ALBERTA FINANCE
Office of Budget and Management
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Economic Spotlight

IRELAND AND NEW ZEALAND
Case Studies in Economic Renewal

Key Findings

- The experiences of Ireland and New Zealand demonstrate that prudent fiscal policies can be a significant contributor to economic growth over the long term.
- Ireland and New Zealand have dramatically improved their fiscal positions without increasing taxes – in fact, both have reduced taxes.
- Open trade policies have supported growth in both countries.
- High labour productivity has made a significant contribution to Ireland's economic performance, supported by high levels of investment in education.
- The exceptional growth experienced by Ireland since the early 1990's has slowed down recently. There are indications that Ireland is now running into capacity constraints, and may be expected to return to more 'normal' rates of economic growth in the future.

Comparisons to Alberta

- Ireland and Alberta are both closely linked to major world economic powers. Ireland is closely integrated with the rest of Europe, while Alberta is tied to the United States. On the other hand, New Zealand finds itself distanced from all major world economic centers.
- Ireland and New Zealand have historically lagged behind other major OECD countries, and have been 'catching up' only over the past decade or so. Their recent growth follows nicely the 'theory of convergence', which predicts that poorer countries will experience above-average growth during their transition into modern, developed economies. On the other hand, Alberta has historically been one of the wealthiest regions in the world. As such, it is expected to experience more 'normal' growth.
- Alberta, New Zealand and Ireland have historically been dependent on natural resources for their economic development. Future growth will depend more on the ability to develop high-tech manufacturing and services sectors. Ireland has been very successful at this over the past decade.
- The key elements to Ireland's success in transforming its economy have been its low tax rates (both personal and corporate), sound fiscal management, and success in developing a highly educated and productive workforce.

IRELAND
RECENT ECONOMIC DEVELOPMENTS

Background:

Historically, Ireland has been one of the poorest countries in the developed world. Until the mid-1990s, Ireland's real gross domestic product (GDP) per capita ranked near the bottom among OECD countries, resulting in the widespread emigration of its youth in search of opportunities abroad. Despite poor economic growth, government policy gradually steered the country towards a more open, competitive and productive economy.

Combined with a more recent move towards fiscally responsible governance, Ireland's history of competitive corporate tax rates, open trade policies, and the development of a highly educated workforce created a strong foundation for economic renewal. As international firms were keen on gaining access to the emerging European market in the early 1990s, Ireland began to attract large amounts of foreign direct investment. Ireland's trade sector experienced rapid growth as a general economic upturn occurred in both the United States and the rest of Europe.

By 2003, Ireland's GDP per capita ranked third among OECD countries, after Luxembourg and the United States. Ireland's economy had been transformed, with high-tech exports contributing a major portion of GDP growth. While some issues still need to be addressed (including lagging public services), Ireland has made tremendous progress over the past two decades.

Key Developments:

- Real GDP growth in Ireland outpaced every other European country between 1993 and 2003, averaging 7.9%. Over the same period, real GDP among the OECD countries grew at an average annual rate of only 2.0% (France, 2.1%; Germany, 1.4%; United Kingdom, 2.9%).

- Ireland's employment-to-population ratio increased from 32.8% in 1994 to 44.8% in 2003 (Alberta's ratio stood at 54.3% in 2003). Ireland's unemployment rate fell from 16.0% to 4.9% over the same time period.

- Ireland has had competitive corporate taxes since the 1950s. In the 1980s, the manufacturing and financial services industries were targeted for preferential tax treatment, with corporate tax rates at 10% for each industry (Ireland is currently in the process of returning to a single general corporate income tax rate). In 2003, Ireland had the lowest general corporate tax rate in Europe at 12.5%.

- Public sector debt totaled 110% of GDP by the mid-1980s, and Ireland's annual budget deficit stood at 13% of GDP in 1986. Following a period of fiscal restraint, the deficit was eliminated by 1998 (although relatively small deficits have returned since 2001).

