The Economic and Social Review, Vol. 23, No. 3, April, 1992, pp. 315-318

"Fiscal Adjustment in Ireland in the 1980s": A Comment*

JOHN P. MARTIN
OECD, Paris

The Irish experience with fiscal adjustment is interesting, not just for a domestic audience but also for an international one. If one confines the comparison to the OECD countries, the Irish experience can be seen as part of a general trend towards fiscal consolidation, in which it stands out in one major respect. Whether one focuses on 1979 (a cyclical peak in OECD activity) or 1982-83 (the trough of the cycle) as a starting point, Ireland had by 1990 experienced the largest fiscal adjustment of all OECD countries in terms of the size of the swing in the general government budget deficit/GDP ratio.[1] The only other countries to approach it are Japan, Denmark and Sweden.

Why Did Ireland Embark on Fiscal Adjustment?

The paper opens with a provocative question for students of recent Irish political and economic history: why did Ireland make this dramatic fiscal adjustment? Professor Honohan's preferred answer is that the prevailing fiscal path at the beginning of the 1980s was unsustainable and, more importantly, was recognised as such by the electorate and the politicians. It is a pity that the paper does not go a bit deeper into the reasons why the fear of a solvency crisis apparently gripped the public imagination in the early 1980s.

1. These data are drawn from the *National Accounts of OECD Countries* and are based on the standardised System of National Accounts (SNA).

*The views expressed here are my own and should not be held to represent those of the OECD.

I would like to suggest some partial answers to the question of why Ireland pursued the path of fiscal rectitude. First, there was a common recognition among most OECD countries of the need for fiscal adjustment after the second oil shock and the sharp downturn in 1981-82; ample testimony of this shift in perception — which was not always translated into rapid reality — can be found in the OECD Ministerial Communiqués of the period. Thus, Ireland was not unique in pursuing fiscal adjustment. The fact that most of the dramatic improvement in the Irish fiscal outlook occurred post-1985 is also typical of other OECD countries — as a recent paper by an OECD colleague, Howard Oxley, and myself demonstrates (Oxley and Martin, 1991; OECD, 1989).

Second, the spectacular failure of the "dash for full employment" in the late 1970s finally sounded the death-knell of activist fiscal policy in Ireland. When this was combined with Irish membership of the ERM, the severe limitations on fiscal policy in a small, open economy committed to tying its exchange rate to a low-inflation anchor became apparent to everyone. Perhaps like the Mitterand "dash for growth" between 1981 and 1983, we needed a massive policy failure to convince the Irish electorate and the politicians of the wisdom of changing course!

The paper highlights the central rôle played by tax increases in securing the dramatic turnaround in government borrowing. Once again, Ireland is not unique in this. Howard Oxley and I have calculated that over half of the improvement in the OECD-wide budget deficit post-1984 was due to a rise in the tax/GDP ratio despite the fact that many OECD countries had implemented wide-ranging tax reforms over the period.

But spending restraint also played a rôle in the Irish adjustment. While the rhetoric of spending cuts was common to most OECD countries, Ireland has been more successful than most in reining-in the growth of the public sector. In terms of trends in spending/GDP ratios, Ireland is one of only six OECD countries — the others are Austria, Belgium, Germany, Japan and Switzerland — where the ratio of general government spending (including debt interest payments) to GDP in 1990 was lower than in 1979.

How the Spending Cuts were Implemented

The final part of the paper discusses how the spending cuts were actually implemented and it is interesting to contrast the Irish experience with the process in other OECD countries. The following measures to restrain spending were used in Ireland:

- cut-backs in public investment;
- getting tighter control of the public sector wage bill, via restraints on both public sector pay and recruitment;

— the imposition of cash limits;
— attempts to promote decentralised budgetary responsibility and greater managerial efficiency.

As Howard Oxley and I document in our paper, much the same process was applied in other OECD countries in an attempt to restrain spending. Public investment fell as a share of GDP in most OECD countries and governments in many countries sought, with some success, to enforce cuts in public sector pay relative to the private sector. I agree, however, with Honohan's conclusion that it is difficult to enforce relative declines in public sector pay over a long period. There are clear signs in many countries of a recovery in relative public sector pay in recent years.

At the same time, the recruitment ban on public sector employees enforced in Ireland is rather unique. While growth of public sector employment slowed considerably in the 1980s in most OECD countries, Ireland (after 1984) and the United Kingdom are the only two OECD countries which actually succeeded in cutting the level of public sector employment. So long as future hiring does not compensate for these cut-backs, this represents a permanent benefit in terms of lower spending in the future.

I am less sanguine about the success of cash limits in restraining spending, in anything other than the very short run. Evidence from other OECD countries suggests it is relatively easy to evade such limits. I am also frankly sceptical of arguments that attempts to reform managerial practices in the public sector and assign decentralised budgetary responsibility will prove very successful in restraining spending and improving efficiency. This is an old tune, but there is precious little evidence from other countries that attempts to dress it up in a modern air are likely to produce a hit-parade single.

I am more sympathetic to attempts to foster greater use of market signals within the public sector. I have in mind innovations such as the use of vouchers, greater recourse to user charges and to contracting-out certain goods and services, and franchising and private financing of public infrastructure. The fact that such innovations are not mentioned in the paper suggests that they have been little used in Ireland. This may reflect what Honohan calls "the relative absence of ideological commitment in Ireland to a reduced rôle for government". In any event, some discussion as to why these alternatives have been so little used in Ireland would be welcome. It would also be interesting to speculate why there has been so little recourse to privatisation as a vehicle for both cutting the deficit faster and spurring efficiency in public enterprises.

To conclude, we should be grateful to Patrick Honohan for this interesting

review of the Irish success story. Fiscal adjustment in Ireland had many parallels in other OECD countries. But the Irish economy in the early 1980s was a more serious situation than most and correspondingly required more drastic medicine. The improvement, when it finally came, was more dramatic than in any other OECD country, giving rise to headlines in foreign newspapers referring to the Irish economic miracle. But "battle fatigue" on the fiscal adjustment front appears to be the order of the day in many countries and it will be interesting to see whether Ireland can continue the process of fiscal consolidation and budgetary control in the more stormy waters of the 1990s. The fiscal "crisis" may be over, but severe problems remain.

REFERENCES

OXLEY, H., and J.P. MARTIN, 1991. "Controlling Government Spending and Deficits: Trends in the 1980s and Prospects for the 1990s", *OECD Economic Studies*, No. 17 (forthcoming).

OECD, 1989. *Economies in Transition: Structural Adjustment in OECD Countries*, Paris: OECD, Chapter 5.