

Interrogating Irish Policies Revisited

William Kingston

This book anticipated the deflation of the 'Celtic Tiger' bubble, reprinting ten articles which had cast a cold eye on Irish politics, and added an updating Chapter.¹ It showed how well Ireland illustrates the observation of Keynes's biographer that 'belief in the superior wisdom of the State breeds pathologies which deform, and at the limit destroy, the political economies based upon it'.²

Since it appeared, Ireland has clearly passed from deformation to destruction, to the extent of the serious prospect of having to call on the International Monetary Fund (IMF) to discipline what the EU does not already control. Their enemies claimed that the Irish would never be able to govern themselves, and having to follow Hungary and Iceland in this way would be an admission that the enemies were right.

But why has such a destructive belief been so particularly strong in this country? The earliest of these articles, which like three others appeared originally in *Studies*, blamed the proportional representation electoral system, which produces politicians 'whose self-abandonment to the Party in its mindless rush for votes resembles the extraordinary migrations of the lemmings, those strange little animals of Norway, which are said to have as their only object their own destruction by drowning in the ocean.'³

The Democracy/ Property Rights Balance

The principle on which the book is based is that democracy is essentially a property-rights system; it can only work to the extent that the power it gives to numbers is balanced by property, which *is independent of the*

State. In contrast to other ex-colonial countries, the Irish Free State was fortunate in having this condition so largely fulfilled at its outset, because the British administration had already distributed land ownership widely.

However, this balance has been progressively eroded, because of the interventionist policies to which proportional representation inevitably leads. Although Sean Lemass did not begin these policies, he gave them their definitive push in the form of the protected industries, which began the cancerous funding of politics by business. Joseph Brennan, the earliest Secretary of the Department of Finance, wrote with insight that Lemass had 'an exaggerated belief in the efficacy of state action and if he retains this he may do a lot of harm'.⁴

In theory, interventionist politicians could be compensated for by the ethos and competence of a country's bureaucracy, but the ability of the Irish public service to perform this role has been progressively nullified, both by a change in its demography and by loss of its independence. It has been politicised, and its morale undermined, as part of giving it interventionist tasks that it cannot fulfil, as discussed Chapters 7 and 8.⁵ That the country's entire export trade in food products was at risk, because the much-vaunted and enormously expensive 'traceability' system incredibly omitted the earliest link in the food chain, is only one of many more failures which can be added to the lists in those Chapters.

An important reason why the public sector works so badly is the doctrine of the 'corporation sole,' taken over from the British system. According to this, all actions by a government department are deemed to be those of an individual Minister, not of his agents. This worked in England in the days when a class-based Civil Service could be counted in tens, but is nonsensical once the State apparatus has grown to modern levels. When there is a failure in the modern civil service, therefore, the Minister is responsible, but cannot be blamed, because in all probability he never knew anything about it; the civil servants who perpetrated it, cannot be blamed, either, because they are not 'responsible.'

The result is that the more the State intervenes in the economy, the less anyone at all is responsible for anything. Nobody loses their job as a result of failure, and because of this, tasks that can only be seen through

successfully if they are directed by people who will gain if they succeed and pay the price if they fail, are undertaken blindly and end in disaster. One of the reasons why belief in the superior wisdom of the State is so damaging is that it progressively increases the proportion of activity in the economy of which nobody is in charge.

A basic reality which Irish policies have progressively ignored is that in the democratic balance 'if we don't get the laws of property right, intervention can't work, and to the extent to which we can get them right, intervention is unnecessary.' Appropriate rights make self-interested action serve the public interest, and Zimbabwe shows what happens when individual property – no matter how unjustly distributed – is destroyed. There could be no better illustration of the validity of this principle than the Irish property bubble.

Capture of legislation by interests

The causes of this included national laws which allowed developers to earn obscene profits, in a context where there was virtually unlimited access to finance. This, in turn, was available because of an explosion of credit-creation in the outside world, again because of failure to get (or in this case, keep) appropriate laws of property. Most harm of all was done by extending the privilege of limited liability to banking, because of how this underwrote excessive risk-taking.

The privilege of being able to invest without having one's whole fortune at stake is an enormously valuable social invention. It is found for the first time anywhere in a 1782 Act of the old Irish Parliament, which provided for limited liability partnerships.⁶ Significantly, however, that Act *explicitly denied it to anyone whose business was 'dealing in money'*. Banks were similarly excluded from the benefits of the first UK Acts in 1855-6, which gave limited liability to shareholders in almost all other kinds of company. Because of this, nineteenth-century bank failures did not harm the depositors; it was their owners who suffered the losses, because, as partners, their liability was unlimited. Baring's over-extension in 1890 cost that family the bulk of their great wealth, for example.

However, when the law was changed to extend the privilege of limited liability to bank shares, Barings was able to become incorporated in 1905.

The eventual result was that the second time the bank could not meet its liabilities, because of outrageous risk-taking in the Far East, the fortunes of the shareholders were largely protected. This time, it was the depositors who lost. It is inconceivable that, if the owners had still been liable for losses up to the entire limit of their wealth, they would have allowed Nick Leeson to trade so recklessly with their money.

