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SPECIAL AREA ZONES – THE IRISH EXPERIENCE

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My name is George Shaw from the Prime Minister's Department, in Dublin, Ireland. I would like to thank you for your kind invitation to address this important conference.

What I will try to do during my presentation is to briefly refer to Ireland's industrial policy and corporate tax regime, illustrate a few examples of special area zones and one zone in particular, and then explain the link between the financial services special zone in Ireland and regulatory reform.

I should perhaps initially give you some current statistics about Ireland and the Irish economy so that you can have a context for my remarks.

Ireland is an independent sovereign state and a constitutional democracy, a full member of the European Union and the OECD, and has a stable multi-party parliamentary system. It is a founder member of the Euro and its only native English-speaking member. It operates in the same time zone as London and offers maximum overlap between the Asia Pacific region and the Americas.

Ireland has a population of 3.9m people, with one million living in the capital, Dublin. It has a temperate climate with a land area of 70, 282 sq kilometres.

The unemployment rate is 4.4% and inflation is 2.7%. The Current Account Balance is €1.7bn, compared to €1.3bn in 2003.

So that is a brief thumbnail outline of Ireland.

So now to the subject of my remarks.

'Special Zones' of themselves are not a common feature of the Irish economy. Industry policy has tended to regard Ireland as a region in itself – as my later remarks about EU Structural Funding will illustrate - and the development of Ireland's corporate tax regime reflected this approach.

Ireland's industrial development policy over the years has been to provide a positive business environment and an attractive climate for investment. The goal of this policy is the creation of jobs. A long established tradition of providing low corporate tax rates for business has been a cornerstone of Ireland's economic development. Successive Governments have been consistent in recognising the need to facilitate corporate investment planning by providing an attractive tax regime over a relatively long time frame.

Currently under our agreement with the EU, with effect from 1 January 2003, a new standard rate of corporation tax of 12.5% was introduced for all companies with trading income. Ireland’s corporation tax rate is among the lowest in Europe.

Ireland joined the GATT in December 1967 and, in 1973, the European Economic Community (EEC), as it was then. Economic development took off in Ireland through the impact of such policy changes as investment in education, and new inward investment prompted by low costs, attractive incentives and a hard working and efficient English speaking workforce.

There are a number of examples in the Irish context of what could be described as area zones. These zones all had in their own way a positive effect on the Irish economy.

They are:

(a) The Shannon Free Zone,

(b) Ireland as an Objective One region within the EU, and

(c) the International Financial Services Centre (IFSC).

I will concentrate my main comments on the IFSC, but I would like to initially focus on the other two examples.

The industrial free zone at Shannon, Co. Limerick, established in 1957, is perhaps the first example of a special zone in Ireland. It is situated in the south-west of Ireland, adjacent to Shannon Airport, Co Clare.

The Irish Government at the time through a modification in existing legislation permitted industrial development to be carried out in the zone.

There were a number of unique features and incentives designed to attract foreign industry. A zero corporation tax rate and a zero value added tax (VAT) applied to the zone, which also included deferral of import duties, provision of advance factories and State employee training schemes.

All of the unique “Shannon” incentives have been eroded over time either through legislative change or by being replicated elsewhere.

The Shannon zone today is a very different model to that established in the 1950’s and it operates in a very different environment. The Shannon Free Zone now successfully competes head to head with newly developed state- of- the- art business parks, digital parks and technology parks, at home and abroad.

Lets move to Europe for the next example of a special area zone.

The European Union, since its inception as the EEC in the late nineteen fifties, has been committed to the principle development of economically-lagging regions of the Community. This commitment ultimately found expression in the formulation and development of policies designed to reduce regional disparities and encourage the poorer parts of the Community to converge on average Community levels of prosperity.

A particularly important component of this policy was the focusing of Community assistance on those regions known as Objective One.

