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Seán Lemass and the Nadir of Protectionism

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Abstract: This paper considers the move to protectionism in Ireland with the advent of the new government in 1932. Using material from an unpublished paper by Lemass the paper shows the logical basis of the protectionist policy adopted: designed as a means of increasing employment and possible development. This paper then places the collapse of protectionism in the late 1950s within the context of a general failure of protection to provide for development and a mismanaged macro-policy, leading to the acceptance of outward looking policies.

I INTRODUCTION

Prior to independence Ireland was part of an integrated single market within the United Kingdom, and the United Kingdom was committed to the free trade world that had benefited it for so long. After independence the first government in Ireland maintained the status quo, but the advent of the Fianna Fáil government in 1932 led to a fundamental change in policy away from Free Trade to protectionism – a change that took more than a quarter of a century to reverse. At the time there was a general move towards protectionism in Europe both because of the difficulties following the First World War and because of the Great Depression. In Ireland the movement to widespread protection was slow initially but then was embedded quickly in the economy. There were two strands to the protectionist argument: one, propounded by Lemass, concentrated on the consequence for Ireland of a

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reliance on comparative advantage to determine the pattern of production – leading to an economy determined solely by cattle and dairy products, while the other, formulated by de Valera, sought self-sufficiency, in the context of a vision of Ireland and Irish society. The first approach saw increased industrial employment and incomes as the objective, while the second approach envisaged a harmonious society producing almost all its requirements with some production for export to meet needs that could not be satisfied by home production. In the event, these two strands came together in the stagnation and impoverishment of the society in the 1950s that was only relieved by mass emigration. What Garvin (2004) makes clear is the self-sufficiency model was deliberate and that the lack of development associated with that model was de Valera's preferred outcome. Thus, those who believed that incompetence in policymaking lay behind the poor performance of the economy missed the important point that this was the intention behind the second strand.

II THE ROOTS OF PROTECTIONISM IN THE IRISH CONTEXT

Since at least the 18th century various Irish writers have documented the political context of economic development. Jonathan Swift for example wrote pamphlets on money supply, tariff-barriers on Irish exports to England and the need for economic patriotism. Daly (1992, pp. 4-5) summarises the historical evolution of this preoccupation:

> The belief that the condition of the Irish economy was politically determined dated back to eighteenth century writers such as Jonathan Swift, George Berkeley, and John Hely Hutchinson.
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> Daniel O'Connell, the early nineteenth century constitutional nationalist, advocated protection for Irish industry, and in the 1840s the Repeal Association produced a report that emphasised the benefits of tariffs. Young Ireland's Thomas Davis enthused about Germany's industrial development through tariff protection and claimed that given such measures and a native government Ireland could support a population of up to 35 million people.
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> In 1885, Charles Stewart Parnell expressed the belief that industrial revival would prove impossible unless Ireland had an elected parliament with tariff-creating powers.

At independence the new government committed to free trade. The logical basis for this was a belief that Ireland's comparative advantage lay in grass-based production (cattle and milk) and that the objective should be to maintain a low domestic cost base in order to ensure the profitability of these agricultural activities. The same issues applied to firms and sectors that were export oriented such as brewing and distilling. Shortly after independence, in

1923, the government appointed a Fiscal Inquiry Committee to examine both the effect of the existing fiscal system on industry and agriculture and the effects of any change in system to foster the development of industry and agriculture. The committee made no recommendations for protectionism. As Meenan (1970, p. 139) noted:

> …the industries that were then regarded as the major industries showed no desire for protection. The maltsters, the biscuit industry, and the jute industry, went so far as to oppose any application of tariff protection to their activities. The brewing and distilling industry, and other industry with a high agricultural content, such as bacon-curing and butter-making, did not even appear before the committee.

While there was this commitment to free trade, government had introduced some tariffs, but on a selective, not a general basis, in 1924. In Europe as a whole there was a shift to greater protection as one response to the Great Depression and the UK itself was set to introduce a tariff. For a short time Ireland was in an almost unique situation:

> For a few months at the turn of 1931 into 1932, between the introduction of the British tariff and the change of government in Dublin, it (Ireland) was the last surviving example of a predominantly free-trading state left in the world. (Meenan, 1970, p. 142.)

Within a matter of months this had all changed and the country became one of the most heavily tariffed in the world.