- European Union transfer payments played a significant role in restoring Ireland's fiscal health. During the 1980s and 1990s, net EU payments averaged 9.4% of Ireland's total expenditures (peaking at 15.3% in 1991). By 2003, this figure had fallen to 3.4%.

- By 2002, Ireland's public debt-to-GDP ratio had fallen to 34%. This was well below both Canada and the United States - at 45% and 43%, respectively.

- Ireland's government expenditures peaked at 62% of GDP in 1983. A period of fiscal tightening during the late 1980s helped expenditures to fall to 46% of GDP by 1991. Expenditures continued to decline as a share of the economy throughout the 1990s, reaching a low of 35% in 2000. This was lower than Canada (39%) but higher than government expenditures in the U.S. (29%). The decline was largely due to rapid GDP growth. Ireland's expenditure-to-GDP ratio has since risen slightly, due to slower recent GDP growth.

- Ireland's government revenues increased from 41% of GDP in 1980 to a high of 50% in 1984, due to a rise in personal and value-added tax rates. Since 1984, Ireland's revenue-to-GDP ratio has experienced a gradual downward trend, as GDP growth outpaced revenue growth. By 2000, government revenue was 38% of GDP (Canada =41%, U.S. = 32%).

- Foreign direct investment increased from U.S. $100 million in 1990 to over U.S. $27 billion in 2002, as international firms sought access to the newly emerging European market through Ireland's fast growing and tax-competitive economy.

- Exports have been a major component of Ireland's economic growth. Goods exports rose from 51% of Ireland's GDP in 1991 to 81% in 2001. By 2002, high-tech exports accounted for almost half of Ireland's total manufactured exports.

- EU transfers have been a relatively minor contributing factor to Ireland's economic growth, at least in direct terms. It is estimated that "Structural Fund" payments (representing about half of EU transfers), designed to help rebuild Ireland's infrastructure, contributed about 0.5% annually to Ireland's GDP growth in the 1990s. Indirect effects are more difficult to measure, although business confidence did improve as a result of deficit/debt reduction.

- Inflation remained low throughout Ireland's economic expansion. Ireland's wage inflation was kept under control through consensus-based national wage agreements and, as economic expansion started to take place, through increased labour supply via immigration. Substantial amounts of foreign direct investment mitigated Ireland's capital pressures.

- Education policy is widely credited with making a significant contribution to Ireland's economic growth. From the 1960s onwards, a policy of (largely) free post-secondary education has led to a dramatic increase in educational participation rates. Ireland's emphasis on access to education has provided solid support for its continued productivity gains.

Current Status and Future Implications or Challenges:

While Ireland has witnessed tremendous economic gains over the past decade, continued rapid growth, as recently experienced, is unlikely. Inflation has recently begun to rise, as any slack left in the economy disappears. Future growth is expected to moderate substantially from levels experienced in the 1990s. Real GDP per capita growth fell to only 0.7% in 2003.

Some discussion has emerged as to whether the recent growth Ireland experienced was an 'economic miracle,' or merely a fast and efficient example of the 'theory of convergence.' According to this theory, poor countries are expected to grow faster than wealthy countries, until some point in the future when economies converge to a 'steady state' equilibrium growth rate.

In any case, Ireland appears generally well positioned to deal with future economic challenges, with its highly educated and productive workforce, an internationally competitive tax regime, and one of the lower debt burdens among developed countries.

NEW ZEALAND
RECENT ECONOMIC DEVELOPMENTS

Background:

Historically, New Zealand's economy has centred on agriculture, with a large dependence on the United Kingdom for the purchase of its exports. In the 1950s, New Zealand was one of the wealthiest countries in the developed world, but since then, its international ranking has fallen dramatically. As a result of the United Kingdom joining the EU in 1973, New Zealand's key markets shifted from the United Kingdom to Australia, the United States and Japan. During the 1970s and 1980s, New Zealand's economy was unable to keep pace with growth in the rest of the OECD.