In the United States, it was because similar irresponsibility on the part of the banks was seen to have contributed so much to the 1929 crash, that the US Congress passed the Glass-Steagall Act in 1933. This, at least, prevented banks from underwriting securities or even partially owning firms that dealt in shares. It is *ex-ante* regulation of them, and it is the only kind that can work. However, after no fewer than twelve attempts, reflecting millions of lobbying dollars, these restrictions were gradually removed, and were finally lifted in 1999.

The consequences from which the world is now suffering, were inevitable and were foreseen. In 1987, as Head of the Federal Reserve Board, Paul Volcker argued prophetically that even the partial relaxation of banking discipline then proposed 'would recklessly lower loan standards and allow bad loans to be marketed to the public' – exactly what caused the sub-prime debacle.

Ex-post regulation cannot work

The traditional political and bureaucratic response to bad results of laws is to leave the laws that are the cause of the problems unchanged, and to set up regulatory bodies to try to repair the damage. But economic activities can only be effectively regulated *ex-ante*, through the way the laws of property on which they depend are shaped, and not by *ex-post* interventions. There has never been greater proof of this than the catastrophic worldwide failure of regulation of financial institutions.

The phenomenon of 'regulatory capture' (whereby regulators fall under the power of those they are meant to be supervising) has been well known to economists since George Stigler. No matter what the gamekeepers are paid, the poachers can always hold out the prospects of jobs at multiples of their salaries to influence them. Because the poachers are the innovators, the gamekeepers can never be ahead of them, but in fact struggle to keep up.

Further, the imbalance in motivational terms between the two parties is overwhelming. Regulators, even if people of personal integrity, are civil servants, and there is no reason why they should be passionately motivated to study and understand the subject matter of their task. Nor can outcomes affect their personal situation much one way or the other. Consequently, they can never be a match for those whom they are supposed to regulate: the Masters of the Universe (who eat, sleep and dream their project in hand). The regulators can never win, because they have been given a task they simply cannot perform: bankers only listen to laws. 'If you seek a monument,' just look at the enquiries into the regulatory failure in respect of Anglo Irish Bank, and do not exonerate the politicians who wanted 'light touch' regulation in Ireland so as to attract mobile funds from abroad to the Financial Services Centre.

Property in the Irish Constitution

But why has the property boom and slump been so especially sharp in Ireland? It is not by any means fanciful to see one of the roots of this in a Papal encyclical. As part of a response to the threat of communism, Leo XIII's 1893 *Rerum Novarum* included an exceptionally strong endorsement of individual ownership, and this Catholic social teaching was an important influence on de Valera in shaping his 1937 Constitution. The result is that this contains protection for individual property rights that is unmatched anywhere else in the world. This is invariably invoked to protect individual gain when this is in conflict with the public good, as in the outrageous cost of buying out the M50 motorway tolls.

Perhaps the most important way in which the excessive protection of individual property rights in the Constitution contributed to the property bubble, was its use to prevent adoption of the Kenny Report on control of land prices. This included a proposal that local Authorities should be allowed to buy land for housing at its agricultural value plus a limited percentage. It received scant consideration from the Fine Gael Taoiseach of the time, who had no interest in depriving the owners of land who supported his party, of potential profits. Neither could it be expected to get support from Fianna Fail, the party of the builders and developers, so that a measure, which could have curbed much of the land speculation and corrupt rezonings that were characteristic of the building boom, remained a dead letter.

All along, the excuse has been that Kenny's proposal was unconstitutional because of the way it could interfere with individual property rights. Not even the Labour Party, when it had power, was ready to try to legislate, and if the Supreme Court ruled their law unconstitutional, to look for a referendum to change the situation. It is hard to imagine that the ordinary people - in contrast to those who benefited from excessive rights to property - would not have voted for such a change. But that same Constitution, in contrast to the Irish Free State Constitution it replaced, put the initiative for a referendum solely in the hands of politicians. So, although few things can be more important than getting the State's fundamental law right on the balance between individual property rights and the public good, once again, Irish political institutions and people failed the country.

An alternative to foreign direct investment

It is now clear that policy-makers' preference for intervention in the economy, rather than creative law making, has to change, if the country is to keep out of the clutches of the IMF. *Interrogating Irish Policies* argued that, by continuing to underwrite rent-seeking as the national norm for business and the trades unions, the Government had rendered an indigenous economy, based on genuine entrepreneurship, impossible: 'The country's future is therefore irrevocably locked into policies of the United States, and the Irish economy will swim and sink in line with that country's external deficit'.

The economy is now so uncompetitive that the only way of staunching the hemorrhage of jobs is devaluation, which is incompatible with membership of the Eurozone. In any event, the era of inward foreign manufacturing investment is over, although tax freedom on patent royalties for inventions made here will enable the Industrial Development Authority (IDA) to obscure this by talking in terms of numbers of projects rather than their investment value. If a firm employs a few people for what they call 'Research and Development' (R&D) it can route any amount of money through R&D as royalties, whether or not the inventions themselves actually earn anything at all. This is the State Agencies' version of Ireland as a tax haven, which parallels that located in the Financial Services Centre.

