



# Introduction

Best case policy? Need best case structures.

**This paper was written in January 2012. Significant progress/change since then. Useful to compare “first principles” approach with what has happened/is happening.**

- Structure of presentation
  - Briefly look at pathology of policy advice failure
  - Look at track record of various organisations
  - Can one design “best case” policy structures?
  - Recognise significant improvements since 2011
  - A brief look at fiscal governance in Europe
- Policy focus: Fiscal policy
- Perspective focus: Org. Management / HR.

# We All Know the Story...

- “Groupthink” (Nyberg report)
- “Lack of Co-ordination” (White report)
- “No-one but a brave few warned about the crisis” (Conventional wisdom)
- “Lack of economists in Govt” (Dr. G. Fitzgerald)
- “Lack of PhDs in Dep’t Finance” (Dr. Karl Whelan)

# Or do we ?

- Analysis of supply and demand side to crisis widely underplayed or ignored:
  - Failure to implement Kenny Report,
  - Spatial policy failure, Decentralisation, lack of urban densification leading to sprawl
  - Zoning , transport, planning failures
- Analysis of link between need to reform political structures and cause of crisis too vague
- There were more warnings than we realise

A photograph of a clipboard with a white sheet of paper titled 'TRACK RECORD'. The paper has several rows of text and checkboxes, some of which are filled in with blue ink. A silver pen is resting on the paper. The clipboard is on a dark green surface.

# TRACK RECORD

So just how  
did policy  
advice  
making  
structures  
perform in  
terms of  
warning  
us?

# If you talk the talk...

- **September 2004 (Magill):** Article responding to Bertie Ahern's announcement that he was a "socialist" heralded a danger era of electoral spending that threatened our fiscal stability.
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- **October 2004 (DEW conference):** Paper (Coleman (2005)) warning that the Stability Pact had been eroded, leading to a deterioration in Europe's financial stability
- 
- **July 29<sup>th</sup> 2005 (Irish Times):** Article warning that bank lending was excessive. First of several written in that vein over the ensuing two years
- 
- **September 21st 2005 (Irish Times)** Interviewed with ECB President Jean Claude Trichet calling on countries "which are very dynamic and have a lot of real financial authorities" clear warnings to our financial regulator to act on credit growth.
- 
- **March 31<sup>st</sup> 2006 (Irish Times)** Beginning with the sentence "Stop the Economy I want to get off" I warned that "Nobody, absolutely nobody, is in control" (of financial regulation).
- 
- **July 7<sup>th</sup> 2006 (Irish Times)** warned that tax growth was "lopsided" and "crazy" and that "remedial action is needed now". Minister Brian Cowen responded in denial a week later
- 
- **July 17<sup>th</sup> 2006 (FF Economic conference Galway)** Confronted Brian Cowen over his denial and challenged him to prepare a contingency budget in case of recession. He refused.
- 
- **6th October 2006 (ISME annual conference)** I warned that a recession would start in 2008. George Lee chaired the session. The recession started in 2008 at the beginning of the year.
- 
- **17<sup>th</sup> April 2007 (Irish Times)** I warned that *all* political party manifestos in the 2007 election were based on overly ambitious growth forecasts.

# European Central Bank

**September 21 2005, President Jean Claude Trichet interview (Irish Times)**

*“Although not alarming at a euro-zone level [in other words very alarming at national level] we have a lot of good reasons to follow up and monitor closely what happens in countries of the euro zone. In some countries...which are very dynamic and have a lot of real growth – there is a case for as appropriate national action as possible to calm down the market”*

*“The dynamism of the monetary aggregates M2 and its most liquid component M1, particularly sensitive to the low level of interest rates, is significant. It is also telling to see the dynamism of loans to the private sector that is much faster than growth in GDP in value terms...we are in a posture of particular vigilance”*

*“We remind the executive branches that it is absolutely necessary for the sake of EMU not to be shy in expressing opinions and taking decisions”*

# Economic and Social Research Institute

## Good track record in forecasting:

### Medium Term Economic Forecast, April 1994

- Forecast Celtic Tiger (average growth 6-7 % out to 2004) with remarkable accuracy (John Fitzgerald)
- Slowdown in export led growth began 2004 as predicted

### Medium Term Economic Forecast of December 26<sup>th</sup> 2005 (John Fitzgerald)

*“There are significant dangers on the horizon. ...the US economy is on an unsustainable growth path with ever rising deficits”*

*“The very high level of dependence on the building and construction sector leaves the economy vulnerable to shocks”*

Warned that 90,000 jobs could be at risk from a US downturn alone.



