A STRATEGY FOR DEVELOPMENT 1986-1990

KEY POINTS

National Economic
and Social Council

nesc

An Chomhairle Náisiúnta
Eacnamaíoch agus Sóisialach

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1. INTRODUCTION

The National Economic and Social Council is a body comprised of the main interest groups in society: trade unions, employers, agricultural representatives and Government nominees, including two from the National Youth Council of Ireland. It was established in 1973 in order to provide a forum for the discussion of the principles relating to the efficient development of the national economy and the achievement of social justice, and to advise the Government on these matters. This advisory function is performed through the presentation of reports to the Government and through direct discussion with the Taoiseach and cabinet ministers.

Since its inception the Council has produced over eighty reports on a wide variety of issues, including industrial policy, policies on natural resources, social policy and various sectoral issues. A regular publication of the Council in the past has been an annual economic and social report. These reports have tended to be short term in nature, incorporating a review of developments in the previous year, an assessment of prospects for the year ahead, and a presentation of the Council's views on matters of short-term economic and social policy.

Last year, the Council had become extremely concerned at the scale of the economic and social problems facing the country and was worried about the consequences of continuing present policies. The Council recognized that the nature of the problems was such that it would take several years to resolve them. The Council therefore decided to adopt a medium-term perspective on the economic and social situation and prepare a more detailed and comprehensive analysis of the major economic and social problems facing the country. The outcome of this exercise was a report in which the Council put forward a strategy for the management of the economy up to the end of the decade. The report, which was submitted to the Government and published in November 1986, is entitled *A Strategy for Development 1986-1990.*

What makes this report different from reports by other organisations on the economic and social situation? The major distinguishing characteristic of the report is that it commands the unanimous agreement of the social partners. The report marks a significant advance in the Council's identification of common ground

between the social partners and in its ability to achieve consensus on a comprehensive range of economic and social policy measures for the medium term. As such the report should be particularly helpful to Government in that it now has available a strategy for economic and social development which has been endorsed by all the major interest groups in society.

In the view of the Council the conclusions reached in this report are of such importance as to merit a much wider audience than that to which NESC reports are usually addressed. This pamphlet therefore presents a summary of *Strategy for Development 1986-1990* in a language which makes it accessible to the general reader.

The Council also wishes to restate the main conclusions and analysis contained in the report in a summary form in order to ensure that the balance in the presentation accurately reflects the balance in the report. In particular, the Council wishes to draw attention to the fact that the strategy is composed of four integrated elements: macro-economic policy, tax reform, developmental policies and social policy. The Council wishes to emphasise very strongly that the Council's unanimous agreement on these four elements of a strategy was an agreement to all the elements taken together. The groups represented on the Council consistently stressed that none of the elements could be taken seperately as a recommendation of the Council.

2. OVERVIEW

- **The seriousness of the economic and social problems facing the country cannot be overemphasised.**
- **Persisting with present policies is not a viable option.**
- **However, it is possible to *simultaneously address* the twin problems of mass unemployment and chronic fiscal imbalance through...**
- **...an integrated medium term strategy...**
- **...which must command widespread acceptance throughout society if it is to be successful.**

The economic and social problems now confronting the country are extremely grave. This is particularly the case in respect of unemployment and the public finances. Some improvements in economic performance have taken place, such as the sharp fall in inflation and the substantial reduction in the balance of payments deficit. However, such developments must be viewed against the background of trends in the economy as a whole. In particular, a major qualification attaches to the apparent improvement in the balance of payments since it is due in large measure to the weakness of domestic demand.

In any event the economy over the past several years has been overshadowed by the deterioration in the unemployment and public finance positions. The extent of the deterioration since 1980 is documented in the section *Main Features 1980-86.*

While the current situation is grave, the Council is even more concerned at the fact that, without a radical change in policies, the medium term prospects offer no relief. Even in the face of a modest upturn in the world economy, Ireland's prospects for economic growth under present policies are not good, and are certainly not good enough to lead to significant increases in employment or to suggest that the public finances will improve automatically. In fact under some of the assumptions outlined in the report the situation could deterioriate even further. This is the daunting background against which the relevant policy choices must now be formulated and *decisions taken.* The prospects which attach to a continuation of existing policies clearly

indicate the urgent need for radical policy changes. In the Council's view the continuation of existing policies is not a viable option.

Solutions to the twin problems of unemployment and fiscal imbalance must be found. In seeking solutions a question immediately arises as to whether the two objectives can be pursued simultaneously or whether progress towards one of the objectives must inevitably retard progress towards the other. In the short term this might be true. Cutbacks in Government expenditure in themselves imply a reduction in domestic demand and, if unaccompanied by other measures, could be expected to reduce employment in the short-term. However, the experience of other European countries indicates that correcting fiscal imbalances does not inevitably lead to a reduction in employment, even in the short term. Moreover, medium-term effects must be considered, in particular the beneficial effects on output and employment because of the impact on interest rates of reduced Government borrowing.

Grounds for believing that it is possible to reduce unemployment *and* correct the public finances simultaneously are provided by the recognition that the fundamental problem of the Irish economy is that the *level of national output is too low.* In large measure, therefore, the existing problems of high unemployment and imbalances in the public finances derive from the same source.

What is required therefore to tackle the central problem of low growth and its associated symptoms of fiscal imbalance and growing unemployment is that policies be formulated as part of an integrated medium term strategy for economic and social development. The strategy itself is described later under the heading of Strategy for Recovery. The rationale for a medium term perspective is that the grave problems confronting the economy have accumulated over a period of years and that their resolution can be brought about only by concerted and determined action sustained at least to the end of the decade. Finally, the strategy, if it is to be successful, must command widespread acceptance throughout society.

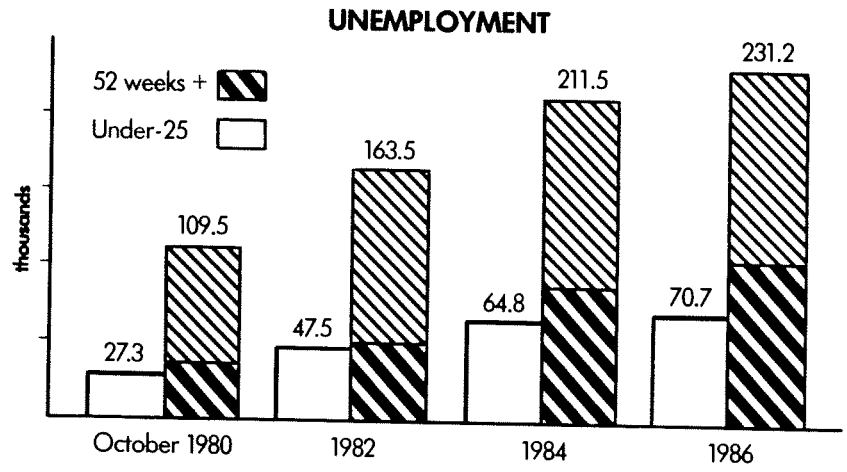
3. MAIN FEATURES 1980-1986

- **The number on the Live Register increased from 100,000 in 1980 to 250,000 at the end of 1986...**
- **...despite the fact that net emigration of 75,000 took place between 1981 and 1986.**
- **The state of the public finances worsened with the current budget deficit in 1986, at 8.5% of GNP, the largest ever...**
- **...and the National Debt at over £24bn or 148% of GNP compared with under 88% of GNP in 1980.**
- **National output in 1986 was no higher than it was in 1980 whereas it grew at almost 4% annually between 1975 and 1980.**

Although inflation has slowed down remarkably and there has been a substantial reduction in the balance of payments deficit, the performance of the Irish economy since 1980 presents a picture which is almost unremittingly grim. The most disturbing aspects of this performance have been the rapid increase in unemployment and the continued deterioration of the public finances.