In response to this economic decline, New Zealand began substantial structural reforms in 1984. These reforms included privatization of public sector enterprises, tax reduction/reform, overhauls of tariffs and subsidies, elimination of capital and credit controls, and expenditure restraint. New Zealand's reforms gained a high international profile, resulting in an increase of foreign direct investment and higher immigration.

Over the past decade, New Zealand has experienced stronger economic growth (averaging 3.3% annually in real terms), and its fiscal position has improved dramatically. Its economy is now much better positioned to weather future challenges. Nevertheless, New Zealand still has a long way to go to regain it former economic position, as its GDP per capita remains well below the OECD average.

Key Developments:

- Between 1993 and 2003, real GDP growth averaged 3.3%, compared with 1.9% in the 1980s and 1.7% in the 1970s.

- New Zealand 's GDP per capita grew 0.5 percentage points faster than the OECD annual average between 1992 and 2002, although it reached only 85% of the OECD average in 2002.

- New Zealand's employment-to-population ratio increased from 43.4% in 1993 to 48.4% in 2003 (Alberta's ratio was 54.3% in 2003). The unemployment rate fell from 10.3% to 5.2% over the same time period.

- Following the introduction of inflation targeting in the early 1990s, the annual inflation rate was reduced to around 2%. In the 1970s and 1980s, New Zealand's inflation rate had been among the highest and most volatile of all OECD countries.

- New Zealand ran large deficits through most of the 1980s, with the ratio of debt-to-GDP increasing from 14% in 1980 to 50% in 1992. Beginning in the early 1990s, fiscal restraint policies helped to eliminate the deficit. Government expenditures were reduced from 43% of GDP in 1990 to 32% of GDP in 1996. In 1994, New Zealand reported its first surplus in more than a decade. As a result, New Zealand was able to decrease its debt-to-GDP ratio to 14% by 2000, a 36-percentage point decrease from 1992.

- Tax reform was a major component of New Zealand's restructuring program. The centerpiece of this reform was a shift from a narrowly-based, high rate system centred on personal income taxes to a more broadly based, low rate system. Personal income tax rates were lowered, while at the same time an awkwardly administered wholesale tax was replaced by a goods and services tax (GST). Between 1980 and 1998, personal income taxes declined from 62% of government revenues to 40%.

- In 1980, corporate tax rates were 45% for resident companies and 50% for non-resident companies. Corporate tax rate reforms resulted in a reduced uniform rate of 33% for both resident and non-resident companies. Despite this reduction in rates, corporate income tax accounted for 15% of total tax revenue in 2001, up from only 6% in 1990.

- During the reform process, tariffs were reduced to one-third their pre-reform levels. By 1995, 90% of all imports entered New Zealand free of quotas, duties or other restrictions.

Current Status and Future Implications or Challenges

While there is general optimism regarding the impact of New Zealand's reforms, many observers had expected higher economic growth than has been achieved to date. The New Zealand government has recently turned its attention to this issue. Areas that are being investigated include education and skills training, public infrastructure, foreign investment, domestic savings, research and development and improved global connectedness.

There has recently been pressure to reverse some of the reforms that have taken place over the past two decades, as New Zealand's fiscal restraint measures continue to meet significant resistance and pressures on public services have become more acute.

Despite significant ongoing challenges, New Zealand's strong finances and very low debt burden place it in a good position for the future.

Appendix

GDP Per Capita, 2003

At 1999 prices, in U.S. dollars

OECD Member countries[1]	Based on purchasing power parities[2]	Percent of OECD Average	Rank	Rank (1990)
Alberta[3]	$34,224	127	(3)	(4)
Canada	$29,025	107	8	6
Ireland	$31,609	117	3	21
New Zealand	$21,637	80	20	19
Luxemburg	$47,527	176	1	1
U.S.A	$34,831	129	2	3
Norway	$31,197	116	4	8
Iceland	$29,424	109	5	4
Denmark	$29,139	108	6	5
Switzer-	$29,137	108	7	2
Australia	$27,474	102	9	17
Netherlands	$27,124	100	10	11
Austria	$26,969	100	11	10
Sweden	$26,455	98	12	12
Japan	$26,264	97	13	7
Belgium	$26,020	96	14	14
Germany	$25,506	94	15	9
Finland	$25,476	94	16	16
U.K.	$25,476	94	16	18
Italy	$25,202	93	18	13
France	$24,853	92	19	15
Spain	$20,954	78	21	20
Portugal	$17,688	66	22	22
Greece	$17,556	65	23	23
Turkey	$6,478	24	24	24
OECD Average	$27,002	100	n/a	n/a