# Economic and Social Research Institute

## Good track record in policy?

### Depends on your perspective

- Strong inclination to engage in detailed advocacy of **tax increases**
- Work in area of spending reduction/reform more muted and vague
- Exception: Dr. Alan Barrett's 2009 study on public private pay differentials

### Keynesian bias?

Fitzgerald (2012) paper assessed macroeconomic impact of contraction **but** only quantified channels impacting negatively on growth (immediate consumption) and ignored those impacting positively (lower interest rates, Ricardian effects of future debt reduction). This is **crucial** given possible Ricardian impact of promissory note deal

**Caveat to above:** ESRI called for full €3.1 billion fiscal adjustment in Budget 2014

# National Economic and Social Council

**Deeply embedded in Department of An Taoiseach**

**Strongly influenced by social partnership**

**Formal links with National Economic and Social Forum. Informal contact with TASC**

**Did it do anything to warn about overheating?**

One paper “Housing in Ireland; Performance and Policy, NESC Report 112” called for a “significant level of additional housing output during the coming decade”

Tempting to see this as negative: At the time case for additional housing was strong.

But no vigilance or response to emerging overheating in 2005-2007 period

# National Competitiveness Council

**Independent from Government Departments**

**Less influenced by social partnership**

**Diverse inputs not just from academia and civil service but also business**

Almost from its inception in 1997, the NCC warned about overheating in the economy, loss of competitiveness and structural issues to be confronted

In contrast to NESC NCC Commissioned a hard hitting warning about overheating in the housing market. Produced in 2004, however the paper wasn't published until 2009.

In 2008 the NCC was the subject of two council members refusing to sign its annual report. Without getting into the specific members or rights and wrongs of their arguments, this is a healthy sign of an organisation that isn't subject to groupthink.

# Verdict?

Pundits: Many of those who did warn not given credit. Those who warned in 2007 given too much. Horse bolted by then. When it should have focused on accuracy and technical thoroughness of “warners” media was focused on their celebrity status.

**Boy who cried Wolf syndrome: Calling it too early & for wrong reasons undermines efforts of those whose warnings are well timed and researched**

ECB: Given limited mandate of economic governance pre 2012 Treaty, it did its job in highlighting the risks of overheating. Not its fault that national authorities ignored it

ESRI : Good track record of forecasting boom and – if somewhat mutedly –highlighting risk of overheating. John Fitzgerald too hard on himself. Not his fault warnings weren’t heeded. My view: ESRI research agenda has a Keynesian / “tax & spend” cultural bias

NESC: Called for more housing stock in 2004 but didn’t address overheating or the crisis until 2009

NCC: Good, repeated track record of credible, well researched warnings in the area of competitiveness. Wasn’t NCC’s job to monitor banking housing or fiscal policies. But its warnings were giving us strong indications of overheating in these areas.

# “best case” economic advice: Issues and principles

Group think:

Proximity versus  
Independence (eg NESC/NCC)

Duplication:

Inevitable  
But can minimize through co-ordination

Fisc. Resp Act 2012:

