NATIONAL ECONOMIC DIALOGUE

BEING A SMALL OPEN ECONOMY: CHARTING OUR PATH IN A CHANGING GLOBAL ENVIRONMENT

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This paper has been prepared as a contribution to the discussion in the break out session at the National Economic Dialogue. It should not be seen as prescriptive but rather seeks to set out the current factual situation and to suggest some of the key questions which participants may wish to consider.

Key Guiding Questions:

- ***What are the emerging global and EU risks and constraints for Ireland's future as one of the most open economies in the world?***
- ***How can we maximise our trading and inward investment capacity in a constantly changing world? What are the trade-offs?***
- ***What is the evolving economic role of the diaspora in 2015 and in the years ahead? How can we support returning migrants within fiscal constraints?***

BACKGROUND

Since the late 1950s, a key platform of Ireland's economic policy has been its openness to international trade and investment. Following membership of the then European Economic Community, Ireland has become increasingly open to external influences particularly by way of deepening integration within the European Union, a deepening that is perhaps best exemplified by Ireland's membership of the euro.

As a result, Ireland has become one of the most open economies in the world for which evidence can be seen across a number of key macroeconomic variables. For example, Irish exports represented over 110 per cent of GDP in 2014. Reflecting a long-standing policy of attracting inward foreign direct investment (FDI), the foreign-owned sector makes a significant contribution, accounting for a quarter of Gross Value Added (GVA) in 2013. In addition, 15 per cent of the labour force is made up of non-Irish nationals. This openness was an important factor in supporting the economy over recent years with export performance showing considerable resilience when domestic demand was contracting sharply.

World Trade Organisation (WTO) figures show that Ireland's share of total global export markets stood at 1 per cent in 2013, a similar figure to that which prevailed at the beginning of the century. However there has been a significant compositional change over this period, with Ireland's share of the global services market increasing.

INTERNATIONAL DEVELOPMENTS AND RISKS TO FUTURE PROGRESS

At present, the external environment is reasonably favourable, with economic recovery gaining momentum in both the US and UK, while in the euro area the recent economic trends have been relatively positive. The depreciation of the exchange rate is a positive development, while monetary conditions are supportive. Having said that, there are clear risks to the short-term outlook and we must be cognisant of these. A non-exhaustive list includes:

- As a net oil importer, if oil prices were to increase significantly there would be a reduction in disposable income. Such an increase would also negatively impact trading partner growth and Ireland could therefore face a "double hit" to growth prospects.
- A re-emergence of the euro area sovereign debt crisis triggered by developments in Greece is a risk. While the direct exposure to the Greek economy is small, indirect effects could potentially be significant (although current indications are that contagion has been limited).
- Unconventional monetary policies (near zero interest rates and "quantitative easing")

by central banks, while necessary to support stagnant economies, have led to ultra-low interest rates globally. Ultra-low interest rates can incentivise investors to undertake riskier investments and present financial market stability risks. Furthermore, market expectations are for a tightening of monetary policy in the US in the second half of the year, which could lead to a shift in investor sentiment.

- The current low inflation environment could negatively impact our growth prospects by increasing debt servicing costs and making deleveraging more difficult.
- Uncertainty regarding the future of the UK in the European Union could threaten Irish economic performance even in the short-term.

POTENTIAL SUSTAINABLE GROWTH STRATEGIES

A non-exhaustive list of strategies to maximise trade and investment opportunities in an increasingly globalised economy include::

- *Supporting international trade liberalisation efforts* – in particular through the Transatlantic Trade and Investment Partnership (TTIP) which aims to strike a deal on trade and investment between the EU and the US.
- *Selecting the right policy tools* – flexibility to be able to respond rapidly to changes in technologies, the ongoing shift from goods to services, and to changing demographics and consumer demands with the right policy tools is imperative.
- *Developing sectors where we have a comparative advantage* – Ireland's export strategy has focused on specialising in niche areas where we have a comparative advantage (i.e. Agribusiness, Financial Services) and where we have proven capabilities (i.e. ICT, Pharma). This approach could be continued and developed to include sectors and markets in which there are both clear opportunities and first mover advantages in, for example, convergence technologies and in high-growth markets such as Asia, South America and Africa.
- *Continuing to invest in human capital* – To meet the needs of sectors that are expanding globally, Ireland will have to continue to invest in education and skills. Furthermore, with almost half of those emigrating from Ireland in 2014 holding a third-level qualification, it will be important to reverse the brain-drain of recent years by incentivising the return of the Irish diaspora.
- *Maintaining and supporting competitiveness* – For Ireland to continue to be internationally competitive it will be required to manage cost competitiveness, including in areas such as transport, telecommunications infrastructure, human capital etc. To ensure the focus is on the right areas for development, Ireland needs to continue to benchmark its competiveness across these and other areas using a broad range of measures.

FURTHER GUIDING QUESTIONS

- What are the key risks that Ireland is likely to face over the next ten years?
- How can Ireland be best prepared to mitigate these risks?
- How does Ireland ensure it is focussed on the right export sectors both now and in the future?
- Is a strategy focused on high value-added / "high tech" sectors, optimal in terms of supporting export growth while at the same time maintaining high living standards?
- Are there "win-win" polices that support both indigenous Irish SMEs and growth in exports?
- Is there sufficient focus currently on identifying the opportunities that come with further integration of the EU single market?
- Could Ireland be doing more to build on its long standing relationships with business groups and leaders across key global markets?
- How can Ireland best support the needs of those who have found it necessary to move abroad and who might now be contemplating returning home? What more could be done to convince more highly educated and experienced diaspora to return to Ireland to work?

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