Source: Groningen Growth and Development Centre, Total Economy Database, OECD

[1] Pre-1994 membership countries only
[2] Purchasing power parities (PPP) are used to calculate the relative value of currencies based on what those currencies will buy in their nation of origin. They are used in international income comparisons.
[3] Alberta rankings are given for comparison only. Alberta is not included in OECD rankings

Economic and Fiscal Indicators

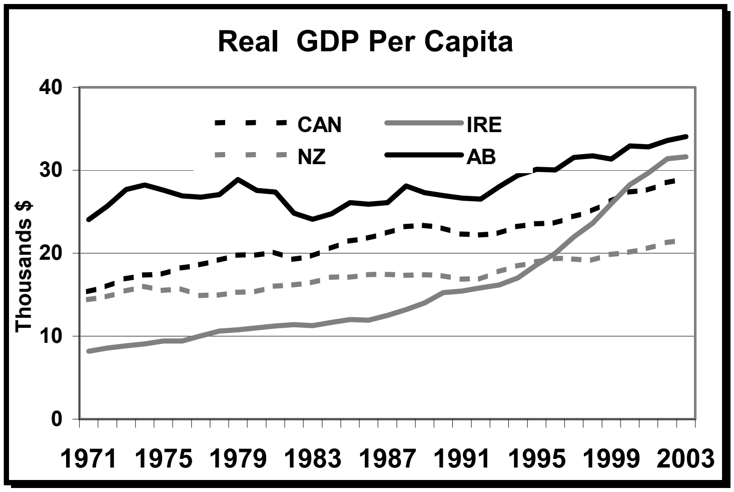
Source: OECD, IMF, Statistics Canada, Alberta Finance, Ireland Department of Finance and the New Zealand Treasury.

Economic and Fiscal Indicators	Alberta	Canada	Ireland	New Zealand
Population (Millions) (2003)	3.2	31.6	3.9	4.0
Population Growth (1993-2003 annual average)	1.7%	0.9%	0.9%	1.3%
GDP per capita* (2003)	$34,224	$29,025	$31,609	$21,637
Real GDP growth (1993-2003)	4.0%	3.5%	7.9%	3.3%
GDP Implicit Price Deflator (1997-2002 annual average)	3.8%	1.5%	5.3%	1.7%
CPI Inflation rate (2003)	4.4%	2.8%	3.0%	1.8%
Employment (% of Population) (2003)	54.3	49.5	44.8	48.3
Employment Growth (1993-2003 annual average)	2.9%	2.0%	4.1%	2.4%
Unemployment Rate (2003)	5.1%	7.6%	4.9%	4.6%
Exports of Goods and Services (% of GDP) (2002)	57.7	46.0	94.9	36.7
Imports of Goods and Services (% of GDP) (2002)	54.3	40.8	80.5	35.1
High-Tech Exports (% of Manufactured Exports) (2002)	n/a	15.3	47.5	8.4
Foreign Direct Investment (% of GDP) (2002)	n/a	3.9%	9.6%	3.4%
Net Government Debt (% of GDP) (2002)	0%	38%	34%	16%
Total Tax Revenue (% of GDP) (1999)		33.7%	25.1%	35.2%
Corporate Income Tax (% of GDP) (1999)	3.9%	3.6%	3.0%	3.6%
Personal Income Tax (% of GDP) (1999)	12.5%	14.1%	10.6%	14.7%
Goods and Services Tax (% of GDP) (1999)		9.1%	9.6%	12.7%