The logical basis for tariffs was outlined in a paper believed to have been written by Lemass during 1929 or 1930.[1] In this paper the general case for free trade is argued in a global framework but dismissed when it comes to individual countries, where the gains might be unequally distributed, and in particular to Ireland, which was perceived to have totally lost from free trade within the UK.

> If one considers the world as a unit it can be shown that its total wealth will be increased if all impediments to the transportation of goods over national boundaries are abolished. The same is true of any smaller unit. It is not difficult to demonstrate, for example, that the free movement of goods throughout the twenty-six Counties constituting the Free State, is more conducive to prosperity than would be the granting of extended fiscal powers to County Councils resulting in the establishment of Custom barriers on the

[1] The paper is untitled and unsigned. It carries a handwritten note on the front page "Lemass sometime in 1929 or 1930" and is contained in the Frank Gallagher papers in the National Library of Ireland, Dublin. See Garvin (2009, p. 45).

various County borders. If Great Britain and Ireland are considered as a single entity, free trade between all its parts would undoubtedly result in an increase in its total wealth. Indeed, if the only factor to be taken into account is the welfare of mankind as a whole, irrespective of local or national interests, the case of unlimited freedom of trade is unanswerable.

When, however, we come to consider the world as it exists today we are brought at once up against the concrete fact that Nations exist……

Every Nation is, naturally, desirous of maintaining and increasing its population and of providing a reasonable average standard of living for its people. Experience has taught us that these ends can be best achieved when a Nation is politically and economically free, that is to say, when control of the factors affecting the internal life of the Nation is exercised within its boundaries and, primarily, in its interests. Each Nation, therefore, strives towards economic self-sufficiency and utilises to this end the various instruments which human ingenuity has devised – Tariffs, prohibitions, State Monopolies, and Subsidies. The rulers of those Nations know that Free Trade over the world, or over a definite area such as the Continent of Europe, may result in an increase in the prosperity of the area as a whole, but they also know that it may not increase the wealth or prosperity of each part of the area in equal measure. They are not so much concerned with the welfare of mankind as with the welfare of men and women of their own nationality. Free Trade between Great Britain and Ireland increased the combined wealth of both countries but we know from experience that the benefits were confined to Britain and that its effects in Ireland were wholly bad. It destroyed our Industries and struck down our population by more than half, within less than a century. If we were concerned only for the welfare of the old political unit known as the United Kingdom we should not deplore the decay of industry and loss of population here because they were more than counter-balanced by the growth of population and industry in the other island. We regard ourselves as a Nation, however, and the prosperity of our own people in Ireland is our main concern. We are not prepared to watch calmly the depopulation and impoverishment of our country. We desire political and economic freedom so that we can take action to protect our vital National interests. We wish to be able to use for Ireland the same methods which other European countries are now using for themselves. Unless we are prepared to see the scattering of our people over the face of the world and the destruction of our Nation, we must take steps to preserve and develop here the industries which mean employment for our people in their own country. The agitation for the protection of industries, therefore, is identical with the struggle for the preservation of our Nationality". (Lemass, 1929-1930, pp. 2-4.)

Thus, several years before taking office and the 'Economic War' Lemass had argued that the free trade policy followed since independence had failed because of the high level of unemployment, the fact that the only increases in employment by sector took place in protected industries while decreases occurred in sectors where tariffs were not applied or refused, and because emigration was so high. His paper went to great lengths to show that unemployment was at 50,000, or much higher than the imperfect official figures indicated. It was on firmer ground with actual data in relation to protected and unprotected industries but did not consider the link between the two and the effect that the economic circumstances at the time had on unprotected industries. Finally, it dismissed free trade on the basis that over the previous 15 years over half a million people had emigrated – a somewhat interesting test given the level of *net* emigration of 530,000 in the 15 years 1946-1961.