Good progress so far

Human Capital

Retain & develop economist skillsets

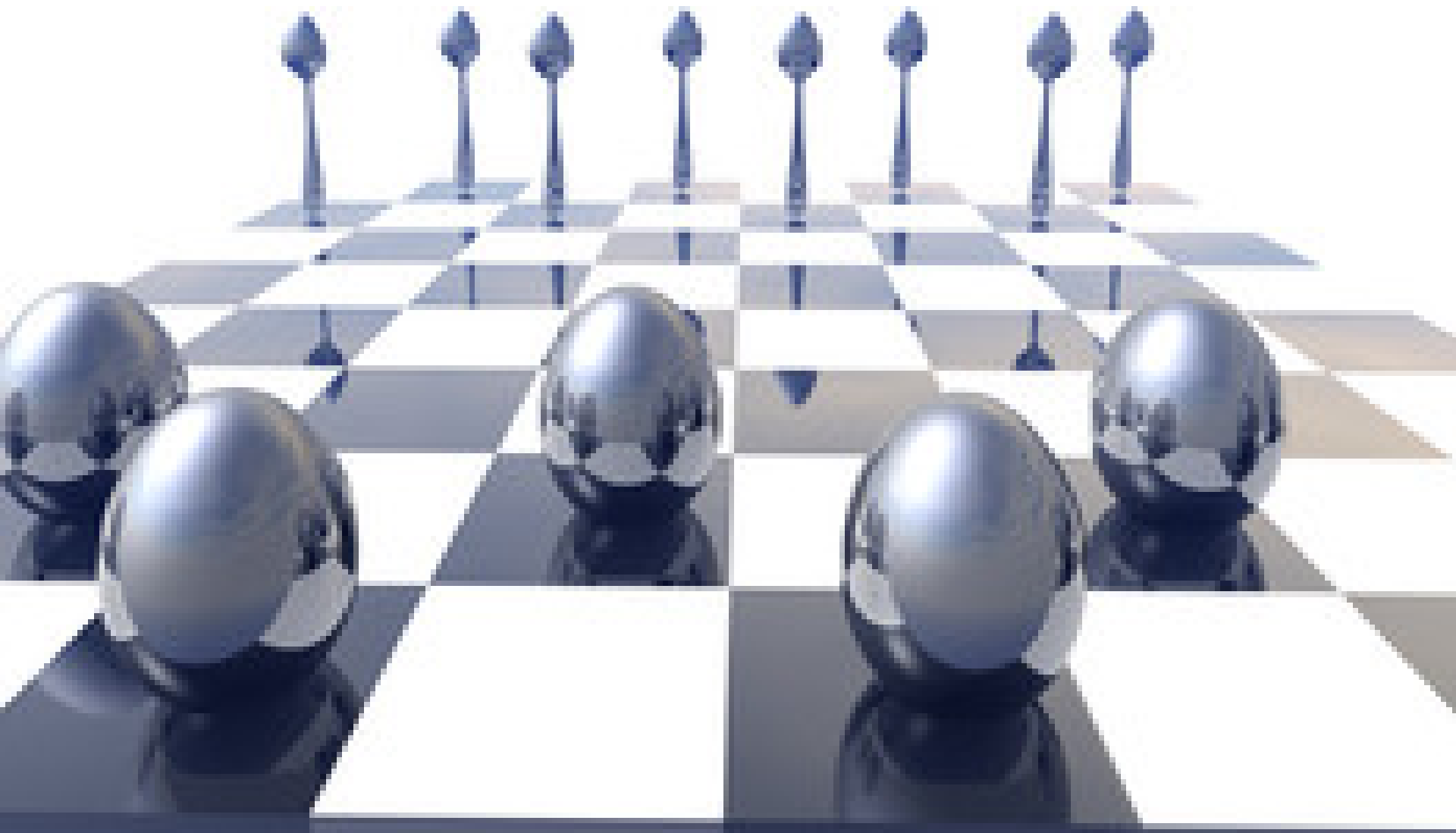
Informing media/public

A well informed citizenry is crucial to  
ensuring good politicians are rewarded

Diversity of perspectives

Pl. De. on h2

# Conflicts of Interest / Public choice



# Interacting “conflict” issues:

**Public choice**      Argument that those who derive income or net from state share interest in maximizing its size, revenue and power.