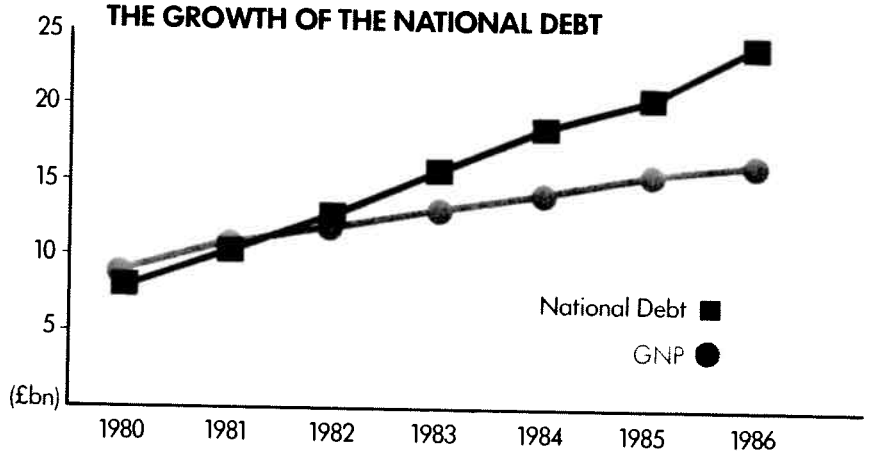
At the end of 1986 the number out of work was 250,000, equivalent to almost one-in-five of the total labour force. The corresponding figure for 1980 was 100,000 persons or, one-in-twelve of the labour force. The enormous increase in unemployment which has taken place over the last six years would have been greater still were it not for the fact that net emigration of 75,000 took place between 1981 and 1986.

Aspects of unemployment other than its sheer scale and extent are also matters of serious concern. Chief amongst these are the incidence of long-term unemployment and of unemployment amongst young people. Over 45% (almost one-in-two) of all those on the Live Register have been unemployed for more than a year, while over 62% (almost two-in-three) have been registered for over six months. At the end of 1986, 70,700 of those unemployed, almost one-third of the total Live Register, were aged under 25 (see chart 1).



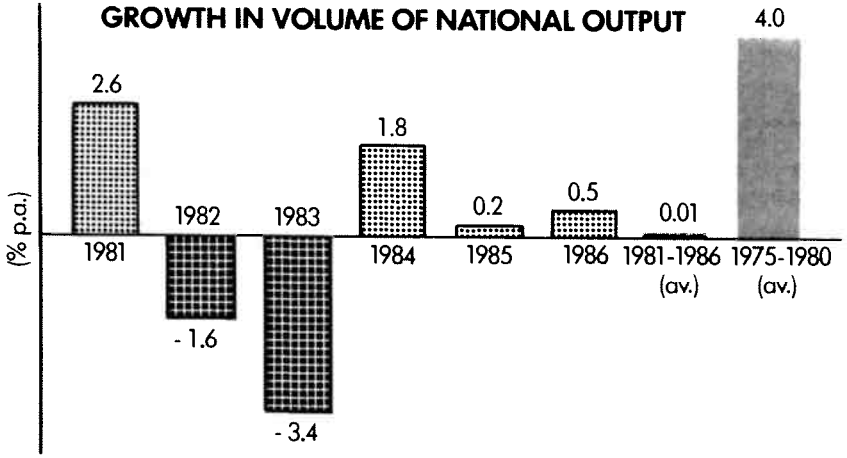
Although the Exchequer Borrowing Requirement in 1986, at 13% of GNP, was broadly similar to that recorded in 1980 and substantially lower than in 1981 and 1982, the 1986 current budget deficit, at 8.5% of GNP, was the largest on record. Trends in the current budget deficit have in recent years become increasingly dominated by interest payments on the National Debt.

In absolute terms the National Debt more than trebled between 1980 and 1986, increasing from under £8bn, to over £24bn. Meanwhile the ratio of National Debt to GNP increased from 88 to 148%, while the cost of servicing the debt absorbed a sum equivalent to 12% of GNP in 1986 compared with 7% in 1980 (see chart 2).



The twin problems of mass unemployment and chronic fiscal imbalance cannot be viewed in isolation from the underlying growth rate of the economy. Real GNP in 1986 was virtually unchanged from its 1980 level having declined sharply in 1982 and 1983, while increases in the remaining years of the period were barely sufficient to compensate for this. By way of contrast, real GNP growth increased by almost 4% annually between 1975 and 1980 (see chart 3).

3.



Of the three principal sectors of the economy only one - agriculture -performed better in the 1980-1986 period, when output increased by 2.5% annually, than in the years 1975-1980, when output actually declined at a rate of over 1 per cent annually on average. Over the past six years the rate of output growth in both industry and the services sector was but a fraction of what it had been between 1975 and 1980. In industry the average growth rate in the respective periods fell from 6.6 to 2.3 per cent and, in services, from 4.5 to 1.2 per cent.

4. THE OUTLOOK TO 1990

- **Under present policies, even if there is a modest upturn in the world economy, economic growth in Ireland will remain weak over the next few years.**
- **Under such circumstances there would be no automatic tendency for the public finances to improve ...**
- **... nor is it likely that any significant increase in employment would take place.**
- **Indeed there is every probability that both unemployment and the public finances would deteriorate further.**

Projected growth rates in output under present policies for the 1986-1990 period for the three main sectors of the economy are set out in the table below. The projections correspond to an 'optimistic' and 'pessimistic' scenario.

Trends in *the agricultural sector* will be dominated by reform of the Common Agricultural Policy which is likely to keep both farm prices and farm output severely depressed. As a result the level of agriculural output in 1990 in real terms is expected to be somewhat lower than that reached in 1985.

PROJECTED GROWTH IN OUTPUT, 1986-1990
(% per annum)

	'Optimistic'	'Pessimistic'
Agriculture	- 0.2	- 0.2
Industry	5.8	3.7
Services	2.0	1.0
GDP	3.2	1.9

The slowdown of investment in *manufacturing* in recent years, especially by overseas firms, will severely limit output growth. This is likely to be reinforced by the persistence of competitive difficulties in the labour-intensive sectors. *Building and construction output* may recover from present levels but any improvement will be quite modest.

