2. Perspectives on the Fiscal Challenges Facing Ireland

Robert Watt[13]

Introduction

As Ireland is preparing to exit the EU/IMF Programme, it is an appropriate time to consider the challenges that Ireland is likely to face in the immediate future as well as over the medium-term. The manner in which these challenges are to be addressed is a matter for society to debate. One key decision is, of course, the level and quality of the public services that will be provided and the volume of resources that will be raised from taxpayers to provide such services. In liberal democracies such as Ireland, addressing the question of how the provision of public services, or the relationship between the State and the citizen, should progress is a dialogue within society articulated through on-going and open debate that is mediated through elections and governments.

It is therefore important that we are open about the challenges Ireland faces in arriving at such decisions. The first and most obvious is that there are finite resources available to the State for providing public services to citizens. These fiscal constraints set the overall context within which Ireland can address the challenges it is likely to face. In learning to live within these constraints, a key challenge will be to ensure that the choices that are made support sustainable economic and social progress.

Another challenge is how to utilise the available resources as efficiently and effectively as possible and to organise the provision of public services in a manner that best meets the needs of citizens. While nobody can say what the future will look like, it is clear that there will be particular pressures on public expenditure, such as those associated with the changing

13 Robert Watt is writing in a personal capacity. A version of this paper was presented at the *Social Justice Ireland* Policy Conference on 19 November 2013. The subject of the Conference was “A future Worth Living For”.

demographic profile. Other challenges, such as the risks associated with being a small open economy within the Euro area and climate change, are known but their impacts vary or need to be balanced against significant benefits that are not perceived as immediate. The challenge is to identify the likely impacts and potential costs of hypothetical events.

This paper focuses on the challenges facing the public finances and related issues. It does not examine in detail labour market and social policy challenges which I understand are the subject of other papers at this conference. Hence, the paper does not purport to be a comprehensive examination of challenges we face.

This paper begins by providing some overall context in terms of the role of the State and the relationship between the State and the citizen. The paper then examines the resources that the Irish State has available to it and what services are provided and how this has changed over time. The next section sets out the main features of the on-going fiscal consolidation effort before setting out a number of selected challenges that Ireland is likely to face in the next few years and over subsequent decades.

Role of the State

Seventeenth and eighteenth century social contract theorists who examined questions relating to the origins of society and the legitimacy of authority saw the State in terms of its capacity to provide citizens with security, protection of property and development of people and their abilities. The deepening of this relationship between the State and the citizen is perhaps most evident in the evolution of welfare supports over the last century or so, the origins of which are in part associated with nineteenth century Prussia. Of that, Galbraith (1991: 210-11) observed that the passing of legislation in the Prussian Reichstag in 1884 and 1887, providing for elementary accident, sickness, old-age and disability insurance, was an example of 'fear of revolution as an inducement to reform, [as] Bismarck pressed for amelioration of the more stark cruelties of capitalism'.

In the twentieth century, the potential of state involvement in the promotion of economic growth has been strongly associated with the work of John Maynard Keynes, especially in terms of raising the level of investment spending for public purposes in order to tackle the problems of persistent under-employment and under-investment. However, rising inflation and unemployment in the 1970s undermined the efficacy of the Keynesian model for policy making and contributed to the counter-reaction, emphasising the use of monetary policy to control inflation. The 1980s in the UK and USA have become associated with such policies supporting free-markets, non-intervention, privatisation, deregulation and income tax cuts.

When examining the role of the state in development, Fukuyama (2005) based his analysis around the two dimensions of 'scope' and 'strength'. 'Scope' focuses on what it is that the state does. The World Bank (1997) has set out a list of the state's functions which ranges from the 'minimal' (e.g. providing pure public goods such as defence, law and order, property rights and basic protection of the poor) to 'intermediate' (e.g. addressing externalities through education and economic regulation) to 'activist' (e.g. industrial policy and wealth redistribution). 'Strength' does not simply refer to the state's ability to enforce laws but includes its institutional capabilities such as the ability to formulate and implement policies in an efficient and transparent way.