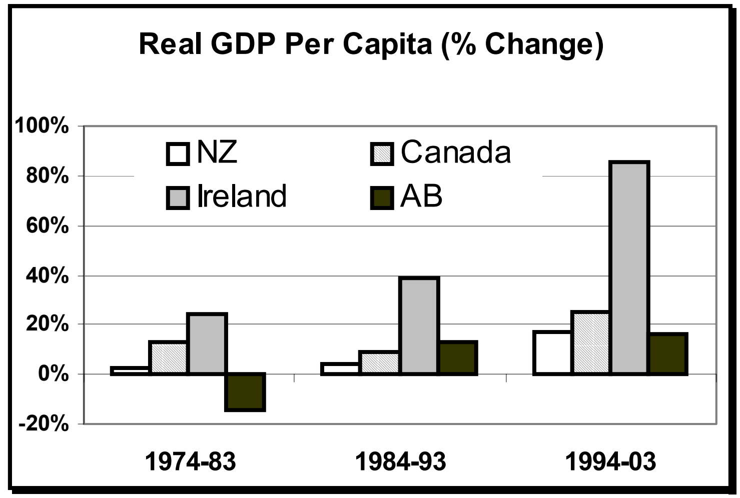
*In 1999 U.S. dollars, Adjusted for Purchasing Power Parity

Economic and Fiscal Trends

New Zealand, Ireland and Canada



Source: Alberta Finance, OECD



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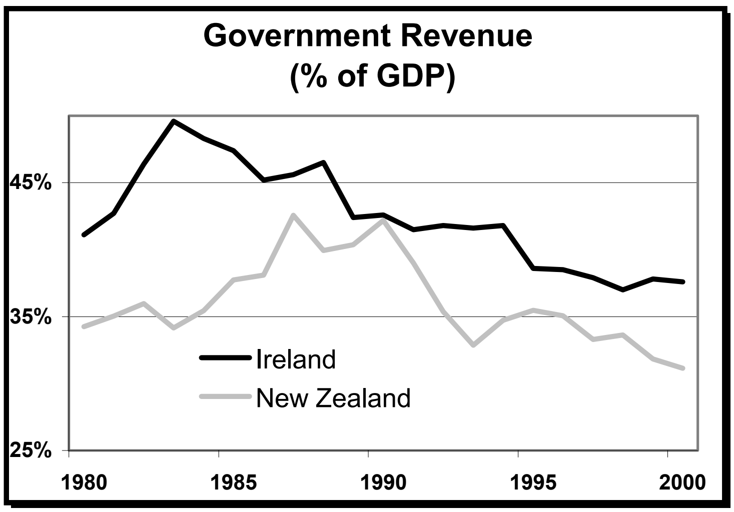
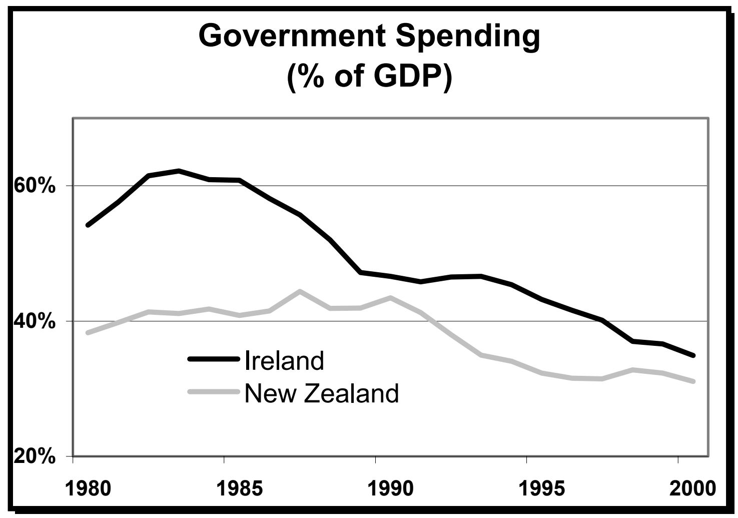
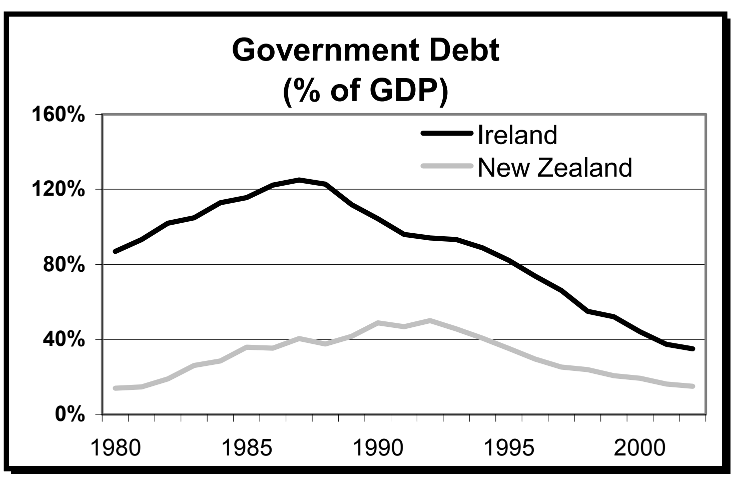