Output growth in the *services sector* will depend very much on how the internationally trading sectors of the economy perform and also on trends in the public sector. It is projected that services sector output growth will average 1-2% annually in the years 1986-1990.

At best an annual growth rate of 3% in GDP seems in prospect for the period. A pessimistic, but perhaps more realistic projection would be of an annual average growth rate of about 2%.

The higher growth rate could result in a modest increase in *total employment*, of somewhere in the region of 30,000 between 1986 and 1990. There can be little doubt however, that the lower growth rate would be insufficient to prevent employment from falling even further. With a 2% growth rate total employment would be at least 25,000 lower in 1990 than in 1986.

What these projections imply for *unemployment* depends on the evolution of the total labour force. The most important factors here are the likely trends in emigration and in labour force participation rates. A labour force of 1317 thousand in 1990, 27 thousand higher than in 1986, is projected. This is based on the assumption that emigration will average 25,000 annually in the 1986-1990 period.

This labour force projection, combined with the 'optimistic' scenario for employment growth, would see unemployment marginally lower in 1990 than in 1986. However, under the 'pessimistic' employment scenario, a further substantial rise in unemployment would be likely.

What is important about the report's findings is that the very modest reduction in unemployment which might be in prospect under the 'optimistic' scenario, is entirely due to the assumed continuation of high levels of emigration throughout the remainder of the decade.

In relation to the public finances, an increase in the ratio of National Debt, and of National Debt servicing costs, to total national output (GNP) is inevitable in circumstances where the nominal interest rate exceeds the rate of growth in the money value of GNP. Only if non-interest public spending falls relative to Exchequer revenues can this be avoided.

If present policies continue there can be little doubt that the nominal interest rate will continue to exceed nominal GNP growth. If real GNP growth averaged 3% annually over the 1986-1990 period (with annual inflation averaging 3%) there would probably be some

reduction in non-interest spending relative to revenues without any change in policies. This, however would fall well short of what would be needed to stabilise the debt-GNP ratio.

If real GNP growth averaged 2% over the period it is likely that non-interest spending would increase relative to revenue under existing policies. These projections indicate quite clearly that even the 'optimistic' scenario for overall economic growth would be insufficient to prevent a significant further deterioration in the public finances. The growth rates projected for the period up to 1990 under present policies, with the consequent implications for unemployment and the public finances, are unacceptable in the Council's view. The objective of the strategy put forward by the Council is to achieve a more acceptable position on both the employment and public finance fronts than that envisaged under a continuation of present policies.

5. STRATEGY FOR RECOVERY

- **It is only the internationally trading sectors of the economy that can act as the locomotives of economic growth.**
- **Their growth requires the maximum degree of cost competitiveness in the short term...**
- **...followed by the expansion of productive capacity through investment.**
- **The present level of national output is clearly insufficient to generate jobs for all those seeking work...**
- **...or to sustain the present level of public expenditure at acceptable levels of taxation and prudent levels of borrowing.**

The Council believes that the economic prospects which attach to a continuation of present policies clearly indicate the urgent need for radical changes. Adhering to present policies is not a viable option. If the grave problems of mass unemployment and chronic fiscal imbalance are to be tackled policies must be formulated as part of a coherent medium-term strategy for economic and social development.

The Council is advocating the adoption of a strategy comprising four essential elements (see summary in Panel). Central to such a strategy must be the recognition that the internationally trading sectors – agriculture, manufacturing industry and internationally traded services – are the locomotives of economic growth. It follows that the sheltered sectors – the bulk of the public sector, the building and construction industry, and most of the private services sector – cannot act as an independent source of sustained economic expansion.

Strong sustained economic growth can best be secured by applying national resources to the greatest extent possible to those sectors of the economy which engage in international trade. The growth of the internationally trading sectors requires the achievement of the maximum degree of cost competitiveness in the short term, followed by the expansion of the economy's productive capacity through investment.

THE FOUR ELEMENTS IN THE NESC STRATEGY

1. An integrated macro-economic policy, the purpose of which is to correct the chronic imbalance in the public finances while establishing a better environment for the internationally trading sectors of the economy.
2. Fundamental reform of the tax structure designed to enhance the efficiency and equity of the system of taxation.
3. The progressive removal of major inequities in society.
4. A set of improved long-term development policies in which state intervention would be directed with greater efficiency and effectiveness towards resolving structural problems in industry and agriculture.

If the requirements of the internationally trading sectors are to be paramount (which they must necessarily be if sustained economic growth is to be achieved), strong implications follow for policies in relation to the exchange rate, taxation, incomes and other costs of production and policies which seek to promote the long-term development of agriculture and manufacturing industry. Strong implications follow also for policies in relation to the public finances.

The present state of the public finances acts as a powerful brake on economic growth in several respects. Foremost is the fact that the cost of servicing the National Debt now absorbs a sum equivalent to 12% of GNP. This represents a very substantial drain on national resources. It also absorbs such a large share of government resources as to severely limit government's ability to engage directly in activities which would expand output and employment.

Furthermore, the size of the National Debt, and of Exchequer borrowing in successive years, has been associated with a very sharp rise in real interest rates which has caused a colossal fall in investment. This decline in investment has reduced the economy's productive potential and is likely to constrain the ability of the internationally trading sectors to expand output and employment in the years immediately ahead.

Ultimately it is the level of national output which determines the level of sustainable employment and also the level of public spending which can be sustained. The present level of national output is clearly insufficient to generate jobs for all those seeking work and is, by

extension, insufficient to ameliorate the principal factor responsible for the unequal distribution of income, wealth and opportunities in Irish society today, namely unemployment. It is also insufficient to sustain the existing level of public spending at acceptable levels of taxation and prudent borrowing.