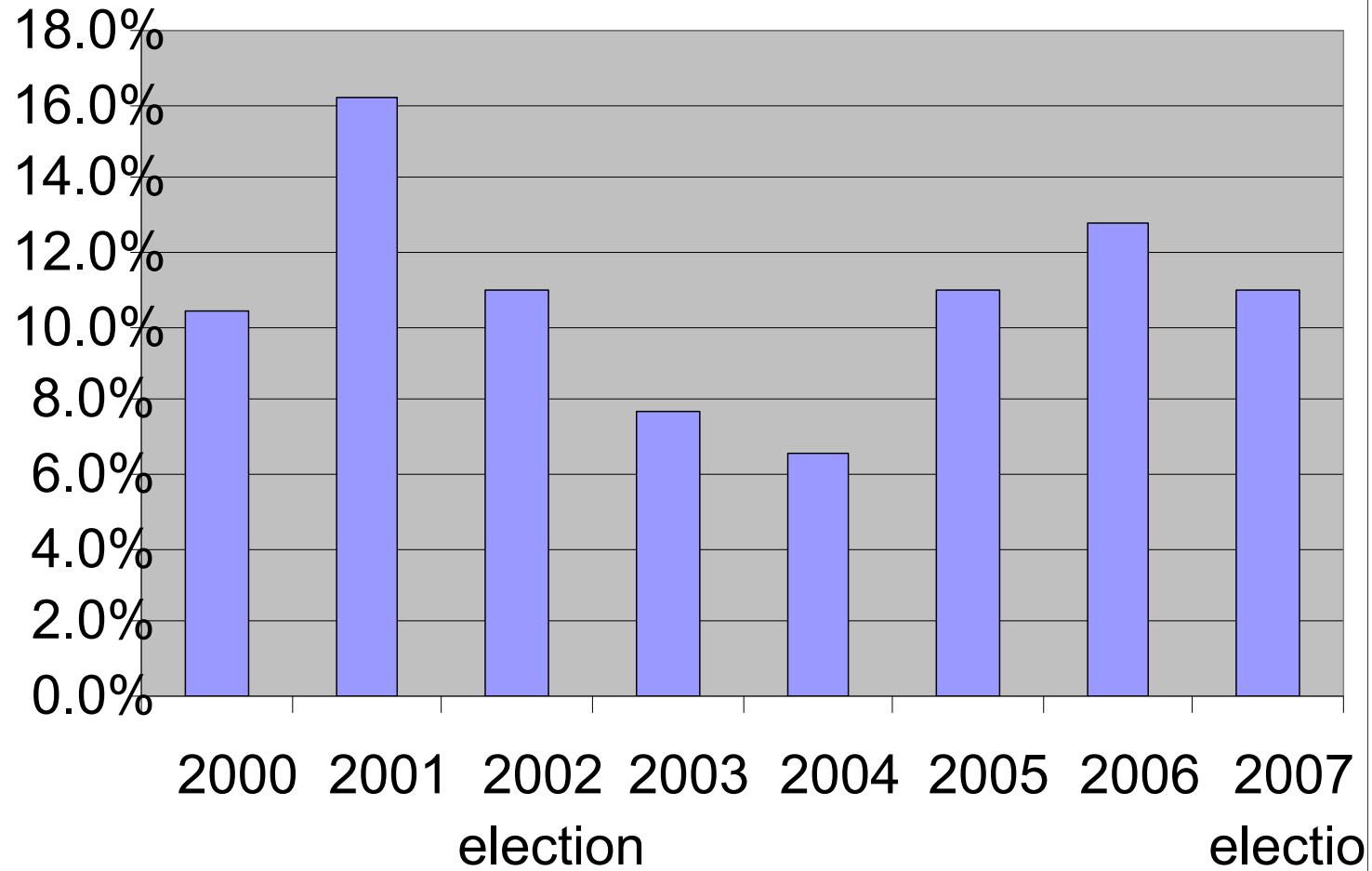
**Lobbying**            Those who have public funds & job security already are in strongest position to lobby to retain and expand their funding

**Logrolling**          Phenomenon whereby groups with varying interests but a common interest engage in “trading favours”. So one branch of the publicly funded economy may advocate / support the introduction of a tax to fund another sector of the economy in return for getting contracts from that sector.

