A two-tier credit system fuels the OECD's fastest-growing economy

by Kathy Burdman

Irish bankers in the United States are bemused at the various proposals put before the new Reagan administration to increase real capital investment here. "You Americans seem to want to encourage your banks to make productive loans to increase real economic growth," one leading executive told *EIR* this week. "In Ireland, things are much simpler. The central bank *tells* us to do it. And we do a lot of it."

With the American economy stumbling into a second recession, and the Volcker Federal Reserve intent on sustaining a level of long-term interest rates which make industrial investment prohibitive, the United States has a great deal to learn from the tiny Republic of Ireland. For the past 15 years, the Irish government and the dedicated public servants of the Central Bank of Ireland have helped create an economic miracle. Ireland today has the fastest economic-growth rate in the entire OECD, and the fastest rate of export growth.

This has been largely accomplished by the Irish central bank's forthright policy of throwing out the window the traditional British central banking philosophy of "free enterprise." For several hundred years, while under the domination of the Bank of England, Ireland was an underdeveloped rural fiefdom, producing cheap farm products for the British economy. With all the capital of the highly developed British "free-enterprise" banking system available to it, Ireland discovered that the Bank of England's high interest rates, and the British banks' preferences for real estate and land speculation over industrial investment, meant that Ireland was free to stay backward. The British did not invest in Ireland.

"It was the dog that wagged the tail," as one Irish banker said ruefully, "and as you know, the bulldog doesn't have much of a tail."

Two-tier system set up

Beginning in the early 1960s, the Irish government therefore determined to industrialize the nation itself. One of its first acts was the creation by the Irish central bank of a *two-tier credit system*, done with the help of advisers from de Gaulle's French 5th Republic, modeled on the Gaullist system of directing credit to industry. It was an extensive system of central bank guidelines which each year set limits on "speculative lending," preventing the Irish banks from utilizing much of the nation's scarce capital resource on real estate, commodity, and other speculation. These same guidelines encourage the banks to extend large amounts of credit for high-technology industrial investment, especially for the rapid, capital-intensive mechanization of Irish agriculture, whose investment growth has been spectacular (see Figure 1.)

It is not only Irish industry and agriculture that have profited handsomely.

Irish bankers like to point out to foolish American banks, who might protest at this central bank "interference" in the sacred free market, that Ireland's commercial or "associated" banks, as they are known, have become among the world's most profitable as a result. The Bank of Ireland and the Allied Irish Banks Group, who together control some 80 percent of domestic lending in Ireland, have experienced an average annual growth of post-tax profits of 47.6 percent and 52.3 percent, respectively, during the 1975-1980 period, and an average annual rate of deposit growth of 30.5 percent and 33.2 percent during that time.

Rather, it is here in the United States that the central bank is still dominated by Bank of England methods.

A similar proposal for reform of the U.S. central bank, the "Federal Reserve Reform Act of 1981," has been put before the U.S. Congress by the National Democratic Policy Committee, whose advisory board is chaired by Lyndon H. LaRouche, Jr., *EIR*'s Contributing Editor.

LaRouche proposes to issue new Fed credit through the Fed discount window, where bank loans for speculation would be penalized by being nondiscountable, while bank loans for "the production of tangible wealth or capital improvements" would be discountable up to 50 percent of their value, ensuring a vast new credit supply to industry. Discountable loans would include those for "the purchase of raw and intermediate materials and capital goods, construction of facilities, or employment of labor to produce or transport manufactured goods, agricultural commodities, and construction materials," among other productive activities, according to the Federal Reserve Reform Act.