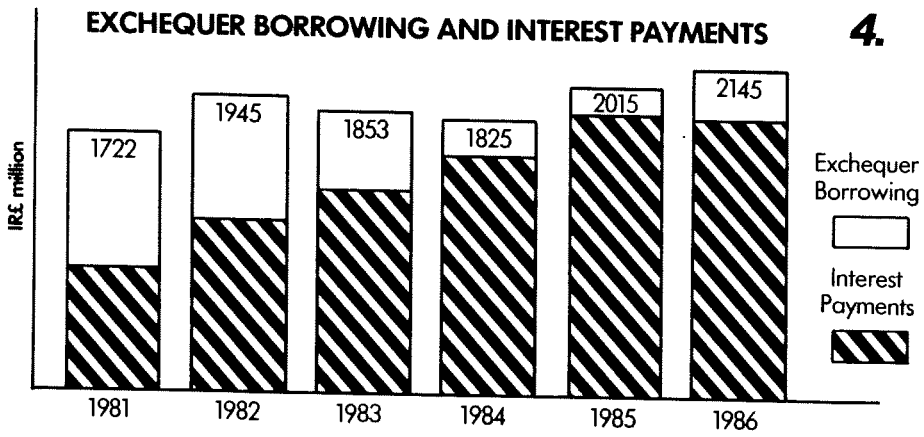
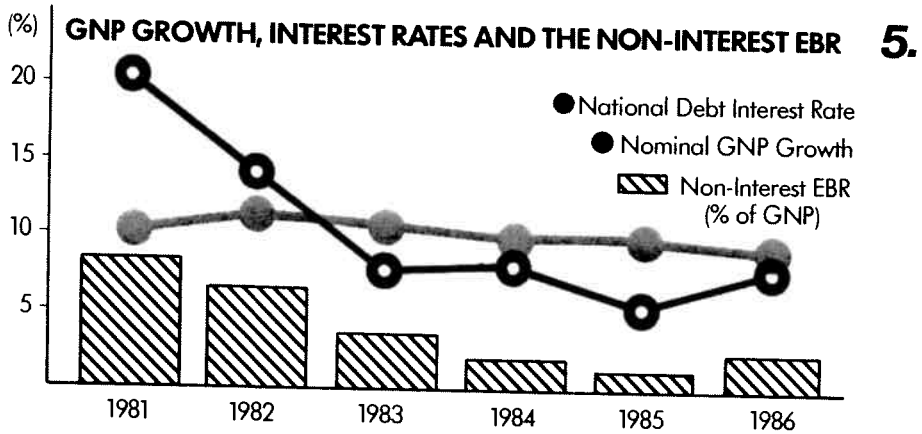


Chart 4 breaks down total Exchequer borrowing between that undertaken to finance interest payments and that required to finance 'new' spending. More than half of the borrowing in 1981 was undertaken to finance 'new' spending but by 1986 almost 90% of borrowing was required to meet interest payments on the National Debt.

Chart 5 shows that since 1983 the interest rate which applies to the National Debt has been higher than the rate of growth in the money value of National Output (GNP). For the ratio of National Debt to GNP to have been stabilised under these circumstances would have required that Exchequer revenues exceed spending on all items other than interest payments. Chart 5 shows that this did not happen: although Exchequer borrowing for the purposes of financing non-interest ('new') spending declined between 1981 and 1985, it was not eliminated altogether. In 1986 such borrowing still amounted to over 2% of GNP or £330m.



6. POLICY FOR THE PUBLIC FINANCES

- **Halting the growth in the National Debt-GNP ratio must be the over-riding aim of policy in relation to the public finances.**
- **The stabilisation of the debt-GNP ratio must be achieved as the necessary first step towards reducing it.**
- **The Council believes that order must be restored to the public finances through cuts in current and non productive capital spending...**
- **...because increasing the overall burden of taxation is neither feasible nor desirable...**
- **...and because productive capital projects should not be set aside.**
- **The absolute size of the spending reductions which will be needed will depend on the timespan over which the debt-GNP ratio is stabilised.**

At the end of 1986 the National Debt amounted to over £24bn or 148% of total national output (GNP). It is now three times larger than it was in 1980. The real problem with the National Debt is that it gives rise to interest payments and other servicing costs. These costs have also grown rapidly in recent years. In 1986 they came to £2bn, an amount which absorbed 12% of GNP and one third of all tax revenues collected by the Exchequer.

It is clear that these trends cannot be allowed to continue. If they are, the cost of servicing the national debt will drain an ever-increasing proportion of the nation's resources which might otherwise be used to expand output and employment. It will also absorb an ever-growing share of tax revenue making it more and more difficult for the Government to continue providing essential services.

Halting the growth of the National Debt-GNP ratio must be the over-riding aim of policy in relation to the public finances. This is essential and must be regarded as the minimum requirement of a sound financial strategy on the part of Government. Stabilisation of the debt-

GNP ratio should be followed by steps to reduce it, since stabilised even at its present level relative to GNP, the National Debt would remain extraordinarily high and the costs of servicing it would continue to absorb an excessive share of national resources.

The Council believes it is neither feasible nor desirable to restore order to the public finances by means of higher taxation. Public spending reductions are therefore the most appropriate means of correction. In the Council's view the burden of adjustment must be borne by reductions in current spending and in non-productive capital spending. Great care should be taken to ensure that productive capital projects are not set aside in the process of correcting the public finances.

The amount by which spending will need to be reduced in order to do no more than halt the growth in debt relative to national output, depends on what happens to interest rates and on how quickly national output grows. If the interest rate which applies to the National Debt exceeds the rate of growth in GNP, then stabilisation of the debt-GNP ratio can only be achieved if Exchequer revenue is greater than Exchequer spending on all current and capital items other than interest payments (see also charts 4 and 5). The accompanying table shows the surplus of Exchequer revenue over non-interest spending that would be required to halt the growth in the debt-GNP ratio, at various combinations of interest rates and growth rates.

The balance of likelihood would suggest that a 3% of GNP *surplus* will be required on the Exchequer's non-interest account. This compares with a corresponding *deficit* in 1986 which amounted to 2% of GNP. It follows that a shift in the non-interest balance on Exchequer account of almost 5% of GNP will be required if the debt-GNP ratio is to be stabilised. If the necessary adjustment were to be entirely borne by non-interest current spending it would require a reduction in this item from its 1986 level of 38% to 33% of GNP.

The absolute size of the spending reductions which will be needed will depend on the timespan over which the debt-GNP ratio is stabilised. In general, the longer this timespan, the smaller will be the volume cuts in spending required each year but the higher the level to which the debt-GNP ratio will have risen in the meantime, and the greater the vulnerability of the public finances to adverse movements in interest rates and exchange rates.

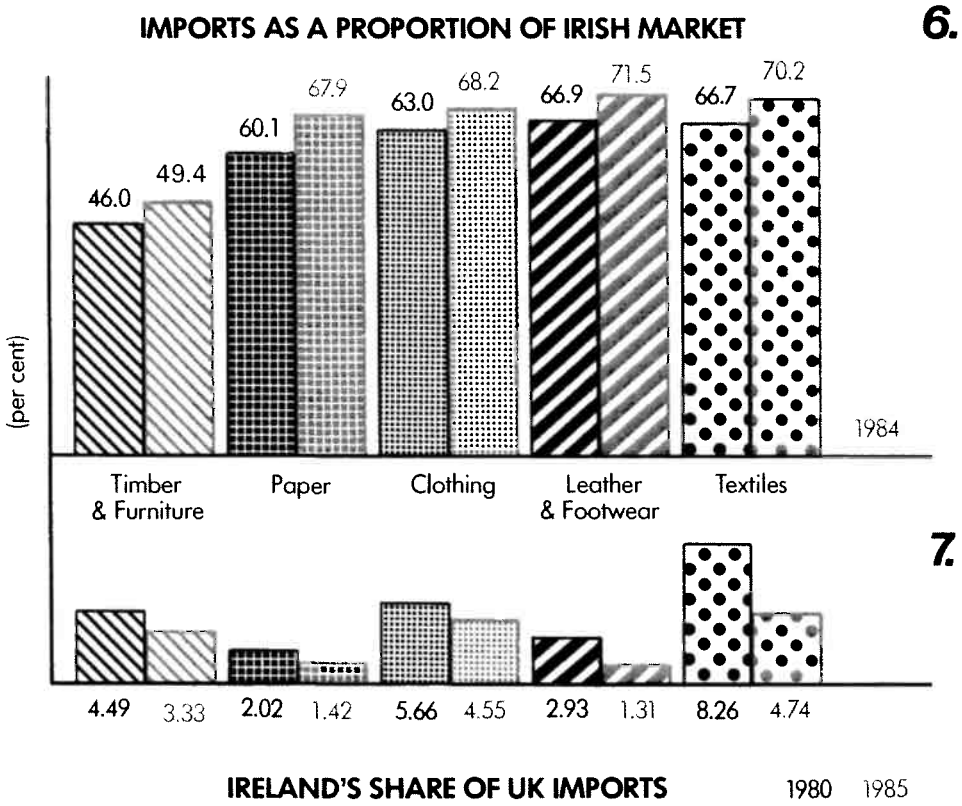
Moreover, the more distant the target year for stabilising the debt-