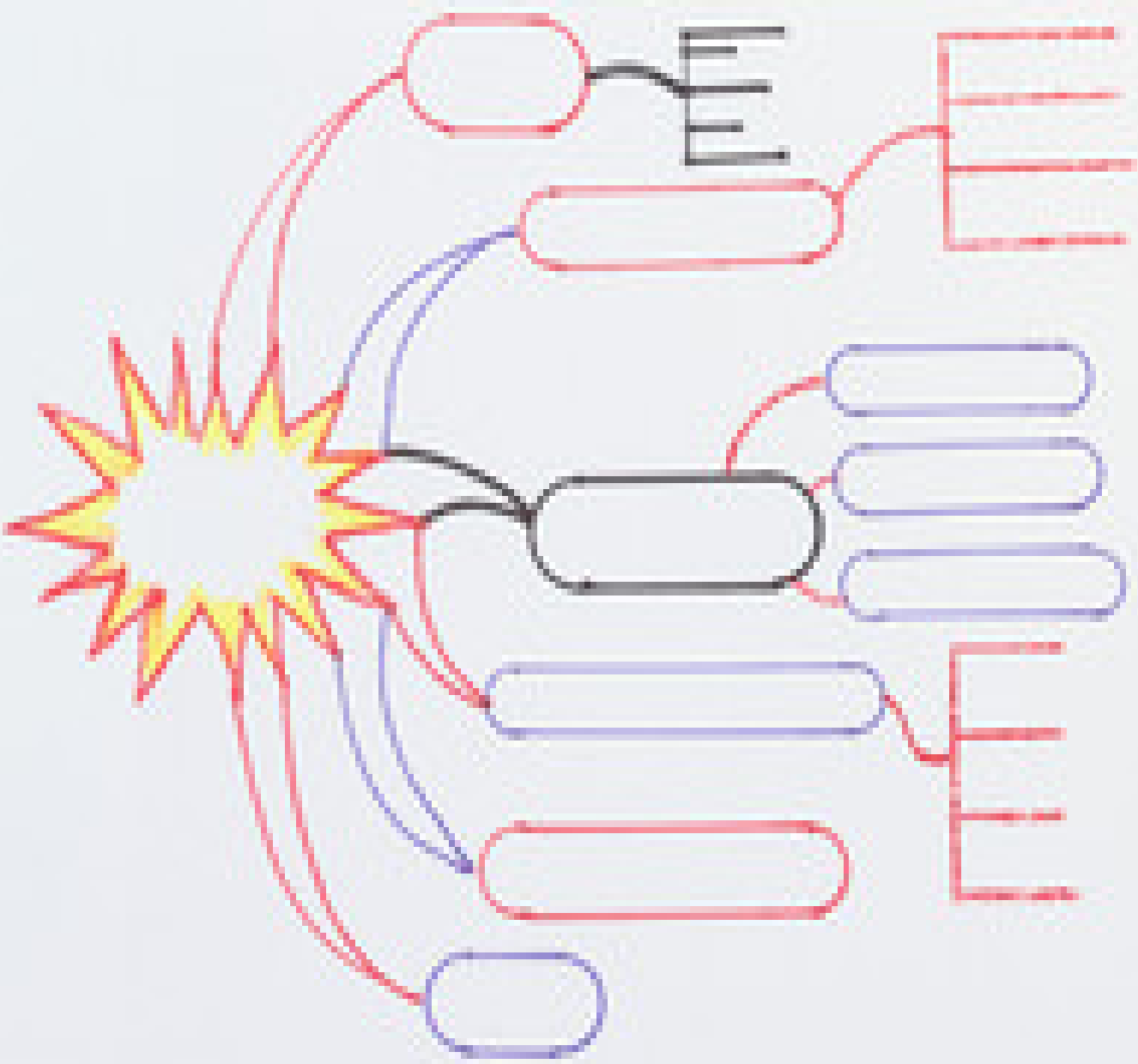
**Spiral effect**        Tendency of those coming into organisations with differing views/perspectives to “spiral” down to the organisation’s consensus view

**Electoral cycles**    Tendency of governments to “pump prime” economy

# Rate of increase in governε







**Designing  
“best case”  
Structures  
for policy /  
advice...**



# Challenge:

Wanted: An organisational structure that is

- Independent in spirit and yet integrated in policy making structures
- Timely and accurate in analysis but able to engage in crucial medium/long-term research
- Meet gov't 2012 commitment re “shared services” without triggering (too many) turf battles
- Leverage comparative advantages of existing bodies

**Mission impossible?**

# Gov't/ Oireachtas

- Cabinet Economic Management Committee
- Jt Oir. Committees
- Leaders of parties