While all of the above tend towards 'top-down' or 'expert led' approaches, it should not be forgotten that in liberal democracies there is a very direct relationship between the citizen and the State through general elections. In elections, the citizens play an important role in selecting their political leaders and choosing between political parties that often compete for support by offering different policy platforms. While there may be some debate about the degree to which policy choice informs voter behaviour, in Ireland, the evidence shows that the pledges included in election manifestoes are included in the government programmes formulated and agreed after an election (Mansergh and Thomson, 2007).

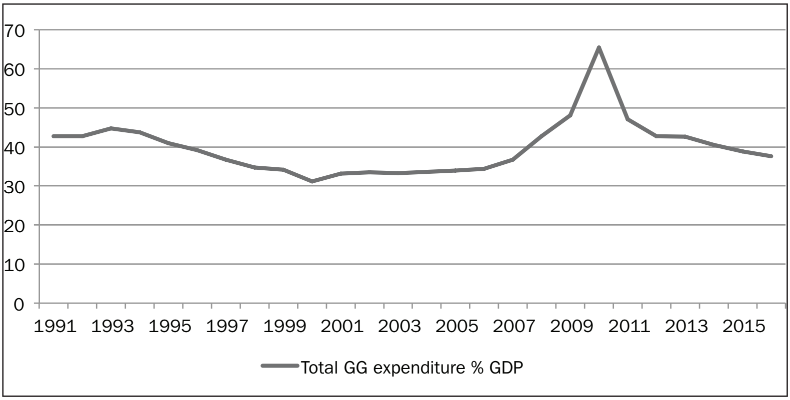
The Size of the Irish State
General Government Expenditure

General government expenditure is defined as overall expenditure including interest costs on our debt and expenditure of the local government sector. Over time there have been significant changes in the volume of Government expenditure and of course its size relative to the overall economy. In nominal terms, general government expenditure will have increased from under €17bn in 1991 to a projected €69 billion in 2014; in real terms the State's expenditure has tripled in size since the early 1990s.

As a proportion of the overall size of the economy, total Government expenditure has varied around a long-term, pre-crisis average of 38% of GDP[14]. At the turn of the millennium, government expenditure represented a more modest 31% of output which is low by historic standards. As the downturn materialised, total and underlying spending (excluding interest costs, expenditure related to the economic cycle, and banking-related once-offs) increased to well beyond 40% of GDP in 2010. For 2014 it is expected to return to 40 per cent of GDP.

Based on this broad measure spending is heading towards its pre-crisis average and it is expected to be there by 2016. The level includes significant debt service costs on serving the larger stock of Government debt.

Figure 1: Total General Government Expenditure % GDP



Source: Dept. of Finance

[14] For convenience throughout this paper GDP is used. Of course, GNP is a better measure of available resources to Irish citizens but this does not affect the arguments here.

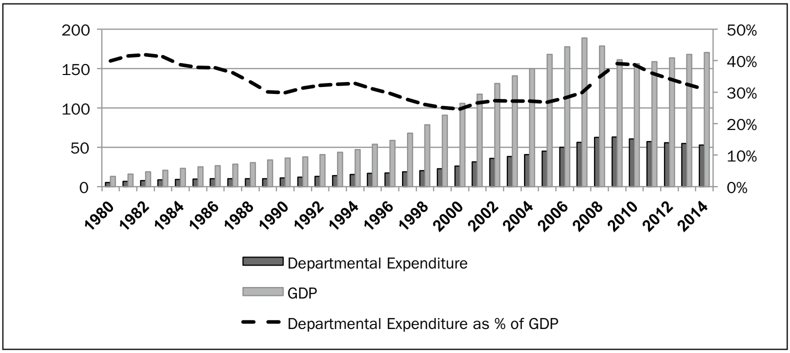
Voted Government Expenditure

Government Voted Expenditure refers to spending on the day-to-day provision of public services to citizens including investment in infrastructure. It excludes debt service costs and it is this type of expenditure that is the main focus of Budget Day announcements.

In Budget 2014, the Government announced that the overall voted expenditure allocated to Departments for 2014 is €52.9 billion - €49.6 billion current spending and €3.3 billion capital – and this will account for about 31% of GDP in 2014. Since the early 1980s, Departmental expenditure has accounted for, on average, 32% of GDP. From Figure 2 it is clear that Departmental expenditure as a proportion of the size of the economy has varied from just over 40% in the early 1980s to around 25% of GDP at the turn of the millennium. In the first few years of the economic crisis, this ratio increased from just under 30% in 2007 to 39% in 2009 and has now fallen back due to some growth in GDP and lower spending.