GNP ratio, the greater will be the Exchequer's borrowing requirement in the intervening years and the stronger the pressure on domestic interest rates. If a longer period of adjustment puts upward pressure on domestic interest rates, the depressing effect on economic activity, especially investment, which would result, would further weaken the medium-term prospects for economic growth.

On the other hand the process of adjustment must recognize the need to avoid excessive economic dislocation and to command confidence that whatever targets are adopted can be achieved. The reductions in public spending which would be required to stabilise the debt-GNP ratio in one year are so large as to be, in the Council's view, outside the range of what is feasible or credible.

Non-Interest Surplus Required to Stabilise Debt-GNP Ratio (% of GNP)

		Nominal Interest Rate		
		8½%	7½%	6½%
Growth in money value of GNP	6%	3.7	2.2	0.7
	5½%	4.4	3.0	1.5
	5%	5.2	3.7	2.2



7. COMPETITIVENESS AND THE EXCHANGE RATE

- **A considerable strengthening of our international competitiveness will be required if output and employment are to grow rapidly.**
- **The average rate of cost increase in Ireland should not exceed the weighted average of cost increases in our trading partners.**
- **The exchange rate should not be used as a means of compensating for excessive cost increases...**
- **...since this would contribute to the illusion that currency adjustments are the key to competitive success.**
- **The objective of exchange rate policy should be to provide a stable currency environment for the internationally trading sectors of the economy.**

If employment and output are to grow more rapidly than indicated by the projections described earlier, a considerable strengthening of all facets of international competitiveness will be required. The evidence of recent years, especially the evidence of increased import penetration of the Irish market and of a diminishing share of the UK market accounted for by Irish exports, indicates that our competitiveness has been steadily declining. This is particularly the case in respect of the older more labour-intensive industries. Relevant figures for a sample of such industries are set out in charts 6 and 7.

If increases in costs of production in Ireland outstrip those in our main trading partners there can be little doubt that further job losses will be sustained. The outcome of the various cost determining processes, therefore, should be that the average rate of cost increase in Ireland not exceed the weighted average of cost increases in our main trading partners.

It is essential that this objective be advanced by Government policy in the following ways:

(i) by ensuring a rapid feed-through into domestic prices from reductions in the price of imported goods (such as for example, the very large fall in oil prices which occurred last year);

8. TAX REFORM

- **Cuts in the overall tax burden can be seriously considered only when the ratio of National Debt to GNP has been reduced...**
- **...but a radical restructuring of that burden is both feasible and desirable.**
- **The Council agrees with the general principles adopted by the Commission on Taxation in relation to tax reform...**
- **...and considers that many of the Commission's proposals can be implemented in the short term.**
- **The priority of taxation policy should be the widening of the tax base and the simultaneous reduction of tax rates.**

If overall tax revenues are reduced as a proportion of GNP, public spending cuts greater than those indicated in the section *Policy for the Public Finances* will be required to prevent the National Debt-GNP ratio from rising indefinitely. The Council believes that it is only when this ratio has been reduced that cuts in the overall tax burden can be seriously contemplated.

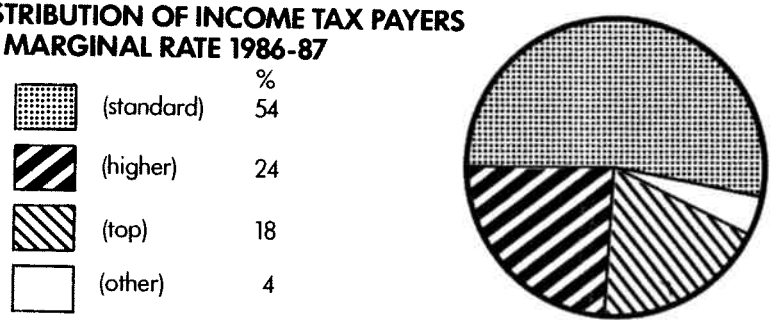
While reducing the overall level of taxation is not at present a serious option, the Council strongly believes that tax reform, by which is meant a restructuring of that burden, is urgently required. The present system is widely viewed as inequitable and as a major source of economic inefficiency. Its provisions are imperfectly understood by taxpayers and impose a heavy burden on those who administer the tax code and collect due revenues.

The need for reform is perhaps most widely felt in the case of personal income tax. This year (1986-87), single persons start paying the top rate of tax at an income which is less than the industrial average. More than one taxpayer in five pays income tax at 58% while almost one in four pays at 48%. Not much more than half of all taxpayers pay tax at the so-called 'standard' rate of 35% (see chart 10).

Meanwhile the tax base has been eroded by a wide variety of

factors, including the existence of exemptions and allowances and the increased usage of reliefs. Income exempt from income tax in 1981-82 amounted to a sum equal to 62% of the income tax base; by 1985-86 this proportion had risen steeply to 77%.

DISTRIBUTION OF INCOME TAX PAYERS BY MARGINAL RATE 1986-87 **10.**



The Council believes that the structure of the present tax system leads to a waste of national resources. Tax reform offers the opportunity of stimulating economic activity at a time when neither reductions in the overall tax burden or expansionary spending policies can. Reform of the tax system may now be one of the most powerful means available to Government to promote faster growth in output and employment in the short to medium term.

The Council has carried out a detailed study of the Reports of the Commission on Taxation. It is in agreement with the key principles adopted by the Commission in relation to tax reform (see panel). The Council believes that many of the Commission's proposals can be implemented in the short-term. Moreover, the Council considers that the implementation of many of the Commission's first-phase proposals need not necessarily mean that all the longer-term proposals (such as the direct expenditure tax) would have to be proceeded with.