Dep't of  
Jobs,Enterprise &  
Innovation  
/  
FORFAS IDA NCC

Dep't of Finance  
/  
Irish Fiscal Adv  
Council

## ECONOMIC ANALYSIS SERVICE

Dept' An  
Taoiseach  
/  
NESC

Dep't of Foreign  
Affairs

- EU Affairs & Trade
- Promoting Ireland Abroad

Dep't of  
Communications,  
Energy and  
Natural Resources

# “Shared services” in Economics

*Attorney General’s Office aims to “provide highest standard or professional legal advice to government and to public bodies”*

*Additional to Dep’t of Justice which has strong legal policy expertise*

*Centrally located*

*Based on statutory footing*

*Separate career structure and remuneration compared to rest of civil service*

*Cost: Approximately €15m p.a.*

*Savings: Possibly billions*

Professional economic advice spread across a myriad of Departments, Central Bank agencies and other bodies.

Most experts on economic policy are working **outside** government.

Progress in last two years impressive.

Much, much further to go: Still no clear understanding of how best to combine economic policy advice from different agencies and feed into central government.

## 3 functions of economic advice:

- **“Dashboard”**: Processes, disseminates data for public and media use, conducts basic analysis and some short term forecasting. Looks at implementation and tactics of policy
- **“Toolkit”** Produces more complex analysis and medium to longer term forecasts. Looks at economic stance, policy responses to growth shocks and engages in cyclical scenario planning. Looks at policy management
- **“Deep Thought”** Looks at deeper, longer term structural issues facing the economy. Looks at policy strategy.

## 3 functions: Examples

- **“Dashboard”**: Analysis of exchequer returns and assesses – using short term indicators – if implementation of budgetary tax rate rises are yielding expected revenue increases.
- **“Toolkit”** Analyses fiscal stance. Prepares a menu of alternative fiscal policy instruments. Research on optimal level and rates of taxation and of public spending.
- **“Deep Thought”** Research on structural reform of state sector. Fiscal impact of population ageing