It is noteworthy that spending on the volume of public services is getting close to average pre-crisis levels as a percentage of output.

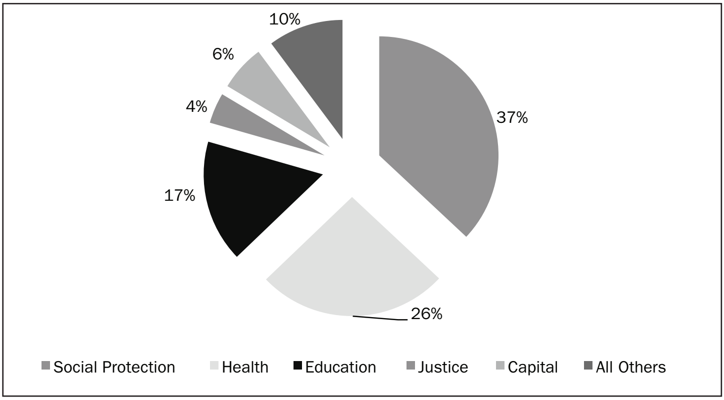
Figure 2: Departmental expenditure as a proportion of economy size



Source: Dept. of Finance

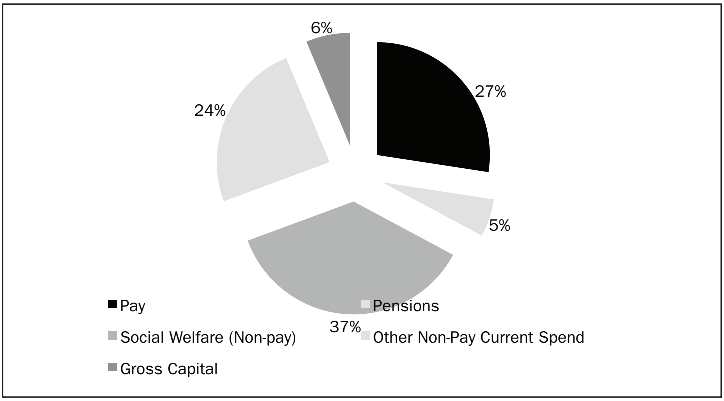
As is evident in the Figure 3A, government expenditure is predominately in the areas of Social Protection, Health and Education and these areas will account for 80% of Gross Total Expenditure in 2014 (or €42.1 billion). Or looked at from a slightly different perspective, (see Figure 3B) public service pay and pensions account for almost a third of total expenditure with the non-pay allocations dominated by Social Protection and the remaining 24% allocated to non-pay costs of delivering day-to-day services in all other areas.

Figure 3A: Allocations of Expenditure by Department as % of Gross Expenditures in 2014



Source: Dept. of Public Expenditure and Reform

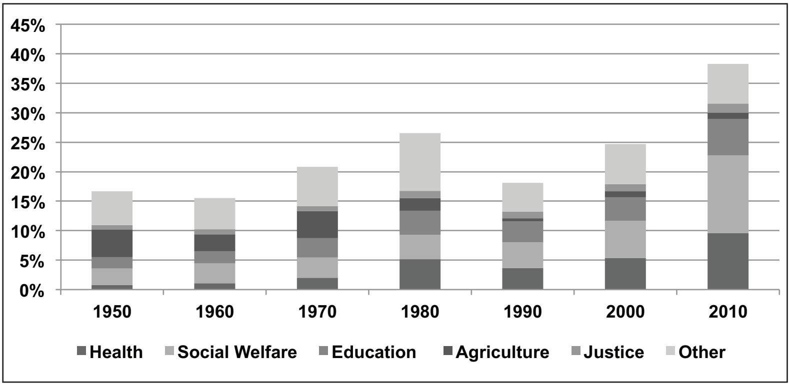
Figure 3B: Allocations of Expenditure as % of Gross Expenditures in 2014



Source: Dept. of Public Expenditure and Reform

There is a tendency to assume that the public services of today were also the public services of yesterday. However, over the last six decades or so there have been some notable changes in the composition of Government expenditure. For instance, while expenditure on agriculture accounted for more than a quarter of total Government expenditure in 1950, today it accounts for about 2%. Conversely, combined expenditure on health, social welfare and education accounted for 33% in 1950.