A strong banking environment

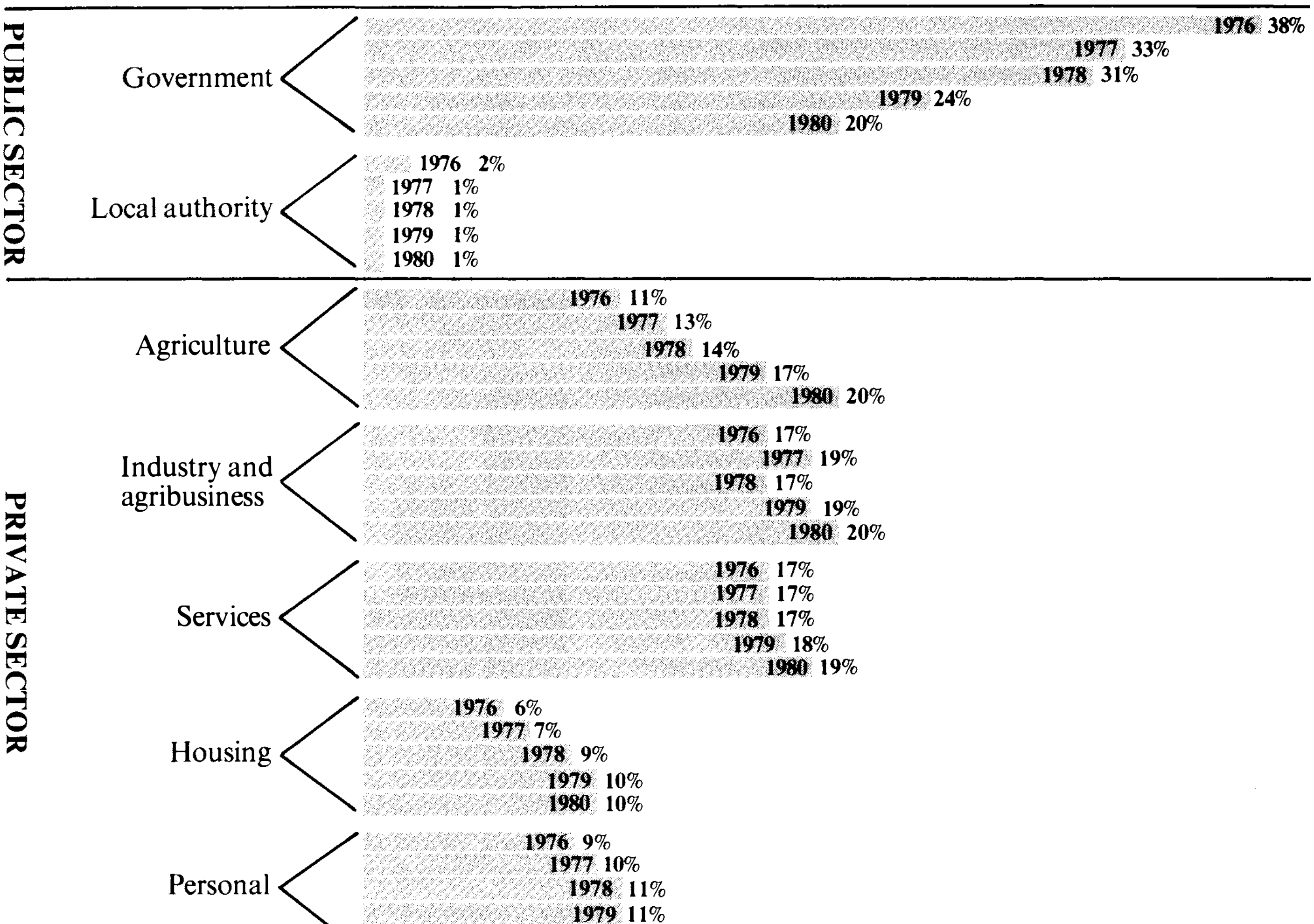
The Irish government has been committed to just these principles of American Founding Father Alexander Hamilton, who was also the inspiration for de Gaulle's banking policy.

Although Ireland gained its political independence from Britain in 1921, when the Irish Free State was established as a Commonwealth dominion, it really only won economic independence recently. In 1949, the Irish Free State severed all ties to the British Crown and became the Irish Republic. But the banking and other close economic links were not fully broken until Ireland joined the European Monetary System in December 1978 and severed the 152-year-old link between the Irish "punt" and the British pound in March 1979.

The European Monetary System was founded in 1978 by French President Giscard d'Estaing and West German Chancellor Helmut Schmidt to return continental European banking to the policies of Hamilton and de Gaulle which first created the postwar European "economic miracle." The firm commitment of the EMS, which the British have yet to join and from which the bumbling Carter administration kept America aloof, has been to stabilize European exchange rates so that interest rates could be lowered and credit directed to new high-technology investment in nuclear-energy development and other capital-intensive, productivity-creating industries.

"We believe in the desirability of creating a zone of monetary stability," said Irish Prime Minister Jack Lynch in his announcement of Ireland's joining the EMS. The objective of the system is a broadly based strategy of improving economic development . . . by enhancing the prospects for trade and investment."