# Specific example:

## Medium Term Economic Strategy

“A” 2008-2013: ECB lowers Main Refi/ Facility by 375 basis points

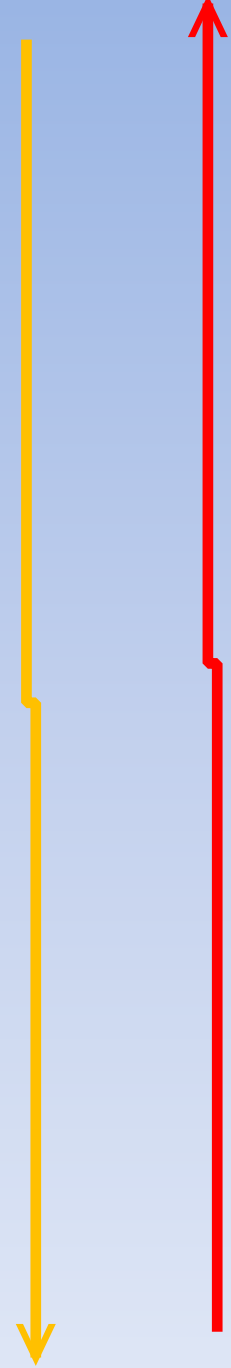
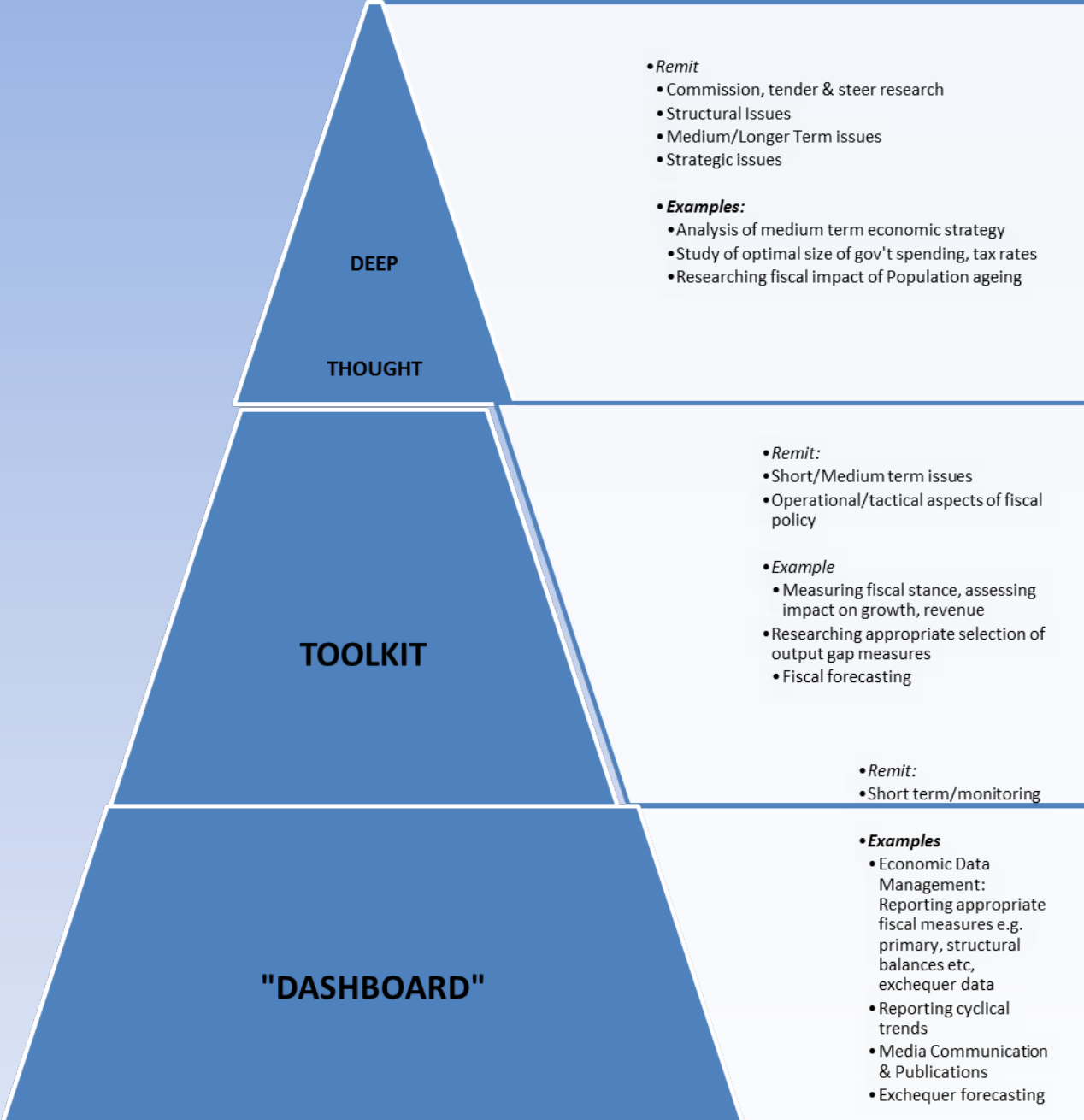
“B” 2008-2013: Main era of fiscal tightening

2014-2020: “A” is about to reverse itself.

At **strategic** level this should prompt “Deep thought” research about the macroeconomic and fiscal implications of tighter monetary policy over the coming 5 years.

At **policy implementation** levels this should prompt “Toolkit” analysis of how monetary tightening is likely to interact with other drivers of the economic cycle and how medium fiscal stance should be adjusted accordingly

At **Dashboard** level this should prompt integration of monetary policy change and its impact on lenders, consumption and the economy into regular briefing. It should prompt tactical thinking on when monetary tightening might be most painfully felt how medium term fiscal stance can be distributed year-by-year to best counter its effects.





# When paper originally drafted (Jan 2012)

- Many significant reforms had yet to take place (eg IGEES; see below)
- IFAC was in its infancy
- There was no certainty as to how IFAC would operate within government

In “Strengthening Ireland’s Fiscal Institutions” (2012) IFAC pointed the way forward on the latter issue. But some of its suggestions received comment in my original paper:

1. Selection of Council: The 2012 paper suggested Ministerial appointment. The Finance Minister should certainly appoint at least one member but my paper argued that independence required a different method of selection, perhaps by the Oireachtas, Council of State or, possibly, a reformed Seanad.
2. “Pro-bono” work on “time out” The 2012 paper suggested that staff could be seconded from other parts of the public service engaging in work “pro bono”. My paper suggested a full time staff was needed to ensure financial insecurity did not compromise independence. This is particularly important given limited employment possibilities for Fiscal economists outside government. Also a diversity of staff has been shown to be essential in terms of avoiding a “groupthink” culture.
3. Funding. My paper argued that, like the Attorney General’s Office, IFAC funding needs to be put on a statutory basis and not be at the whim of the government of the day.