Figure 4: Departmental Expenditure as a proportion of economy size 1950-2010[15]



Source: Dept. of Public Expenditure & Reform

The scope to significantly increase expenditure as the economy recovers will be constrained by binding new EU fiscal rules. (See below for a detailed discussion of these). The new 'expenditure benchmark' will mean that expenditure as a share of GDP (excluding interest payments and payments related to the economic cycle such as unemployment payments) cannot grow faster than the average medium term potential growth rate of the Irish economy. We will return to this point later.

Fiscal Consolidation To-Date

While many of the problems associated with the economic crisis that Ireland has had to endure have domestic roots, the international nature of

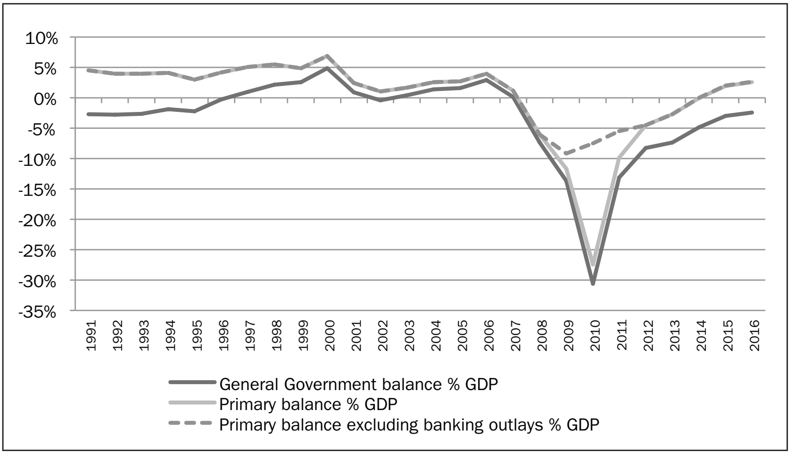
15 As a percentage of nominal GDP.

the crisis made it even more difficult to return the economy to a stable footing. The consolidation effort has required disciplined approach to meeting Ireland's targets under the EU/IMF Programme while at the same time addressing increasing pressures and demands for public services.

Figure 5 shows the evolution of the overall fiscal and the primary balance since 1991. The economic downturn led to a dramatic deterioration in the fiscal position. In 2010, the headline deficit stood at nearly 31% of GDP including banking related costs. Excluding these costs the primary deficit was almost 10% of GDP at the peak of the crisis. The overall deficit is forecast to be 4.8% of GDP in 2014 (below the 5.1% EDP target) with a small primary surplus.

It is uncertain how much of the remaining deficit is structural. Estimating potential output and the output gap is difficult for an economy such as Ireland. However, the economy is operating below 2008 output levels and unemployment is over 13%. This suggests that a cyclical recovery could reduce a large element of the remaining deficit.

Figure 5 General Government Balance and Primary Balance as a % of GDP



Source: Government Finance statistics CSO data for 1991-2012. Projections based on Budget 2014. Figures include impact of banking injections.

Ireland is expected to record a small primary surplus in 2014 for the first time since 2007. In other words, the revenues raised by the State will be sufficient to meet expenditures (excluding debt service costs). This is a key metric in assessing the underlying sustainability of Ireland's public finances. It is a necessary first step towards lowering our debt levels and freeing up expenditure for uses other than debt servicing.

Consolidation Effort

To reduce the fiscal deficits, successive Irish Governments have undertaken a range of revenue and expenditure measures. Table 1 shows how expenditure has evolved since 2007 across a number of key categories. There has been a reduction in aggregate public expenditure of some €10.2 billion since it peaked in 2009.

Looking at the detail in the table it is clear that there have been significant reductions in the public service pay bill. The gross pay bill has been reduced from a peak of €17.5 billion in 2009 to just over €14.5 billion in 2014. This has been achieved through a series of reductions in pay rates and in the number of people working in the public service. The net cost to the Exchequer was lowered by nearly a further billion euro a year from the introduction of the Pension Related Deduction in 2009. In overall terms, the number working in the public service has decreased from just over 320,000 in 2008 to less than 290,000 by end-2014.