The Lemass approach was based on a belief that comparative advantage would doom the economy to low levels of income because of the dependence on agriculture. Net output per head in agriculture was estimated at £80 per head per annum, while average output per person in industry was £266 – though elsewhere in the paper this number is assigned to net output per head in industry rather than average output per head. According to Lemass, the solution to the problem of unemployment:

> …must be sought in the revival of industries required to supply the needs of our people in respect of many of the commodities now mainly imported.
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> We must recognise, in the first instance, that we possess no special advantages which would induce the establishment of industries here, other than the market, such as it is, available in the country. We have not got either valuable mineral deposits cheap fuel or power, or exceptionally skilful workers in special trades or any of the other considerations which determine the development of particular industries in one country rather than another. It is true that we have a profitable export business in Beer & Spirits, Woollens, Biscuits and Bacon. These industries are dependent for their essential raw materials on agriculture and are largely supplied from within the country, but their existence here is largely the result of good management or mere luck. Similar industries in other countries possess all the natural advantages found here. To a large extent, therefore, the limits of a possible industrial revival coincide with the country's capacity to consume the goods produced. (Lemass, pp. 19-20.)
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> We have already noted that the average output per person engaged in Industries other than agriculture in 1926 was valued at £266. The total value of new transportable goods produced was approximately £20,000,000, and the number of persons employed in these manufactures was 68,500. We may assume, therefore, that in order to provide employment for an additional 50,000 workers the value of the annual production of new goods would have to be increased by about £13,500,000. If we turn now to the Trade and Shipping Statistics for the purpose of discovering the extent to which the Home market is being supplied from outside with goods which are capable of being manufactured here, we find that a conservative estimate of the value of the additional market available at home to Irish Industries would place it at not less than £17,000,000. This estimate is arrived at by taking first, the value of tariffed goods imported in 1928 which was £9,500,000 and adding thereto the

> value of other imported goods, not yet tariffed, but obviously capable of being made here, which was, in 1928 £7,500,000. Included in the latter class are:-
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> 1. Flour, Bread and Buns;
> 2. Bacon and other Pig Products;
> 3. Paper and Cardboard;
> 4. Maize products;
> 5. Cement;
> 6. Agricultural Implements;
> 7. Wooden Boxes;
> 8. Slates.
>
> All these articles, with the single exception of Cement, are at present being manufactured in the country.
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> It is clear, therefore, that if we can preserve this £17,000,000 market for Irish Industrialists, we can simultaneously abolish completely the problem of unemployment without taking into consideration at all the possibility of providing additional employment in House building, Public Utility works or similar enterprises. The absorption of 50,000 people, now idle, into remunerative employment would result in an increase in the value of the available market and provide scope for further development. The impetus thus given to the industrial machine, together with the improvement in Agriculture following on the adoption of a more progressive policy would set the Nation marching on the high road to prosperity.
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> The preservation of the home market, in the goods mentioned for Irish Industrialists cannot be secured in any way other than Protectionism in some form. (Lemass, 1929-1930, pp. 20-21.)

While imports, taken with domestic production for the domestic market, give some idea of the size of the market at prevailing prices, it also provides evidence of what a country is not very good at doing. If there are clear market distortions then a case can be made for protection in some sectors – the so-called infant industry argument – where protection can circumvent the market distortions, and lead to the emergence of new areas of comparative advantage. Economy-wide protection cannot achieve this, as one cannot have a comparative disadvantage in everything. However, the initial intention was to replace imports based on a general belief that industry could be self-sustaining. No case was made for exposing industry to competition or to consider the cost implications for other sectors of increased prices from protected industries. Corden (1997) has shown that where a country's terms of trade are in long-term decline then it should increase its degree of protection to counteract the domestic impact of the terms of trade deterioration, and this could offer some justification for a widespread policy of protectionism. However, the case made by Lemass derived from differences in output per head between the two sectors, with as noted earlier, some confusion between net and gross output per head.

Lemass also discussed the question of the ownership of industry where the clear intention was that it should be in Irish hands. When protectionism was introduced The Control of Manufactures Acts 1932-34 placed stringent conditions on the ownership structures of new firms. Daly (1992, pp. 82-91) has documented how the restrictions in the acts were circumvented.

In the early 1930s many countries turned to protection as a means of countering the effects of the Great Depression. Irish protectionism as introduced by the de Valera government in 1932 to some extent reflected international trends. John Maynard Keynes in a 1932 lecture in Dublin[2] reflected that:

> If I were an Irishman, I should find much to attract me in the economic outlook of your present government towards greater self-sufficiency. (Keynes, 1933.)