**Progress....where are we now?**



# Progress:

## Monetary Policy:

- Central Bank Reform Act 2010: Merged Central Bank and Regulatory functions separated in 2002
- New, highly credible management team
- Some concern “No Irish Need Apply” rule is at work

## Economic policy

- Establishment of an **Inter Government Economic and Evaluation Service**
- Establishment with Department of Finance of an International Economy unit, integrating with Department Foreign Affairs
- Enhanced collaboration with other economic Departments
- Creation of a 4 Minister Economic Management Committee

Far higher capacity for quality and timely research from Departments of Finance & PER

## Fiscal Policy:

- Creation of two new Departments of Finance and Public Expenditure and Reform
- Passage of Fiscal Compact Treaty referendum.

# IFAC

Funding now on a **statutory** basis thanks to this year's **Fiscal Responsibility Act**

The **2013 Memorandum of Understanding** between IFAC and Department of Finance, delineating IFAC's functions to, among other things, assess fiscal policy stance and endorse (or not) macroeconomic forecasts

A core of respected **professional and independent staff** is emerging.

IFAC passed its first test of independence two weeks ago.

- It (reasonably imho) endorsing the government's (reasonably prudent imho) macroeconomic forecasts.
- it (correctly imho) refused to endorse the (less than prudent imho) decision to aim for a fiscal adjustment lower than the €3.1 billion agreed with the troika

It is to be noted that the ESRI also argued to stick with the €3.1 billion adjustment.

# Further questions

- What is to become of NESCC?
- Why hasn't the NCC been rewarded?
- How will economic issues outside monetary and fiscal policy be (spatial, transport, population planning, education) be integrated into central policy making?
- Does the dominance of ESRI's funding from public bodies constitute an issue of concern?

# Stability Pact: A (brief) digression

Nov 2003

- Social Democratic Chancellor of Germany (!) has EDP suspended
- During 2004 and 2005 the Pact is watered down in a series of “reforms”
- This begins a process of deterioration in the Stability Pact’s effectiveness
- The worsening in underlying Euro zone public finances from 2004 is made brutally clear during the sovereign debt crisis from 2009 onwards

DEW 2004 paper “Reforming the Stability Pact: A look at what might have been”

- Warned 2004 Ecofin reforms would weaken fiscal discipline
- Argued for a independent body to police Pact (European Council dominated by Schroeder and Chirac implementing EDP was proverbially putting Dracula in charge of the blood bank)
- Argued for definition of “exceptional circumstances” to be more realistic (0% rather than -2% so that high pot. growth countries could avail of it)
- Argued for deficit discipline to be contingent on debt
- Argued for toleration of structural deficits for low debt countries with high infrastructure

# Stability Pact: A (brief) digression

2011 Fiscal Compact Treaty

2012 Treaty ratified in Ireland

- Makes fiscal deficit discipline contingent on debt levels (60% GDP threshold)
- Enables modest structural deficits for low debt countries
- “Exceptional Circumstances” now more realistically defined: Don’t need to endure a small war or major recession to avail of it.
- Most crucially: Independent fiscal monitoring agencies must now under the treaty be enshrined at statutory level in Ireland.
- This was done this year by the creation of IFAC and made operational this year by the Fiscal Responsibility Act and the Memorandum of Understanding.

# In Conclusion

- Sources of policy dysfunction – public choice/conflicts of interest/ electoral pressures – **“haven’t gone away you know”**
- Designing a robust institutional framework is essential
- A system built purely on “First principles” may not be politically feasible. But looking at those first principles will help improve what we have
- Central Bank, IFAC, Departments of Finance and PER represent significant strides forward in the last two years.
- Fiscal Responsibility Act and establishing of IFAC vindicates those of us who argued not just that the economy was overheating, but who called for robust institutions to protect against policy dysfunction

**Moral of story isn’t**

**“Don’t let a good crisis go to waste”**

**Moral of story is**

**“Have institutions that prevent crises happening**