While measures have been introduced to control expenditure on Social Welfare, it is worth noting the expenditure on the Live Register is more than twice what it was before the economic crisis. Furthermore, the allocation in 2014 for other Social Welfare schemes is €2.2 billion greater than it was in 2007. Decisions in this area have had to take into account cost pressures due to an aging population and costs associated with the very large increase in the number of people on the live register.

Similarly, in Health and Education the 2014 non-pay allocations are greater than they were in 2007. Budgetary decisions in both of these areas have also had to take account of significant increases in demand for services. For instance, over last number of years the number of medical cards has increased by about 600,000 to 1.87 million and the number of students at primary and secondary school has increased by about 75,000 to 889,269.

Table 1 – Evolution in Expenditure by category, 2007-2014

Government Expenditure, 2007-2014 (€ billions)

	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Pay	16.6	17.2	17.5	16.0	15.6	15.3	15.1	14.5
Pensions	1.5	2.1	2.6	2.7	2.8	3.1	3.0	2.9
SW - Live Register	1.4	2.1	3.7	4.1	3.9	3.6	3.7	3.3
SW – Other	13.8	15.4	16.5	16.5	16.8	16.6	16.2	16.0
Other Programmes	15.3	16.6	15.5	14.9	13.8	13.3	13.2	12.9
(of which) Health non-pay	*6.4*	*6.9*	*7.1*	*6.9*	*6.9*	*6.7*	*6.6*	*6.6*
Education non-pay	*1.9*	*2.0*	*1.9*	*2.1*	*1.8*	*2.0*	*2.0*	*2.0*
Other	*7.0*	*7.7*	*6.5*	*5.9*	*5.1*	*4.6*	*4.6*	*4.3*
Gross Current Expenditure	**48.6**	**53.4**	**55.8**	**54.2**	**52.9**	**51.9**	**51.2**	**49.6**
Gross Capital Expenditure	**7.8**	**9.0**	**7.3**	**6.4**	**4.5**	**4.0**	**3.4**	**3.3**
Gross Total Expenditure	***56.4***	***62.4***	***63.1***	***60.6***	***57.4***	***55.9***	***54.6***	***52.9***

Source: Dept. Public Expenditure and Reform. Figures on an Exchequer cash basis and do not correspond directly to general government expenditure volumes.

The largest nominal reduction in expenditure has been on capital investment, which has decreased from a peak of €9 billion in 2008 to €3.3 billion in 2014. However, over the course of the past two decades there has been significant infrastructural investment and upgrading throughout the country. Perhaps the most visible and beneficial legacy is the national motorway network. The investment of €6.6 billion in this area has significantly reduced journey times, accidents and vehicle maintenance costs. Further substantial benefits have also accrued from investment into water and wastewater infrastructure (€6.4 billion) and in primary, secondary and tertiary education infrastructure (€4.8 billion).

It is clear then that expenditure on capital and public service pay have borne the brunt of the consolidation efforts to reduce public expenditure. However, this is not to ignore the impact on citizens of the various measures that have had to be introduced just to keep expenditure on Social Welfare, Health and Education more or less standing still. Furthermore, as the economic position improves, an increase in employment will be associated with a decrease in unemployment which will contribute to a reduction in the costs associated with the Live Register. This will be critical in further reducing the fiscal deficit.

Sustaining Social Cohesion

Almost a third of public expenditure is targeted at helping people and protecting families, and this safety net has been mostly maintained throughout the consolidation period. While it is the case that the economic crisis has meant that people are more likely to find themselves at risk of poverty, evidence published by the CSO shows that social transfers and pensions play a central role in reducing the "risk of poverty" from just over 50% before transfers to just over 15% after transfers (This 35 percentage point reduction is notably larger than the EU average of 27 percentage points).