In the debate prior to the UK leaving the gold standard Keynes argued that tariffs were an alternative to wage reductions, which he thought were impossible, or devaluation, which involved leaving the gold standard, a move that had seemed unlikely (Irwin, 1996, pp. 189-206.) Keynes had argued for protectionism in the UK but had changed his position once the UK had left the gold standard and sterling depreciated.

Within months of coming into government in 1932 Fianna Fáil had transformed the country "to being one of the most heavily tariffed" (Meenan, 1970, p. 142) from its previous position of being among the least tariffed. Ryan (1949) estimated the tariff level in 1931 at 9 per cent, and at 45 per cent in 1936, falling back to 35 per cent in 1938. The measured decline may have reflected the methodology used by Ryan and the application of the tariff regime, as he acknowledges. In addition to tariffs government also introduced quotas, import licences, which had the effect of restricting imports, and import monopolies.

While the argument for protection as outlined by Lemass was well in place before Fianna Fáil came to power in 1932 the outbreak of the 'Economic War' with Britain, whereby Britain imposed tariffs on exports to Britain from Ireland in response to the new government's refusal to continue making payments to Britain agreed under the Anglo-Irish Treaty, and Ireland imposed tariffs on goods from Britain, changed the industrial structure that would have emerged with the new policy on protection alone. Total industrial employment rose rapidly – by about a sixth between 1926 and 1936, with the rise concentrated in protected sectors and with declines in exporting firms.

[2] Keynes had been invited by Professor George O'Brien to give the inaugural Finlay lecture at University College Dublin, named for Thomas Finlay SJ, the university's first Professor of Political Economy.

Protectionism in an economy like Ireland's for self-sufficiency purposes is unlikely to be successful as a long-term development strategy. What it does is give a once-off boost to employment and output in protected sectors.

> In every country, it always is the interest of the great body of the people to buy whatever they want of those who sell it the cheapest. The proposition is so very manifest it seems ridiculous to take any pains to prove it; nor could it ever have been called in question, had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind. Their interest is, in this respect, directly opposite to that of the great body of the people.
> Adam Smith (1776).

The market for many goods was small, many firms were very small, firms were mostly not realising any economies of scale, the quality of many products was very poor, and prices were high. Government sought to plan output-matching supply and demand but generally failed. Industry was not driven by new entrepreneurial ideas, but by rent seeking via the political process or tariffs. In addition, government determined the location of new firms with industrial activities distributed around the country on the basis of local political pressure. (Daly, 1992, pp. 75-102.) Even in large economies protectionism is unlikely to generate viable firms unless competition between firms can be encouraged. In Ireland, the whole emphasis of policy was against competition, which was seen as wasteful. Competition as a force for lowering prices, for innovation in products and processes was not part of the agenda of policy until very recently. In these circumstances firms will tend to stagnate, and when faced with competition from abroad will require higher tariffs.

One consequence of protectionism is that it drew resources away from agri-business the development of which would have been the logical extension of the comparative advantage enjoyed in cattle and dairy production. These have remained essentially commodity production. Protectionism also damaged agriculture as it turned the terms of trade against the farming community. The costs of all non-farm inputs rose reflecting the costs of protectionism. This was particularly disadvantageous at the time of the Great Depression, during the period of the Economic War with Britain, and later with Britain's cheap food policy when output prices were depressed. The impoverishment of farming was a consequence of the strategy, compounded by the collapse in cattle prices following the restriction on imports from Ireland to the UK arising from the Economic War. As noted above a global import substitution policy based on producing goods where the evidence is that the country has a comparative disadvantage is unlikely to be successful. The alternative, putting resources into developing agri-business based on beef and milk, and on those sectors already export oriented such as brewing and distilling, was not attempted.

Many European countries had abandoned or were reducing protectionism by the end of the 1940s or early 1950s. Much of this followed pressure from the US under the Marshall Aid programme. Countries are well aware of the advantages of free trade, and in the context of the situation of Western Europe at the end of the war there was little opposition to the removal of protectionism – culminating eventually in the Common Market. The emphasis in Ireland was on the preservation of the status quo. One of the more surprising outcomes following the end of war was that Ireland, which had not suffered the physical devastation of much of Europe, though had experienced a decline in the capital stock, was unable to benefit from the reconstruction and recovery that took place both in Britain and on the continent. In part this reflected the domestic focus of production and the lack of entrepreneurial ability, but it also reflected the very high cost structure associated with not realising economies of scale.