Ireland played a substantial role in promoting this emphasis on Objective one regions and on what came to be known as the Cohesion

Group. Ireland itself was treated as a single Objective One region or the equivalent of a special zone, before 2000. We were able to show, by reference to the state of Irish infrastructure, the levels of unemployment and emigration, and its peripheral location in relation to the economic heart of the Community, that Community assistance was necessary to achieve the ambition of greater convergence within the union.

Ireland ceased to be eligible for commitments after 2003 because we had exceeded the per capita EUGNP threshold.

From the eighties onwards, Ireland has made it clear that EU assistance would be complemented by a comprehensive package of Government policies to promote economic stability and growth. These have included sound public finances, social partnership, incentives for foreign direct investment and continuing Government investment.

For these reasons, Ireland has secured above average transfers of structural funding, illustrating the success of its negotiations in seeking inclusion as an Objective One region, or a special area zone.

These two brief illustrations bring me to the third example of a special area zone and the one to which I will focus on this morning.

It was the 1980's, and the Irish economy was in deep crisis.

Unemployment had reached 17.5% by 1987 compared to today's figure of 4.4%, and inflation was running at an average of almost 12% in the 10 years to 1987, whereas today's figure is 2.7%. Emigration was at its highest level since the 1950's. Grim figures indeed.

By 1987 a crisis of high unemployment confronted a highly indebted State. Ireland recognised that its future lay in a full commitment to open markets but that required it to be competitive and efficient. Certain factors were important and came into play in a cumulative fashion.

The most immediate *was* the direct contribution of Government (and it must be said, a mature supportive opposition), with the aim of restoring to health the public finances. The Government undertook not to spend money it did not have, i.e., it stopped borrowing for current spending and cut back on public expenditure. These actions did not have the expected severe deflationary effect on the economy for the following reasons:-

- International interest rates came down, reducing the foreign debt bill;
- In the wake of the signing of the Single European Act (1987) an investment-led expansion got underway in Europe ; and
- Moderate wage settlements helped to restore the competitiveness of companies exporting from Ireland.

These crucial policy developments in the late 1980's enabled Ireland to reap the benefits of <u>two</u> long-term policy commitments, the opening of the economy and an investment in human capital. The <u>final factor</u> that must be added was the contribution of the European Structural Funds, to which I have already referred.

Ironically, therefore it was also in 1987, that **the third example of a special zone in Ireland**, the International Financial Services Centre, the IFSC, developed with strong support from the various Government institutions, political, legislative, fiscal and regulatory. The IFSC was built in a part of Dublin, which required extensive regeneration and development. Between its establishment in the late 1980's until the present day it has contributed 14,000 up the value chain jobs to the sector and contributes an enormous €700m in Corporation tax to the Exchequer per annum. In current times it is the most significant example of an economic area zone in Ireland.

Initially the IFSC activities concentrated on developing such areas as banking, corporate treasury and insurance. These areas have experienced dramatic growth and have now evolved into cornerstone activities within the IFSC.

The IFSC now ranks as one of the leading locations world wide for international banking, investment funds, corporate treasury and insurance activities. It is host to more than half the world's top twenty insurance companies and to more than half the world's largest banks.

But how did it all begin?

The rationale behind the idea was that:

- World financial markets had become highly inter-dependent and operated on a round-the-clock basis;
- The technology to set up and run international data and fund management centres was creating an electronic market place; and
- global deregulation of financial services meant that an increasing range of these services was provided from beyond national boundaries.

The key early steps included the establishment of a Committee in the Prime Minister's Department and chaired by his Secretary General, comprising the heads of relevant public agencies, some private sector financial businesses and advisors in the area of finance, law and tax.

This Committee oversaw the following initiatives:-.