The Council believes that the narrowness of the existing base is the immediate cause of the most serious problems and costs which spring from the present taxation system, and a major constraint to developing a system which would be more equitable and would provide greater incentives to enterprise and wealth creation.

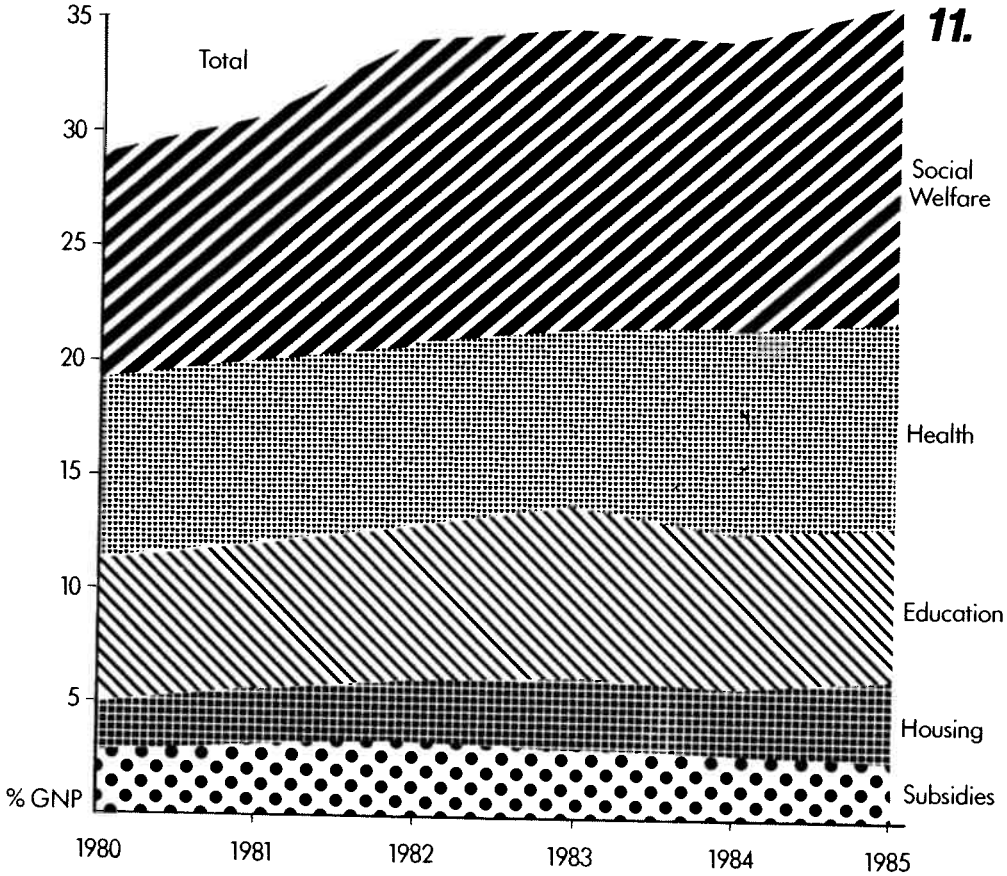
Therefore, the Council urges that the priority of taxation policy in the coming years be the simultaneous widening of the tax base and the reduction of tax rates. This applies not only to personal income tax but

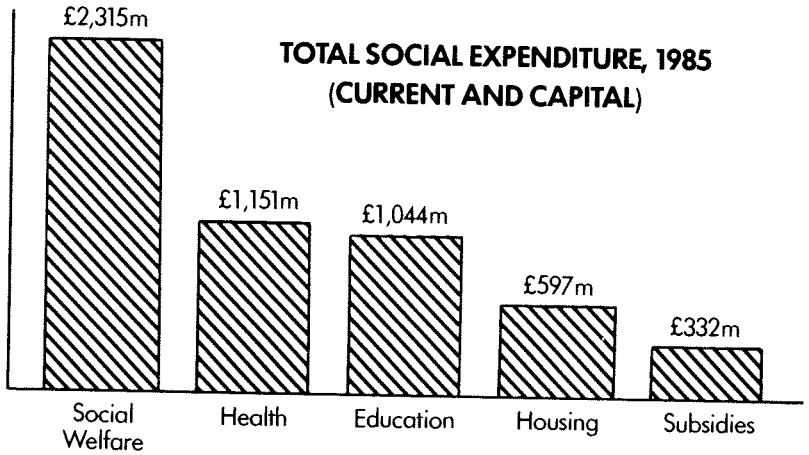
also to capital taxation, company taxation, value-added tax, and the taxation of property.

KEY PRINCIPLES OF THE COMMISSION ON TAXATION

1. That a comprehensive definition of income be adopted as the basic building block in a reformed tax system;
2. That all income in whatever form should constitute part of the income tax base;
3. That income from different sources should be taxed in the same way;
4. That the tax system should be neutral with respect to inflation;
5. That the principle that a tax system should not influence business or individual choices, be adopted as a benchmark position for taxation policy, and that all exceptions or derogations from this view warrant explicit justification;
6. That it is generally preferable to make direct payments to those in need rather than to provide assistance through the tax system.

TOTAL SOCIAL EXPENDITURE (CURRENT AND CAPITAL) AS % GNP 1980-1985





9. A MORE EQUITABLE SOCIETY

- **Expenditure on social services has grown very rapidly and now amounts to 36% of GNP; social welfare expenditure is now the largest, and the most rapidly growing item of public expenditure.**
- **Social goals should not be abandoned because of current economic conditions.**
- **The pursuit of appropriate economic policies will contribute to social development through higher incomes and reduced unemployment.**
- **Social policy objectives and financial restraint can be reconciled if a coherent policy framework is adopted.**

Total social expenditures, current and capital, have grown continuously in the period since 1980, and comprised 35.6% of GNP in 1985 - the corresponding figure for 1980 was 28.9%. Social Welfare services accounted for 34.5% of social expenditure in 1980, and 42.6% in 1985. Social Welfare is therefore the predominant item among the social programmes. It is also the most rapidly growing item; 55% of the nominal increase in current social spending from 1980 to 1985 is attributable to social welfare.

Social Welfare expenditure rose for two equally important reasons: the real value of payments continued to increase and the number of recipients of social welfare payments also grew. Expenditure on unemployment payments was the most significant factor in the overall increase - 44% of the real growth in total social welfare spending was due to increased spending on unemployment payments. Rising unemployment was by far the most important determinant of increased unemployment payments - 8.6% of the real increase in unemployment benefit expenditure is accounted for by real increases in payments, and 91.4% by increases in recipient numbers.

Net current expenditure on health and education increased during the 1980-82 period, declined in the two subsequent years and increased again in 1985. Public capital expenditure on housing fell after 1983.

Social policies are an essential and integrated element in the

strategy for economic and social development proposed by the Council. The difficult economic conditions provide a renewed opportunity to pursue the goal of social equity, rather than a rationale for abandoning that goal. Social equity, and its expression in the form of extensive social services is not fundamentally antagonistic to economic growth and efficiency: the Welfare State is not, in general, a cause of economic decline.