Irish policymakers did not abandon protectionism at the same time as other European countries. Lemass, as Minister of Commerce, was the prime mover behind the state's protectionist 'Import Substitution Industrialisation' (ISI) policy even if he was by then sceptical of its efficacy (Garvin, 2009, p. xii). The necessary generational revolution exemplified by T. K. Whitaker's appointment as the Secretary of the Department of Finance did not occur until the policy ideas he promoted were well-established orthodoxies elsewhere. As put by Bryan Fanning:

> What amounted to a generational revolution had advanced Whitaker to the apex of the Department of Finance around the same time that Seán Lemass, the youngest of the 1916 gerontocracy, succeeded Eamon de Valera as Taoiseach. A logjam had burst that allowed for institutional recognition of what were now long established orthodoxies in other Western countries.
> Bryan Fanning (2008, p. 194).

In the absence of policy reform mass emigration had occurred. Over the 20 years 1926-1946 net emigration had averaged 17,700 per annum. This increased to 24,500 per annum in the period just after the war (1946-51) and rose further to 39,400 and 42,400 in the subsequent 5-year periods. The population in 1951 was 2.961 million so that the net emigration of the 1950s was equivalent to one-seventh of the population. The factors influencing net migration were changes in the level of unemployment here, changes in the level of employment, differences in the rate of unemployment here and in Britain and differences in earnings between Ireland and Britain. (Keenan, 1978.) Throughout the 1950s these factors were operating to maintain high levels of migration from the country. Much, though not all, the migration was from rural Ireland. It was much easier to obtain employment in Britain once initial links had been made than in Ireland where unionisation among the industrial workforce effectively blocked entry. This is the classic insider/outsider problem. That there was concern was reflected in the establishment of the Commission on Emigration and other Population Problems, which reported before the peak level of emigration.

III COMPOUNDING THE PROBLEM

The mass emigration of the period just after the war, the slow/non-existent growth, and the deterioration of the income position relative to the rest of Europe resulted in some policy shifts – the creation of the IDA designed to advise government on how to improve industrial performance. The more important policy shift was the attempt to have an independent interest rate policy. Since independence Ireland had adopted a sterling exchange standard. There was a one-to-one, no margins rate between the Irish Pound and sterling, sterling circulated freely in the Republic and there were no capital controls. Even without knowledge of the Nobel Prize winning Mundell and Fleming open economy IS-LM framework, it should have been well appreciated that in a sterling exchange standard world with near perfect capital mobility it is impractical to attempt an independent interest rate policy (see Blanchard, 2006). This is exactly what was attempted in 1955 following an increase in UK interest rates and the introduction of credit restrictions (see Honohan and Ó Gráda, 1998).

Policymakers believed that Ireland "needed" lower interest rates to encourage development. Commercial banks were prevailed on not to increase either deposit or loan rates. The consequence was a serious deterioration in the balance of payments on capital account, which, taken with a current account deterioration led to a significant loss of reserves. The channels for this loss of reserves on the capital side were direct capital outflows to benefit from higher interest rates in the UK, borrowing in Dublin by UK firms to benefit from lower interest rates in Ireland and to circumvent credit restrictions in the UK. (Bank credit rose from £149.4 million in the first quarter of 1954 to £165.5 million in the first quarter of 1955 and £196.1 in the first quarter of 1956 before stabilising for the next two years.) On the current side there was an increase in imports reflecting increased consumer demand – in turn influenced by a rise in earnings and a fall in the savings rate, the latter perhaps influenced by the relatively lower interest rates in Ireland – and an increase in imports of goods that went to increase stock levels, again perhaps influenced by the relatively lower cost of holding stocks in Ireland than in Britain. There was also a decline in exports reflecting the normal cattle cycle that prevailed following the war.

Faced with the fall in reserves and the size of the balance of payments deficit on current account the authorities acted. First they correctly reversed the decision to have lower interest rates but then introduced a hugely deflationary budget in 1956. GNP fell in 1956 and remained relatively static in 1957 and 1958. Unemployment increased from 6.8 per cent in 1955 to 9.2 per cent in 1957 before emigration pulled the rate down again. Net emigration peaked at 58,000 in 1957 but continued at a high level again in 1958 and 1959.

