

## **‘Looking Forward’**

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It seems hard to believe now that little more than a year ago many were in denial that there was something amiss with the Irish economy. Indeed there were some who even suggested that we were simply talking ourselves into a recession, and that if we did not use the R-word, we would be fine.

As the year progressed, the extent to which we had been living in a ‘bubble’ became clearer by the day as, *inter alia*, banks required massive government support, tax revenues collapsed, exports fell, investment dwindled and unemployment rose sharply. In effect, Ireland had to come to terms with having lived beyond its collective means since the early 2000s, and as a consequence most people today have lower living standards than they had a year or more ago.

It is important to recognise that the effects of the downturn are very uneven. Consequently, while average GNP per head may be similar today to what it was in 2003, the distribution of income is very different. The really big losers are those entering the labour force now (from school or college), those who have lost their jobs because of the downturn in domestic or foreign demand, those whose pensions or incomes come from equity- or property-based sources, and of course the next generation which will inherit higher debt levels. The extent of the burden on the next generation depends on how quickly this generation moves from minimizing its current pain to setting the economy back on track.

Ireland will recover but even on the most optimistic scenarios, it will be the latter part of the next decade before we return to the average post-tax income levels we experienced in 2007. Our recovery depends to a considerable extent on recovery in the major markets with which we trade. Recent events give us some grounds for optimism but we should remain cautious. But international recovery will not automatically translate into a

recovery for Ireland unless Ireland is internationally competitive, and, as the recent NCC report demonstrates, our cost base in many areas is still very high by international standards. The benefits to Ireland of an international recovery also depend on international confidence growing so that we receive the financial support we need from international investors and bankers.

Additional fiscal stimulus is not an option for the Irish government because of the rapid shortfall in tax revenues relative to public expenditure commitments. Since reducing the general government deficit is essential to reestablishing both international and domestic confidence, the government must introduce further increases in taxation and/or further reductions in current expenditure. Tax increases can place recovery at risk by undermining our competitiveness while expenditure reductions place important public services at risk, as well as income transfers to those most adversely affected by the recession.

The extent to which reduced expenditure leads to a real reduction in services depends crucially on two factors: the cost of the inputs used to provide those services and the efficiency with which the services are delivered. This is good news as it means that not all of the reduction in expenditure needs to result in a reduction in services. With regard to input costs, for example, it is still possible, though difficult politically, to achieve further reductions in public sector employee costs, and the cost of produced inputs can be reduced through more effective public procurement. Indeed we have recently seen in the pharmacy sector how the government can use its role as a buyer of services more effectively in the national interest. With regard to inefficiencies, the McCarthy Report has made some suggestions as to how these might be reduced. It is clear from the Report that we need a forensic approach that cuts waste in a way that minimizes economic and social damage, rather than cutting mindlessly across the board. A further advantage of such careful cuts is that other necessary expenditure cuts will be more acceptable when it can be demonstrated that public money is not being wasted.

In my view, the McCarthy Report should not be seen as a template for what should necessarily be done – but rather as a demonstration of what will be done if alternative options are not proposed to meet the required expenditure cuts. The Report is by no means perfect but it helps to establish the necessary mindset change for government departments and agencies, namely, to one where there are no sacred cows. Early signs that this mindset change is happening will see an end to the traditional ‘use it or lose it’ approach to public expenditure budgets in agencies and departments.

Unfortunately, because of the inadequate controls on public expenditure in recent years, one cannot presume that all the capital projects in the NDP pipeline are worthy of support – the present NDP was established at a time where a philosophy of ‘if you are not in, you cannot win’ prevailed. Since full evaluations cannot be undertaken quickly, expedient analyses need to be conducted now to check what should be done. It is important that these analyses are not done by those who originally developed or evaluated the project proposals for the NDP. An added benefit of improved public management, both current and capital, is that it will help improve Ireland’s prospects of rebuilding its damaged international reputation.

The political economy challenges facing the Irish government are considerable in the context of the loss of society’s trust across a range of areas. Inadequate policy design in recent years has in certain instances generated perverse incentives, i.e., where certain incentives generated by policy run counter to the stated objectives of policy. These incentives in turn have resulted in ‘rent-seeking’ behaviour, where groups can realise potential gains that were not intended by the policy. Improved policy design will help both our competitiveness and improve the real purchasing power of consumer incomes. The long promised public sector reform has been painfully slow despite the stated support of numerous governments and of the social partners. It would be sad if, in contrast to 1987, social partnership could not adapt to changed circumstances and find itself today as part of the problem rather than the solution.

If we start to focus on future generations and not just on our own, we can make begin to make progress. Much has been said in recent times about the need for leadership in the political domain. However, what we need now is leadership and a commitment to improved governance across several domains – political, the public sector, business (and especially banking), the professions and the media. In the public sector we urgently need incentive structures that encourage individuals to take the right decisions, which may be difficult, and not merely safe decisions, which cause less disruption. For example, if the Department of Finance is to assume the type of role it took on in the 1950s, working with politicians to address key challenges, a culture must emerge where open debate is the norm and tough decisions, based on the best available evidence, are routinely made.

We urgently need our media to support a more mature and informed national debate – at times it seems that our media are currently struggling to deliver what is needed and to move the discussion beyond giving voice boxes to interest groups. This requires the leaders in this sector to look anew at the challenges they now face if they are to serve Ireland well.