

GOVERNMENT INTERVENTION IN THE IRISH ECONOMY

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"A state comes into existence because no individual is self-sufficing, we all have many needs" (Plato)

Economics and politics are inextricably linked. The question of government intervention in the Irish economy cannot be separated from the broader one concerning the role of the state in the modern world. This is not a question of individual vs. collective behaviour; man being a social animal has assured the existence of familial, tribal religions and economic groupings. We are, rather, faced for the first time in history with the government of an educated mass public. Experiments this century have ranged from totalitarian fascism to totalitarian communism with varying methods of social and economic organisation. The world is still in a state of flux and great anxiety exists over the proper role of the state in today's society.

Ireland is a small open economy, a state midway between centralism and liberalism. It has a quite high (53.7%) public sector share (public expenditure expressed as a percentage of GDP). This figure includes all government expenditure less intergovernmental transfers. Half of it is comprised on transfer payments and the rest on the administration and provision of government functions of defence, policing, health, education and infrastructural provision.

During the 1970s there was a massive increase in the PSS from 39.5% in 1973 to 55.6% in 1982. This was due in parts to increases in transfer payments which increased both in number and the level of benefit and was also due to a tremendous expansion in numbers employed in the public sector (now over 200,000) largely due to the soaring unemployment rate in the wake of the oil crises. This increase in PSS was funded both by the increasing proportion of income taxes taken by the state as nominal income increased, and by borrowing to finance current spending.

This decade has seen a widespread reaction against high levels of government intervention. It has its intellectual expression in such books as "The Road to Serfdom"², "Bureaucracy and Representative Government"³, and "Free to Choose"⁴ which, though not new, have achieved new prominence in the 1980s. In Ireland such intellectual ideas are accepted as people see the Irish economy as being

trapped with the burden of national debt, due mainly to an enlarged public sector.

The problems identified for the public sector are firstly that it is overexpanded, i.e. it is bigger than people actually want. Due to fiscal illusion (the phenomenon whereby inflation pushes wage earners into higher tax brackets which are fixed in nominal terms) people did not perceive the true costs of a public sector; if they had, they may have reduced their demand for public services. Secondly productivity in the public sector has grown slowly relative to the other sectors of the economy. However, a fundamental controversy centres on whether such a phenomenon is inherent in the nontechnologically progressive nature of services such as health, policing etc. or whether it is due to the "economic bureaucracy" ⁵ i.e. civil servants' obdurate stance against efficiency in favour of aggrandisement.

I believe that the backlash outlined above should be perceived in its proper context. It is merely the swinging of the pendulum of public opinion away from the unquestioning acceptance of "the omniscient, altruistic public official implicit in the market failure arguments for state intervention" towards the reality of "vote seeking politicians and self interested civil servants" ⁶. There are undoubtedly problems with government intervention but those outlined above are one of practice, not of principle, and so may be mitigated, if not eliminated by reform. Democracy offers the people a most potent instrument to shape and mould Irish society and in particular its economy on which so much else depends. During the present swingeing cutbacks (which in their unplanned and random nature bear many of the faults for which the growth in the PSS in the 1970s was criticised) the beneficial nature of government intervention should not be forgotten. J.M. Keynes is said to have declared that "The political problem of mankind is to combine three things - economic efficiency, social justice and individual liberty". In this essay I shall outline how the government can and does fulfill these functions in the Irish economy.

The most vociferous proponents of the market are those who oppose "big government". Accepting the regulating mechanism of the invisible hand they hold that a social optimum can be achieved with a minimum of government intervention. However, in reality divergences from the theory of perfect competition occur with the existence of imperfect competition, natural monopolies, missing markets and externalities.

The state produces public goods. Merit goods are produced because of externalities i.e. unpriced effects external to the market. Because private and social costs and benefits are not equal, equilibrium in the market is not optimal. Thus the state may

provide merit goods such as health and education which it will believe will benefit society as a whole. It is ignorance (in the economic sense) which leads to underconsumption of such goods (as well as their long term nature as an investment relative to individual time preference), and ignorance also leads to overproduction of demerit goods. Government may discourage such activities through exhortation or legislation e.g. against smoking. Social goods are goods to which the twin principles of the market, exclusion and revealed preference, do not apply due to jointness in consumption and the free riding problem which distorts revelation of preference. These goods include defence, street lighting and public parks. Many public goods are also a source of civic pride.

Natural monopolies throw a spanner in the works of perfect competition. The state may institute anti-trust legislation or it may nationalise the industry for several reasons e.g. to avoid overpricing and exploitation of the consumer or because many such monopolies constitute infrastructural industries and form a direct part of the cost structure of most other economic activities. As in other underdeveloped countries Ireland also took over natural monopolies because the pragmatic considerations of a low capital base and a low willingness to invest induced the state to develop an industrial base in the early years of the Free State. This involvement was also used as a device to bring about social justice through interregional equality by locational planning. The dispersal of such industries has had a profound effect on rural towns otherwise reeling from severe migration, and provided opportunities for employment and thus enhanced liberty through choice. The state also provides equality of opportunity (and thus again enhances liberty) through anti-discrimination legislation.