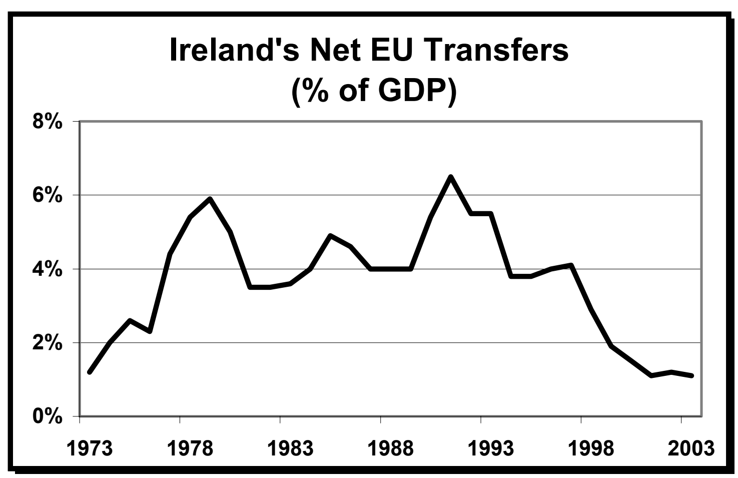
Source: Ireland Department of Finance, New Zealand Treasury