The fiscal response was designed to dampen demand and thereby reduce imports but it ignored the impact of the decline in reserves on the domestic monetary base. This contracted as a result of the fall in reserves and this would automatically have led to a reduction in credit and economic activity. If the interest rate differential persisted then reserves would have been exhausted and the one-to-one parity on the exchange rate could have been maintained. Long before that the shortage of funds would have driven up interest rates. The essential characteristics of the sterling exchange standard were ignored in the fiscal policy response. This whole episode highlights the confused nature of Irish economic policy. Policymakers attempted to use monetary policy for development purposes without taking account of the constraints facing such a policy due to our exchange rate policy.

IV BREAKING OUT

Economic Development (1958) marked a fundamental shift in policy. It was not readily accepted by policymakers (McCarthy, 1990), but they found themselves out of touch with the needs and mood of the society, where the message offered a break with the past, albeit into an uncertain future. While the projections in *Economic Development* have been subject to some criticism, because the outcomes were different, this criticism missed the point. The approach offered an alternative to self-sufficiency and protectionism. Rather than being inward looking the idea was to become outward looking again. The basic message was to make firms competitive in an international environment, forcing competition on them by reducing tariffs and helping firms to adapt to freer trade by restructuring with a system of grants. The fundamental change in circumstances, however, was not a transformation in indigenous industry but the emergence of Foreign Direct Investment (FDI). This had been made possible by a change to the Control of Manufactures Act in 1958, which allowed foreign ownership of firms where the bulk of output was exported, and was encouraged by Export Profits Tax Relief, whereby the profits on exports were free of corporation tax. This had been introduced in 1956 to encourage domestic firms to export, had limited success, and encouraged round tripping. Nevertheless, for foreign firms operating under the modified Control of Manufactures Act this, together with capital grants, was decisive (Durkan, 1996). Originally, it was not expected that FDI would prove important, as the economy was perceived as depressed, the infrastructure was poor, and productivity was low. However by the time the change in policy had occurred the then industrial world was fully employed and emerging and existing multinationals were looking for new locations for increasing production. The impetus for this remained until the first oil shock forced firms to seek low cost locations to restore profitability when much new investment went to the Far East. Later of course access to the single market as well as restructuring associated with the single market gave another wave of FDI.

Entrenched positions built up over a quarter of a century, existing beneficiaries of the prevailing approach make change difficult. Lemass pursued outward looking policies with the same energy he had applied to protectionism but in Whitaker (2006) he had a civil servant that was able to manage entrenched positions that opposed change. The Department of Industry and Commerce, previously the premier department at one time straddling the whole of industrial and commercial activity, were opposed to the outward looking approach, as job losses in existing industry were certain, but gains were not provable. A continuation of the existing system might have maintained employment whereas outward looking policies had an uncertain future. This issue of political economy and management of change by Whitaker is formalised in Walsh and Whelan (2010).

The battle between protectionism and free trade, inward and outward looking policies, can be reduced down to those who believe in a control system and those who believe in a market system. The latter believed that their approach would improve competitiveness, widen the market and lead to greater output and employment, while the former were fearful of the unknown and thought better to hold and protect what you have. Fortunately, the latter lost the debate.

V CONCLUSIONS

This issue of *The Economic and Social Review* is dedicated to understanding the nature and extent of social, political, economic and cultural change since the formal beginning of Ireland's developmental trajectory since 1958. This paper suggests that changes since the publication of *Economic Development* cannot be understood without taking into consideration earlier policy shifts and the changing social and economic conditions that contributed to these. As Keynes suggested in Dublin in 1932, the case for national self sufficiency depended upon discretionary national political goals as well as upon wider economic conditions. In the Irish case, protectionism provided a once-off increase in industrial employment but did not lead to self-sustaining growth. The poor performance of the economy in the 1950s, compounded by macro mismanagement forced a reconsideration of protectionism and its eventual abandonment in favour of outward looking policies. The political and policy challenge in the years leading up to the publication of *Economic Development* was to acknowledge these changing realities in the face of the kinds of interest group blocking politics documented by Garvin in *Preventing the Future* (2004) and accompanying institutional barriers to policy change. It took a generational shift amongst the latter, led by Lemass as a Taoiseach now convinced that protectionist policies had failed, to face up to the economic challenges facing the country.

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