Figure 1
Sectoral trends in Bank of Ireland lending



Source: Bank of Ireland

Ireland's commitment to an industrial banking system, however, goes back to a report entitled *Economic Development* commissioned in 1958 by then Irish finance minister Sean Lemass, a devout student of Alexander Hamilton. The report, by Dr. T. K. Whitaker, uncovered the fact that the Irish commercial banking system, then dominated by British banking practices, had enforced the "British disease" of low capital formation and an average economic growth rate during the 1950s of 1 percent per year or less.

Credit for development

Lemass and Whitaker proposed that the government take control of credit policy and drive the banks toward supporting national development. "In our present circumstance," he wrote, "we must be prepared to take risks under all headings—social, commercial, and financial—if we are to succeed in the drive for expansion."

In April 1962, the Irish finance ministry and central bank brought in direct help from the Gaullist Republic of France, when a French team from the Commissariat du Plan was invited to Dublin's Economic and Social Research Institute under the Lemass prime ministry.

During this period, the central bank began to issue its credit policy guidelines, and to encourage the buildup of the domestic Irish associated (commercial) banks. Between 1959 and 1970, dozens of Irish banks were amalgamated and taken over by the two largest Irish-owned banking groups with central bank encouragement, forming the Bank of Ireland and the Allied Irish Banks Group, who today control some 40 percent each of the Irish banking market.

The British banks' control over Irish banking was bought out, and the population patriotically encouraged to bank with the Irish banks. Today the British position in the republic is reduced to the Northern Bank, a subsidiary of Britain's Midland Bank, and to the Ulster Bank, a subsidiary of Britain's National Westminster, which account for perhaps 10 percent apiece of the banking market.

The central bank's policy was coordinated with the creation of the Industrial Development Authority (IDA), which immediately embarked upon a strong policy of attracting international capital investment into Irish industry and agricultural mechanization. The Department of Economic Planning and Development, also created during this period, laid out an extensive tax-incentive program for capital investment, including tax breaks for foreign investors.

As a result, capital investment, especially foreign investment, in Ireland has soared, and has produced some of the highest rates of return in Europe (see Figure 2). For 1981, the government has announced that a special reduced rate of 10 percent will be applied to taxation on all manufacturing industry.

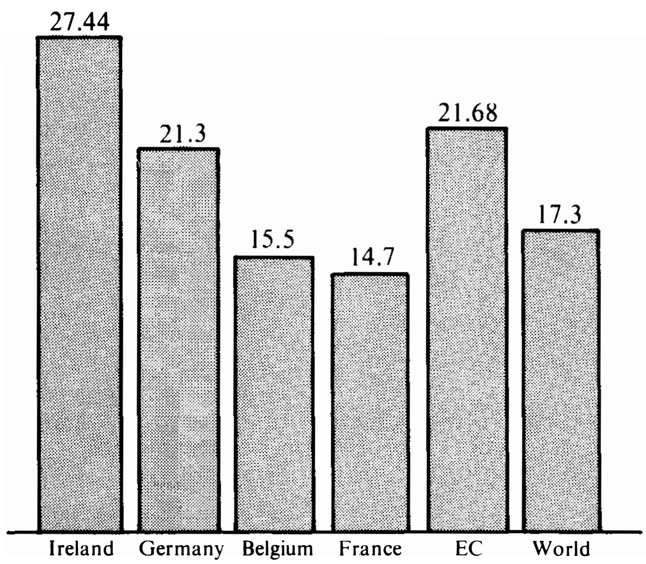
Since 1975 Ireland has had the highest growth rate in the entire OECD western area, averaging almost 4 percent annually, and only falling to 0.3 percent for 1980 because of the aggravated world trade recession. Ireland's export-growth rate leads the OECD, itself led by manufacturing exports.

Central bank guidelines

Since Ireland's entry into the European Monetary System, the Irish central bank has issued a series of guidelines every February that have severely restricted lending for speculative uses of credit. Beginning in September 1978, all lending for "speculative purchase of real-estate land and property" was expressly ruled out altogether by the central bank, and these guidelines have only been partially relaxed since. "Transgressions" of these guidelines are punished by the central bank with a requirement that banks who make such loans are subject to a corresponding increase in non-interest-bearing reserves which they must retain at the central bank, above and beyond the central bank's already strict reserve requirements.

This doesn't seem to faze Irish bankers, whose lending policy is self-professedly *nationalistic*, and who are turning a handsome profit on productive lending. "It is sometimes surprising to me to hear bankers in other countries say that they are in the banking business

Figure 2
Rate of return on U.S. manufacturing investment, 1979
(as a percentage)



Source: U.S. Department of Commerce Survey of Current Business, August 1980 to make money," Jerry E. Casey, New York branch chief for Allied Irish Banks, told *EIR*. "We are, of course, in the business to make a profit, and do so nicely. But we feel we are also in business to provide a service, to make a contribution to the nation's economic development."