- The full engagement from the outset of the regulator, the Central Bank of Ireland, of the activities to be carried out in the Centre.
- The extension to the International Financial Services Centre(IFSC) of the low corporate tax (10% on profits) then available, under Irish law only to manufacturing and some service activities such as software and data processing. The agreement of the European Commission to this change was sought and obtained.
- The role of the Investment Development Agency (IDA), as a marketing force, and leading individuals with backgrounds in relevant state institutions such as the Central Bank and the Revenue Commissioners to promote the concept of the Centre to leading international financial businesses.
- Dublin Docklands were provided with special tax incentives to assist its development and these were passed on to the new occupants of the buildings, adding to the advantages of locating there.
- The major Irish banks were engaged from the outset in the development. There was a full understanding that an open market will grow and benefit all those who were competitive.
- A few leading international companies and institutions were persuaded and undertook activities at an early stage in the Centre. They included Merrill Lynch, AIG and Chase Manhattan. They undertook activities there and gave credibility to it. Soon a

momentum developed which saw a growing number of leading institutions become involved.

In addition, the flexible and prompt response of the public authorities working in close partnership with the financial industry which was itself open, outward looking and welcoming, was critical to the success of the IFSC.

The pro-business attitude of the regulatory authorities in Ireland is an important feature of the financial sector. They have adopted an 'open door' policy in their willingness to meet project promoters and to discuss issues directly with them. Industry associations are directly involved, with high participation in various policy review groups, which comprise industry practitioners and the relevant authorities.

IDA Ireland, the Investment Development Agency, with its Financial Services Division offers a 'one stop shop' for foreign financial institutions that wish to locate financial services activities in Ireland. The Department of the Taoiseach (Prime Minister) provides the political support to all of the initiatives which operate to advance the financial services industry in Ireland.

So that explains how the financial area zone, the IFSC, was established by central government.

Regulatory reform plays a key role in improving resource allocation and accelerating growth. Good regulation in financial services creates the appropriate environment for the attraction of new players into the industry. Our experience in Ireland has been that the financial services industry wants its regulator to be firm but fair, not 'soft' or 'hard', but rather predictable, with certainty for the business community.

In the beginning, however, the issue of regulation for the financial services industry was a difficult one. Although the Centre was being established the regulating skills were not there and had to be built up and developed. This was done in such a fashion that the Irish regulator is now highly regarded and respected internationally.

Regulatory reform in Ireland began later than in many of its EU neighbours, beginning in the 1980’s and slowly spreading throughout the economy in the 1990’s.

The Irish Presidency of the European Union, which concluded at the end of June this year, placed Better Regulation as a core theme of its Presidency.

Many regulations affecting business in Ireland are now determined at EU level. Last January, the Irish Government published a White Paper on Regulation called “*Regulating Better*”.

There were six principles set out:

- **Necessity**: is the regulation necessary? Can we make it easier and simpler?
- **Effectiveness**: is the regulation properly targeted? Is it still effective?
- **Proportionality**: is there a more effective way of achieving the objective? Do the advantages outweigh the disadvantages?

- **Transparency**: have we consulted with stakeholders prior to regulating?
- **Accountability**: is it clear who is responsible to whom and for what? Is there an effective appeals process?
- **Consistency**: is it consistent with other regulations in place?

The objective of these principles is not just to reduce the burden of regulation, but to improve the quality of regulation. The IFSC is an example of this approach – good quality regulation is central to the success of the Centre. In fact, one of the most important advantages of the Centre has been the accessibility of the regulators, the speed with which they can take decisions and the commitment to the early transposition of new EU Directives. This approach makes the IFSC an attractive place to do business, while maintaining the highest quality standards.

We must seek to ensure that new regulations make a positive contribution to competitiveness. Competition policy is central to regulatory reform because, as regulatory reform stimulates structural change, vigorous enforcement of competition policy is needed to prevent private market abuses from reversing the benefits of reform. In the Irish Government's general regulatory reform programme, competition is a main substantive theme.

The Irish Government realises that the quality of regulation can be a source of competitive advantage. We need therefore to ensure that our regulatory system helps not hinders, risk takers, entrepreneurs and innovators.