The third area in which the government can substantially aid economic efficiency is in the area of planning and growth. An optimal allocation of resources at all dates in the future (i.e. optimal economic growth) requires knowledge of all future prices and if there aren't futures markets in all commodities then this is not possible. This is the problem of "missing markets". One way of tackling this problem is for the state to gather and publish information relevant to the growth of the economy. The costs of such information gathering would be prohibitive for all but the largest firms. This was the rationale behind the introduction of indicative planning at the end of the 1950s. It must be added that planning has a bad name, particularly in Ireland. Politicians now boast of "pragmatism" and "dealing with situations as they arise"⁷ which is a rather shortsighted approach to take. Planning would not be what Ritchie Ryan described as "least realistic of

my tasks [being based on] prejudices about the past, hunches about the present and prophecies about the future" if some fundamental reforms were implemented. The first is an improvement in the statistical base both in coverage and processing time. The second problem is that plans become politically tarnished because of overoptimistic targets (and thus casts doubts on the credibility of all government functions). In the Netherlands a Central Planning Bureau independently reviews and costs all plans. Such a body would be very useful in Ireland (indeed one of the criticisms that T.K. Whittaker made of the short lived planning department was that it divorced planning from costs)

The last more intractable problem is that Ireland is an SOE and so government control over the economy is limited. However, planning can be useful for endogenous variables such as the money supply and would be excellent for the public sector. The publication of such a plan would provide certainty for businesses regarding taxation and expenditure and would disarm the criticism that "the more the state plans, the more difficult planning becomes for the individual"⁸. This criticism would not hold if the government published the parameters within which it was constrained, the targets which it hopes to achieve, the means by which it hopes to do so and a routine report on its progress. Ironically, this proposal should be readily accepted by some of the strongest opponents of state intervention - the New Classical Macroeconomics/Rational Expectations school who attach great importance to maximising the information available to the private sector. Such planning would lead to a medium term approach which is now absent from the annual budget. It would involve a co-ordination of government departments now lacking and lastly it would fulfill the political function of preventing a government from being elected without policies and thus having a "mandate" to act as they wish.

Most monetarists lambast the Keynesian approach as being too interventionist and allege that high government intervention is "antithetical to liberty"⁹. However, Keynes held a contrary view; he saw individual liberty being advanced by stabilisation policies; "the enlargement of the functions of government" Keynes would defend "both as the only practicable means of avoiding the destruction of existing economic forms in their entirety and as the condition of the successful functioning of individual initiative"¹⁰. One could also argue that the libertarian arguments employed by Hayek, Friedman and Nozick would in practice enhance the liberty of the capitalist at the expense of those without capital because of its scarcity value. However this a matter of impassioned ideological controversy and is outside the confines of this essay.

Lastly both social justice and individual liberty are enhanced by government redistributionary policies. These include more than transfers, though transfers are the most salient aspect. Transfer payments are just in that they redress the imbalances caused by inequalities of wealth and obviously enhance the liberty of those who would otherwise be in destitution. The universal provision of social and merit goods also provides a degree of categorical equity. The arguments for direct transfers instead of these may be refuted because they would lead to decreased use of these services by the poor and also to a two tier system of provision. Lastly, a service often neglected by economists is the legal system. Independent of the Oireachtas and possessing a proud tradition of its own it treats all citizens equally. Free legal aid also helps the economically powerless to challenge the powerful. In conclusion it should be warned that "it is not sufficient to contrast the imperfect adjustments of unfettered private enterprise with the best adjustments that economists in their studies can imagine. For we cannot expect that any public authority will attain or will even wholeheartedly seek, that ideal. Such authorities are liable alike to ignorance, to sectional pressure and to personal corruption by private interest"¹¹. Once we have recognised this we may keep a close and watchful eye on the government and thus mitigate, if not eliminate, its most glaring flaws. Then government, through benevolent intervention may work for the general good. Those who fear the demise of capitalism should note that "capitalism did not survive in the United States or in the other industrial countries, because of a rigid adherence to the individualist precept—the sacrifice of those who could not make it in a stern competitive struggle. It survived because of continuing and generally successful effort to soften its hard edges—to minimize the suffering and discontent of those who fail in the face of competitive economic power, ethnic disadvantage or mental, moral or physical incapacity"¹².

References.

1. Plato, The Republic, Book II, ch. VI.
2. F. Hayek, The Road to Serfdom.
3. W.A. Niskanen, Bureaucracy and Representative Government.
4. M. Friedman, Free to Choose.
5. W.A. Niskanen
6. J.W. O'Hagan, The Economy of Ireland (5th ed.), ch. 4
7. See text of interview with C.J. Haughey, RTE 10th Jan. 1988.
8. Hayek, ch. VI
9. M. Friedman, Free to Choose, ch. V

10.J.M.Keynes,The General Theory of Employment,Interest and Money,p.380.

11.A.C.Pigou,The Economics of Welfare,pt.II,ch.XX,p.332.

12.J.K.Galbraith,A View From the Stands,p.5