Increased equity, which is the primary aim of social policy, can be furthered not only by improved social services but also by successful economic policies. The adoption of the mix of macro economic and development policies advocated by the Council will bring not only higher output but also greater employment, higher incomes for those who become re-employed and a reduction in the poverty and social ills associated with unemployment. Taxation too is an instrument of social, as well as economic policy. The Council's recommendation that immediate steps be taken to widen the tax base and reduce tax rates, in the context of an acceptance by the Council of the Commission on Taxation's principles, is one aimed at securing a tax system which is more equitable and more efficient.

Social services and the expenditures which they require have to be considered against the background of the public finances as well as the framework of social policy objectives. These objectives can be reconciled with the need to curb public expenditure if targetted, consistent social policies are applied. These policies should be based on the following principles:

- the provision of guaranteed acceptable minimum standards for all in relation to health, housing, education and social welfare.
- the redistribution of resources on the basis of need
- the equitable and efficient raising of revenues for social services
- the structuring of social programmes, especially in social welfare and health, to avoid inefficiencies.

In relation to social welfare services, which absorbs approximately £2½bn annually and is the largest item in the social programmes, the Council believes that the revenue base of social insurance contributions should be broadened, and that it may be desirable to obtain a greater contribution from PRSI to social welfare expenditure.

The Council believes that the rate of increase in social welfare payments requires consideration of these factors:

(i) the budgetary impact of increases;

(ii) the trends in the post tax income of employees;
(iii) the need to continually and selectively improve the nominal payments in such a way as to gradually make the structure of payments more uniform and more equitable, as recommended by the Commission on Social Welfare.

The Council therefore does not recommend overall indexation of payments levels. The very lowest social welfare payments should obtain relative increases.

Housing policies have been successful in securing adequate housing for the population at large. However, more equitable housing policies can be initiated in two ways: firstly by reallocation of resources from the subsidised, owner-occupied sector to the marginal, problem areas of the housing system and secondly, by reform of the local authority rental system to make it more efficient and more equitable.

In the light of recent research on the health services the Council recommends that:

(i) the supply of the most expensive medical resources, i.e. hospital beds, be strictly controlled;
(ii) the commitment to non-institutional, community care should be pursued;
(iii) the tax based financing of private health care be curtailed.

Education policy should, in the view of the Council, take fuller cognisance of the inequalities in education between social groups and between the sexes. Further, the Council has indicated that, although some progress has been made in improving access to participation in Third Level Education, a review of the effectiveness of the financing of Third Level is desirable.

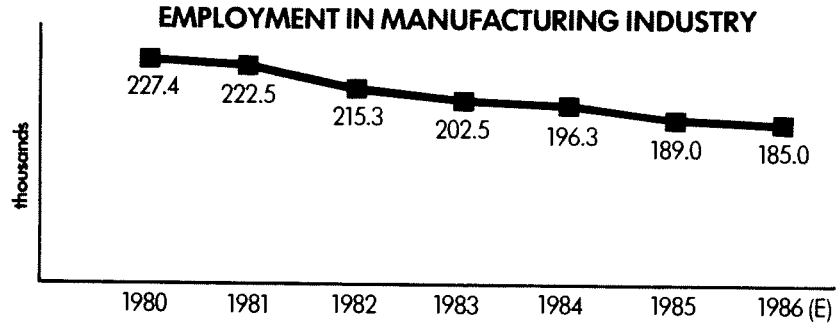
Social policy is a central part of the overall strategy for development. The mitigation of social inequalities and the equitable sharing of unavoidable economic adjustment are necessary, if the policies required in the future are to be accepted by the community as a whole.

10. INDUSTRIAL POLICY

- **Progress towards the reduction of unemployment is unlikely to be made unless industrial employment is substantially increased.**
- **There continues to be a compelling case for an active industrial development policy on the part of government.**
- **Achieving the maximum number of sustainable jobs in industry will warrant the continued attraction of overseas firms...**
- **but it is essential that strong internationally competitive Irish owned firms be developed...**
- **...and that linkages much stronger than those currently in existence be forged between overseas firms and the rest of the economy.**
- **Changes in the type of incentives provided and in the allocation of industrial policy resources must take place to reflect these requirements.**

The Council rejects the view that Ireland has reached a stage of economic development where industrial employment must inevitably decline. The fall in manufacturing employment since 1980 (see chart 13) is more the result of the type of industrial (and other) policies that have been pursued than it is the product of any set of immutable historical forces.

13.



Progress towards reducing unemployment is unlikely unless industrial employment is substantially increased. The Council believes, therefore, that the prime objective of industrial policy must be to generate the maximum number of sustainable jobs in manufacturing and in internationally-traded services.

While a favourable climate for enterprise is necessary, the Council believes that getting the business environment right will not in itself be sufficient to realise national aspirations for higher employment. In the Council's view, there continues to be a compelling case for an active industrial development policy on the part of Government.

The industrial policy currently in place has achieved many notable successes. Amongst them is the fact that manufacturing output growth has been quite rapid, albeit volatile, in recent years.
Clearly however, there have been important shortcomings: output (see table) and export growth from manufacturing have been concentrated in a limited number of sectors and new jobs created have been more than offset by job losses especially in the more traditional branches of industry. The strategy has relied heavily on the attraction of overseas firms, has not resulted in the development of strong indigenous firms, and has failed to forge strong linkages between the modern, predominently foreign-owned sectors of manufacturing and the rest of the economy.

MANUFACTURING: OUTPUT GROWTH BY SECTOR, 1980-1985

	(% p.a.)
Chemicals	10.7
Office Equipment	35.0
Instruments	10.1
Total New	15.9
Non-Metallic Minerals	- 1.0
Other Engineering	0.7
Food	2.7
Drink & Tobacco	1.2
Textiles	- 3.4
Clothing & Footwear	- 2.8
Timber	- 3.0
Paper	- 2.9
Miscellaneous	- 1.1
Total Old	0.2

These shortcomings have resulted in part from the policy instruments employed and the allocation of resources between the various types of incentive. *Firstly,* incentives have not been applied selectively, in that state support has not been confined to the internationally trading sectors of the economy. *Secondly,* there has been heavy reliance on tax-based incentives, which by their very nature are of benefit only to already profitable firms and do nothing to foster the conditions which lead to commercial success. *Thirdly,* direct aid has been heavily concentrated in grants for fixed asset investment rather than technology acquisition, R & D, and marketing. It is in these latter areas that indigenous firms face their most significant cost penalties.

Although achieving the maximum number of sustainable jobs in industry will warrant the continued attraction of overseas firms, it is essential that a set of strong internationally competitive Irish owned manufacturing firms be developed. It is also vital that stronger linkages than currently exist be forged between overseas firms and the rest of the economy. Changes in the type of incentives provided and in the allocation of state resources across different types of incentive must take place to reflect these requirements.