That this is happening is evident from two sources: firstly, it is notable that when manufacturing firms move out, they often leave such a small

group here for 'R&D purposes.' Secondly, study of United States patents, where the owner is a firm located in Ireland (171 patents over the last two years) shows many cases where there is a token Irish inventor in a group, all the other members of which are located in the United States. The main R&D thrust remains at the firm's headquarters, as is logical, with the Irish name on the patent delivering use of the tax loophole here.

This kind of 'pseudo R&D' is no basis on which to try to build an economy, which can now only be based on real R&D and innovation in indigenous industries. India showed the way to do this when it refused to join the Paris Convention, which is a means of extending information protection laws that suit multinational firms to the rest of the world. This enabled that country to develop a highly successful pharmaceutical industry. Ireland has such an industry, too, but it is owned abroad, and the jobs in it can be subjected to the same treatment as Dell in Limerick at any time.

For Ireland to be able to do the same as India on an even larger scale, *Interrogating Irish Policies* discussed protecting innovation *directly*, instead of the indirect protection it receives from intellectual property. Since that particular Chapter was written, this has moved from theory to practice, through the availability of the results from U.S. legislation to encourage the production of drugs for rare diseases.⁷ Direct protection in this case has been remarkably successful, resulting in twelve times more drugs, as well as measurable declines in death rates. If this could be matched in all kinds of innovation, it could be enormously valuable to Ireland in developing indigenous industries.

The causes of long economic cycles

It may even be more important than this. The long cycle of world economic activity, which has ended so suddenly, was largely the result of artificial credit creation on a huge scale, over a period of decades. The scale of the present collapse suggests that the time-scale for lower levels of activity is equally likely to be measured in decades rather than years.

However, long cycles also have another cause. Since the start of the Industrial Revolution, every one of them seems to have begun with an improvement in the way in which law protects information, such as limited

liability in England, Trade Mark registration in France and modern patents in Germany.⁸ Protecting innovation directly just might be the catalyst for a new thrust forward of this type.

In spite of the fact that Article 118 of the Lisbon Treaty takes away the country's power to pass laws of intellectual property that suit its particular needs, introducing direct protection of innovation would not be caught by this. It would not be intellectual property, although it does share with it the great advantage that losses from failures are borne by those who have invested in the hope of success; with other methods of encouraging investment in invention and innovation, such as subsidy, losses are borne by the taxpayer. Also, subsidy needs a bureaucracy to administer it, and this puts a cap on the originality of the projects that will be funded, which appropriate law does not. The book consequently argued for having an elite group in each Government Department whose brief would be to seek to formulate laws – especially laws of property – to replace intervention as far as this can be done in each specific case.⁹

But could the existing mixture of politicians produced by the system of negative natural selection of proportional representation and a politicised and demoralised civil service deliver anything like this? The only test of sound theory in the social as well as the hard sciences is the power to predict, and nothing has happened yet to undermine the prediction that was made in *Studies* as long ago as 1976:

*It is far more likely that for the sake of getting or keeping power, for however short a term, they will continue to destroy the balance between independent property and numbers, until the resultant economic collapse brings about the final extinguishing of democracy and with it their own role. The prospect may sadden, but it should not surprise: once they are on the move, nothing can divert the lemmings from their blind and headlong progress, and there does come a time, after all, when they finally reach the sea.*¹⁰

As this is written, the top of the cliff seems to be frighteningly close.

**William Kingston lectures in the
School of Business, Trinity College, Dublin.**

Notes:

- ¹ Kingston, William, *Interrogating Irish Policies*, Dublin University Press, 2007.
- ² Skidelsky, Robert (1995), *The World After Communism*. London, Macmillan, xiii.
- ³ Chapter I: 'The Lemmings of Democracy.'
- ⁴ Horgan, John (1997), *Seán Lemass: the enigmatic patriot*. Dublin, Gill & Macmillan, 64.
- ⁵ 'What Can We Do About the Civil Service?' and "Systemic Corporate Failure of Public Administration': Reflections on the Travers Report."
- ⁶ French, E. A. (1990), 'The Origin of General Limited Liability in the United Kingdom', *Accounting and Business Research* (21) 15-34.
- ⁷ See Grabowski, Henry (2005), "Increasing R&D Incentives for Neglected Diseases: Lessons from the Orphan Drug Act", in *International Public Goods and Transfer of Technology under a Globalized Intellectual Property Regime* (Keith E. Maskus and Jerome H. Reichman eds.) Cambridge University Press, 457-480.
- ⁸ See Kingston, W. (2006), 'Schumpeter, Business Cycles and Co-Evolution', *Industry and Innovation* 13, (1), 97-106.
- ⁹ Chapter VIII, 'An Alternative Agenda for Public Service Reform.'
- ¹⁰ Note 3 above.