Regulation is necessary - if you cannot be sure of the rules, if there are too many rules, if they are contradictory, if they are too expensive to comply with and if they are not enforced consistently, then Government, industry and society have a problem.

A single regulator has been established in Ireland for the financial services industry. It is called the Irish Financial Services Regulatory Authority (IFSRA). Its role is to oversee the operation of the financial services industry in Ireland. It has a statutory base and is appropriately funded and staffed to carry out its role.

Its special financial zone, the IFSC, with its tax regime and the attraction of financial institutions of international renown and reputation, was a remarkable driver for the development of Dublin in particular and its establishment as an international financial centre.

It has also served as a flag ship project for the Irish economy throughout the 1990's attracting international banks and financial institutions that came and established in Ireland.

But all of this did not happen in isolation.

The election of a new Government in 1987 coincided with a crisis in the public finances to which I have referred. This Government adopted an approach which was central to the beginning of social partnership.
This was based on a strategy report from the National Economic and Social Council (NESC). The NESC, chaired by Department of the Prime Minister, is an important economic body bringing together all the social

partners to advise the Government on the effective development of the national economy and the achievement of social justice.

The Government negotiated the first of a series of social contacts between Government, employers, the farming organisations, trade unions, and the community and voluntary pillar. This first agreement was called the Programme for National Recovery (PNR).

The central message in that NESC document in 1987 was that Ireland needed a strategy to extract itself from the serious situation in which it found itself. The successive national agreements negotiated since 1987, provided for moderate wage increases supplemented by cuts in personal taxation and consensus on spending priorities in economic and social programmes. These agreements, which continue to the present day, underpin a consensus on national development priorities.

Social Partnership was a distinctly Irish contribution to economic success. This " Irish solution to an Irish problem" bears a close resemblance to the tripartite contact between labour, capital and the State developed in many European economies in the 1950's. Social Partnership worked well in the aftermath of the disastrous late 1970's/early 1980's. Social Partnership produces a degree of overall economic stability and business certainty that is capable of transcending political change.

Every Government since 1987 has embraced the concept and worked it in the best interests of Ireland. Social Partnership grew from a shared recognition that challenges facing Ireland could not be satisfactorily addressed by any one group acting alone.

In reading the APEC Outcomes and Outlook 2003/2004, I was struck by the comment that:

"*APEC recognises that strong and vibrant economies are not built by Governments alone, but by partnerships between government and key stakeholders, including the business sector, industry, academia, policy and research institutions and interest groups within the communities*".

In a paper to the First meeting of the APEC – OECD Co-operative Initiative on <u>Regulatory Reform</u> in Singapore in 2001, Roy Jones of the Trade Union Advisory Committee to the OECD, stated with regard to future regulatory reform initiatives that:

"Common to all is the notion that a "partnership" approach is required bringing together representatives of governments, labour unions, business and where necessary other legitimate civil society groups".

Now that sounds familiar, I thought!

In Ireland therefore, since 1987, this consensus or partnership has existed in an arrangement which has allowed economic and social issues to be identified and discussed before any conclusions are reached or decisions taken. It is in the context of such partnership arrangements that decisions on such matters as market regulation and regulatory reform can be raised for consideration.

This morning I have attempted to explain the experience of special area zones, as they exist in the Irish context, concentrating on the most recently established example. In doing so I have tried to show the role of the regulator with regard to that initiative and how it impinges on our competitiveness. The importance which the Irish Government places on regulatory reform is explained and the history of Social Partnership in Ireland is also outlined.

Let me now draw the links together in the Irish case. The IFSC - the zone, IFSRA, - the regulator, - social partnership, and regulatory reform – all moving in the direction of further developing the Irish economy, all motivated out of a commitment to reconstruct and renew following a difficult period for the Irish economy, and all driven from the Prime Minister's Office.

This has been the Irish experience.

Thank you for your attention.