Source: Ireland Department of Finance, New Zealand Treasury



Source: Ireland Department of Finance, New Zealand Treasury



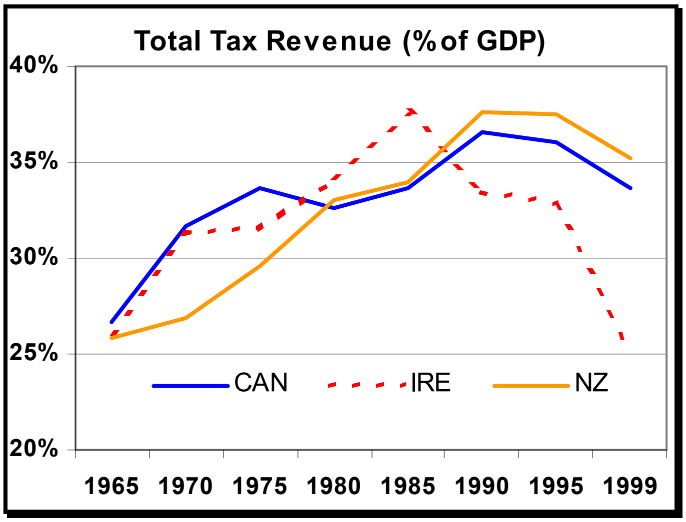
Source: Ireland Department of Finance

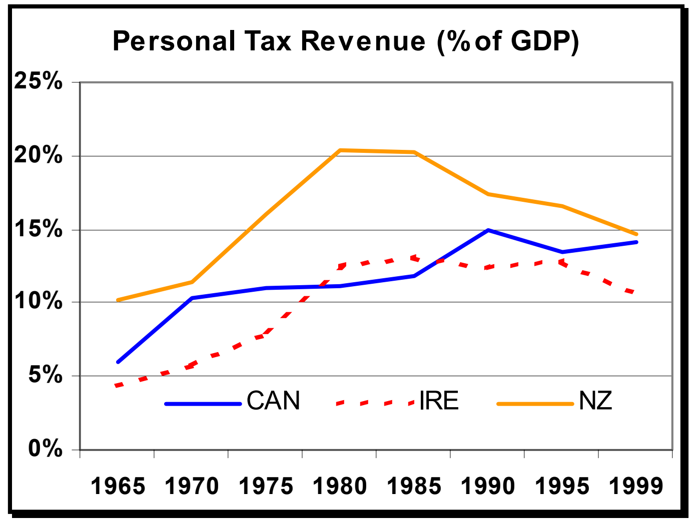
Note: Ireland fiscal data is calculated as a percentage of GNP

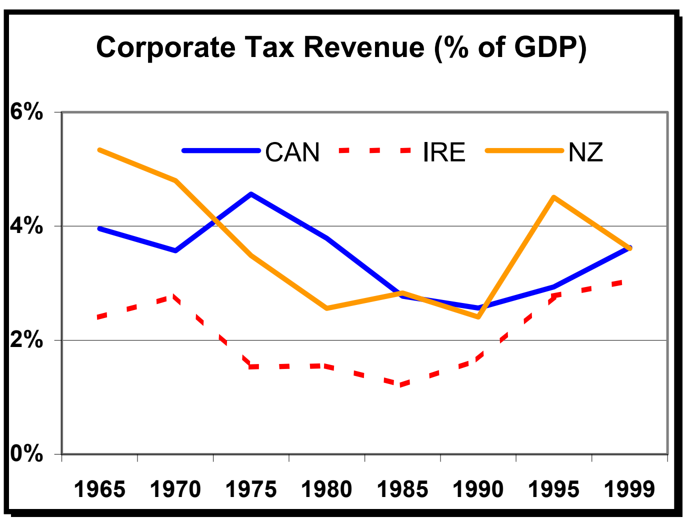
Revenue Sources as Share of GDP

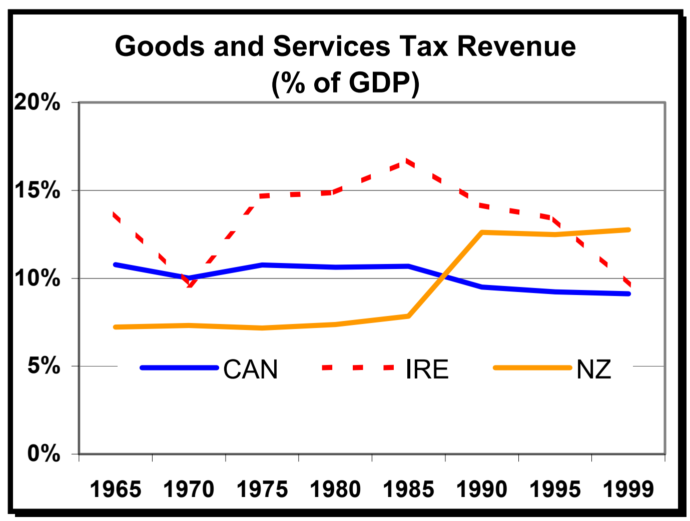
New Zealand, Ireland and Canada

Source: OECD, Revenue Statistics 2001









Revenue Profiles: (Revenue Shares by Tax Type)

Canada, Ireland, New Zealand

OECD: Revenue Statistics 2001