireland today. Whether this new juncture spells the end of the Celtic Tiger depends critically on the success of the country’s newly adopted strategy of R&D-led growth. The extent to which FDI has led to the advancement of indigenous knowledge-based assets and the ability and willingness of high-tech TNCs to move their production in Ireland up the value chain are two critical determinants of the success of the new R&D-based strategy. They will be analyzed in chapter 4.

Background on Ireland’s Development Policies

Any analysis of the Irish FDI-led growth experience in the 1990s has to start with a brief synopsis of the country’s development history. Grounding in the proper historical context is particularly important, since FDI promotion started in the late 1950s. Path dependency was critical for Ireland, as
a number of the country’s location-specific assets in the early 1990s resulted from the cumulative effects of deliberate and fortuitous policies adopted during earlier decades.

After the establishment of the Free Irish State in 1922, the Irish government pursued a free-trade strategy with emphasis on agriculture, followed by an import-substitution strategy in the early 1930s, with high protection and limitations on foreign ownership of domestic productive assets. Average tariff rates rose from zero percent in 1924 to 9 percent in 1931 to 45 percent in 1936 (Whitaker 1983, 62). In addition, the Control of Manufactures Act of 1932 restricted majority ownership of production facilities to Irish citizens. By the 1950s ISI had run into severe difficulties. Balance of payments problems were becoming chronic, and the economy was stagnating. GDP grew at an annual rate of less than 1 percent between 1951 and 1958 (Mac Sharry and White 2000, 21), and over 400,000 people left the country during that period, a reflection of their difficulty to find gainful employment in the industrial sector.

Based on a report on the state of economic development in Ireland by the then Secretary of Finance T.K. Whitaker, the Irish government opted for a new development strategy in 1958, which emphasized a reduction in tariff protection, the promotion of manufactured exports, and the attraction of FDI. The strategy contained many of the same elements that would be advocated for developing countries 30 years later by the World Bank and the International Monetary Fund (IMF). But it differed from the Washington Consensus in its emphasis on financial incentives to stimulate trade and FDI and on proactive government policies to attract FDI. Trade liberalization also unfolded more gradually than it would for many developing countries during the 1980s and 1990s. From the beginning, the Irish strategy of integration into the world economy combined an open-economy approach with selective interventionist government policies.

The Irish government offered a 100 percent remission of taxes on export profits in order to stimulate exports of manufactured goods. Even though this tax incentive was available to national and foreign producers alike, it was predominantly TNCs that benefited from it. Numerous government institutions were put in charge of implementing the new strategy, most importantly among them the Irish Export Board for the promotion of exports and the Industrial Development Authority (IDA). Originally, the IDA was charged with the promotion of industry regardless of ownership. Nonetheless, it spent most of its energy and resources on the attraction of FDI, and in 1993, its charge was officially limited to FDI.

Tariff liberalization started with unilateral tariff reductions in 1963 and 1964, followed by the Anglo–Irish Free Trade Agreement in 1965 and Ireland’s subscription to the General Agreement on Tariffs and Trade in 1967.