The Council believes there is a tenable case for the existence of the National Development Corporation (NADCORP) but considers it essential that expenditure by NADCORP be rigorously evaluated in terms of future rates of return to the Exchequer.

The Council believes that the effectiveness of industrial policy can be greatly enhanced if a coherent system of monitoring and control mechanisms is put in place. This system would incorporate the following elements: an industrial policy budget; regular published reviews of industrial policy achievements in relation to objectives and, the application of performance criteria to the relevant state agencies.

11. AGRICULTURAL POLICY

- **The agricultural surpluses of the European Community must be viewed against the background of global oversupply.**
- **Enhancing the prospects for Irish agriculture within an EEC framework requires a realistic Irish approach including a focus on policy objectives which can win support among food consumers as well as producers and on policy measures which ensure that public financial support for agriculture is used effectively in meeting agreed objectives.**
- **The distribution of sacrifice across the Community must have regard to (i) the present maldistribution of support across the Community, (ii) the importance of agriculture in the various member states; and (iii) the fundamental objectives of the Community.**
- **While a realistic price policy is necessary, quantitative restrictions will be necessary to bring agricultural markets into greater balance in the short term.**
- **With regard to non-EEC issues the main items of vital importance to agriculture are the rate of domestic cost increase, the level of interest rates and land use policy.**

The dominant influence on Irish agriculture over the period to 1990 will be evolution of the Common Agricultural Policy. A number of major problems are now associated with the CAP, in particular, the huge surpluses and the high cost of subsidising their disposal on world markets and of storing intervention products.

The future of the CAP will require multilateral trade negotiations since the internal surpluses in the Community must be viewed against the background of global over-supply. Restrictions imposed on Community producers to reduce the Community's contribution to worldwide agricultural surpluses should be matched by similar steps in

non-community countries.

This international dimension must be accompanied by a resolution of internal agricultural problems. The strategy which Ireland adopts in the negotiations regarding reform of the CAP is crucial. This strategy would involve Ireland acknowledging that a policy of high price support for unlimited production is inappropriate. Securing support for the CAP will also require an acknowledgement that (i) relatively high food prices entail a cost to the consumer as well as a benefit to the producer and, (ii) that agricultural support should be directed more towards solving the problem of low income in farming.

Sacrifices will be necessary from all member states of the Community in reform of the CAP, but the distribution of sacrifices must have regard to a number of factors. These are (i) the present maldistribution of support across the Community; (ii) the importance of agriculture in the various member states and the consequent dislocation arising from adjustment of the CAP; and (iii) the fundamental objectives of the Treaty. In the view of the Council, Ireland's case for seeking a lesser proportion of the sacrifice inherent in the reform of the CAP rests upon the importance of agriculture in the economy (approximately one fifth of GNP is supported by the agriculture and food sectors in Ireland). Ireland's case is also strongly supported by the fact that the divergences in the levels of support across the Member States in spite of severe regional differences (as, for example, between the West of Ireland and the Netherlands) are not consonant with the objectives of the Treaty.

Pricing policy within the community has to address the problems now facing the CAP, in particular the surplus production position, prices to the consumer, and the fact that price support goes mainly to those with high levels of output and incomes and hence does not solve the problems of farmers on low incomes.

However, price policy should not be the only instrument used to bring about greater market balance. In the short-term quantitative restrictions will be necessary to bring supply and demand into closer harmony. In order to deal more effectively with the low income problems in farming preferential access to production opportunities may have to be designed.

With regard to the overall macro-economic environment two features are of vital importance to agriculture: the rate of domestic cost increase and the level of interest rates. Aside from the general level of

interest rates, repayment schedules tailored to the needs of a long-term development programme are essential. With regard to internal agricultural structures the Council believes there is a need for a new land use policy taking into account the changed production and marketing environment within the EEC.

12. CONCLUDING REMARKS

The economic and social problems now confronting policy makers are grave. The continuation of existing policies is not a viable option. There is unlikely to be any improvement in the unemployment or public finance positions even under the optimistic scenario. Persisting with present policies would give rise to continued reduction in the flexibility of policy makers and would also lead rapidly to an erosion of confidence in the economy.

While the problems are severe they are not intractable. The Council believes that the determined pursuit of the strategy outlined earlier will ultimately bring desirable results. However, the nature of the problem is such that remedial action can only be undertaken through a comprehensive medium term strategy. Such a strategy must be founded on three principles: consistency, continuity and credibility (See Panel).

Consistency refers primarily to the pursuit of consistent fiscal, monetary and exchange rate policies.
Continuity refers to the steady adherence to a particular mix of policies.
Credibility involves securing widespread recognition that Government is committed to its economic and social strategy.

The return of confidence to the economy is crucial for any economic and social strategy to be successful. Adherence to the above principles will generate confidence throughout the economy.

Another major requirement for a successful strategy is acceptability. This requirement relates particularly to those who are called upon to make sacrifices to facilitate the attainment of targets. It is particularly important that the burden of adjustment is shared equitably across all sections of society.

Sacrifices will be accepted if some return can be deomonstrated and if major inequities are removed from our economic and social system. This highlights the importance of the simultaneous pursuit of the four elements of the Council's strategy. For example, failure to reduce inequities while undertaking public spending cuts will consign the entire strategy to failure. It will fail because the burden of adjustment will not be accepted by those on whom it is being placed because of a

perception of inequities in the system. Demands for compensation will be made with the entire planning process becoming socially divisive and inimical to the long term interests of the economy.

Finally, while the Council has reached broad agreement on the measures which are necessary to confront the present economic and social difficulties it is of the view there is a need to foster a greater degree of consensus in Irish society if these measures are to be implemented without giving rise to conflict. This consensus is necessary both on the national level and the level of the workplace. The Council intends to pursue this issue further, through examining the institutional arrangements for economic and social planning in a number of European countries and particularly at the mechanisms in place for the achievement of consensus.

NATIONAL ECONOMIC AND SOCIAL COUNCIL MEMBERS

Chairman: Mr. Padraig O hUiginn

Nominated by the Government
Mr John Curry
Dr Miriam Hederman O'Brien
Ms Sylvia Meehan
Mr Kevin Murphy
Mr David Medcalf
Mr Michael Webb
Mr Maurice Doyle

Nominated by the Confederation of Irish Industry
Mr Leo O'Donnell
Mr Liam Connellan

Nominated by the Irish Congress of Trade Unions
Mr John Hall
Mr Dan Murphy
Mr Peter Cassells
Mr Gerry Quigley
Mr Donal Nevin

Nominated by the Irish Co-operative Organisation Society
Mr Gregory Tierney

Nominated by the Irish Creamery Milk Suppliers' Association
Mr Donal Hynes
Mr Ciaran Dolan

Nominated by the Irish Employers Confederation
Mr Thomas Toner
Dr Eugene McCarthy
Mr Paddy Murphy

Nominated by the Irish Farmers' Association
Mr Joe Rea
Mr Michael Berkery