In fact, the central bank's curb on speculative lending has left the Irish banks with a mandate to direct the remainder of new lending, within the average annual central bank credit ceiling of 25 percent credit expansion to the private sector, into capital investment in industry and agriculture.

Mechanized agriculture

Executives of the two Irish associated banks in New York emphasized to *EIR* their institutions' commitment to Irish industrial development. Both cited manufacturing investment and mechanization of agriculture as top priorities.

"We are keenly interested in all sectors of the economy, but especially in new industries and in mechanization of agriculture," Bank of Ireland New York Vice-President Brian Goggin told *EIR*. "We have a national priority to establish rising levels of productive new employment for the Irish people. This policy also leads to the fastest growth for our bank.

"Regarding agriculture, while Irish agriculture has benefited tremendously from exporting to the EMS countries, there is now a general level of oversupply in European agricultural markets, which means that to stay competitive, and continue the benefits of agricultural exports to our balance of payments, Irish agriculture must raise productivity dramatically.

"This means agriculture in Ireland must become like hardcore industry. It is the government's policy and ours to promote capital-intensive mechanization of agriculture, which raises efficiency. This will mean larger farms, which some resist. But although there will always be room for the small farmer in Ireland, it is no longer possible to merely inherit the land from grandfather as used to be done, and not improve it. We must develop agrobusiness as an industry."

Indeed, this has already been done to a remarkable extent. Capital investment in Irish agriculture is rising rapidly (see Figure 3).

Goggin continued, "We are also very active in financing and promoting American and other foreign investment in Irish industry. We have relations with almost 70 percent of all new companies coming into the country. We are especially interested in promoting the high-technology firms coming in, which grow the fastest and have the most rapid employment growth."

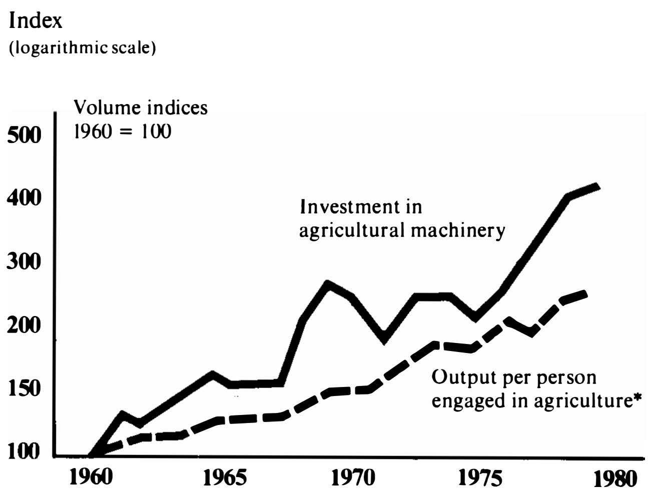
The Bank of Ireland currently estimates its lending is concentrated at 20 percent in industry and agrobusiness; 20 percent in agriculture; 10 percent in homebuilding; 10 percent in consumer lending; and 20 percent in government finance.

"What you Americans call productive lending is a way of life in Irish banking," Allied Irish Banks Group's New York branch chief Jerry E. Casey told *EIR*. "You may talk about encouraging American banks to do economically productive lending through tax policy and central bank attitudes. In Ireland, the central bank tells the banks to do so. Of course, they also guarantee us our costs, lending rates, and thus our margins of profitability. The net result is that we are certainly more profitable than American banks."

Allied Irish Banks Group does not publish a lending breakdown, but Mr. Casey estimates its lending by sector as roughly the same concentrations on industry and agriculture followed by the Bank of Ireland. Allied Irish Banks is perhaps the premier bank for Irish agriculture, especially for mechanization and high-technology investment in agrobusiness.

"We are especially interested in expanding the homebuilding industry in Ireland," Mr. Casey noted. "In Ireland, during the last five years alone, the Irish associated banks have gone into home mortgage lending for the first time, and have done over 358 Irish pounds in mortgages outstanding, which is 30 percent of all mortgages outstanding in the republic. We cannot understand the American interest rates. You should be building 2.5 million homes, not 1.7, a year."

Figure 3
Agricultural productivity and investment



*including forestry and fishing
Source: Bank of Ireland