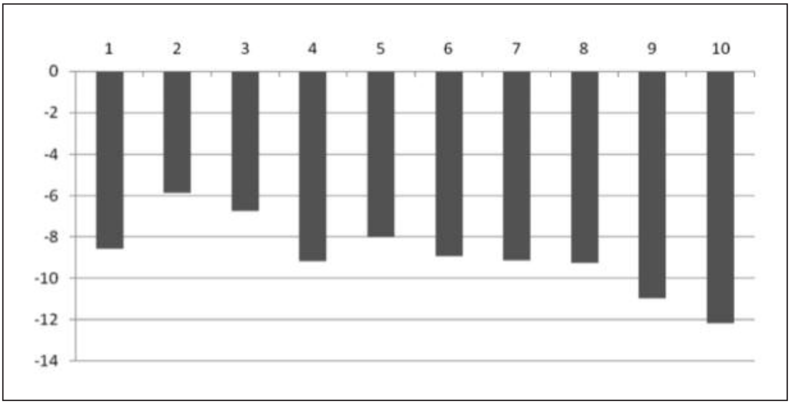
In terms of equality, Ireland has maintained a gini coefficient[16] (based on Household Budget Survey data) of 0.31. This compares favourably with international benchmarks.

Figure 6 sets out the change in equivalised disposable incomes resulting from budgetary decisions. The evidence suggests that those on higher incomes have seen a greater reduction in equivalised disposable income when compared against those on lower incomes. Those who earn most have faced the largest reductions in their equivalised disposable incomes of at least 11%. People who earn least have faced lower reductions of about 6%. A key factor in the lower losses for deciles 2 and 3 is the decision to hold pension rates constant. However, there are a number of breaks in this pattern as the equivalised disposable incomes of those in the lowest and fourth deciles have been reduced by percentages greater than those in an adjacent higher decile. For instance, equivalised disposable incomes in the lowest decile fell by over 8%. This decrease is associated with a combination

[16] The Gini-coefficient is a measure of income dispersion which ranges from 0 to 1, with 0 representing maximum equality and 1 being complete inequality (i.e. one individual holding all income).

of indirect tax increases as well as reductions in particular welfare payment rates for those of working age and reductions in Child Benefit rates.

Figure 6 – Impact of income tax, welfare and public service pay policy changes, 2008-2013 (% change by decile of equivalised disposable income)



Source: Callan et al 2013: 19

Debating the Future – Selected Challenges

The challenges that Ireland faces are contested, that is, they require broad public dialogue to address their implications for Irish policy and to determine their impact on the Irish society more generally. However, these challenges, and others, will remain as there is no end point at which people will be able to say ‘we have arrived’. Instead, there is a need for on-going public debate and discussion about how best to address any and all challenges faced by Ireland.

Living with Constraints of new Fiscal Rules

The reformed Stability and Growth Pact (SGP), including the so-called ‘six-pack’ and ‘two-pack’, introduced significant changes to the way in which EU Member States manage public resources.[17]

17 This reform was complemented by the *Treaty on Stability Coordination and Governance in the EMU* (‘Fiscal Compact’) which was ratified in Ireland by referendum in 2012.

Ireland will remain under the Excessive Deficit Procedure (EDP), or 'corrective arm', of the Stability and Growth Pact until the deficit falls below 3% of GDP.

Once the excessive deficit has been corrected, Ireland will then be subject to the 'preventative arm' of the Stability and Growth Pact. It will be necessary to make progress towards achieving our Medium Term Objective (MTO). Our MTO requires a balanced budget once allowance is made for one-off temporary factors, and the impact of the economic cycle on the public finances.

In Ireland, the new EU rules have been placed on a statutory footing by means of the *Fiscal Responsibility Act 2012 and 2013* and the *Ministers and Secretaries (Amendment) Act 2013*.

The *Fiscal Responsibility Act 2012 and 2013* imposes a duty on the Government to ensure compliance with the budgetary rule and the debt rule, which are provided for in the Act. The budgetary rule requires that the budgetary position of general government must be either:

- In balance or in surplus and this will be satisfied if the annual structural balance is at the medium-term budgetary objective (MTO); or

- If it is not at the MTO target, on the adjustment path toward adhering to the MTO as set in accordance with the Stability and Growth Pact.[18]

These rules also constrain public expenditure because each Government in the Eurozone is now bound by the 'expenditure benchmark'. The application of the expenditure benchmark requires the Government to set multi-annual upper limits on General Government expenditure.

This is the context in which Ireland must set three-year 'Government Expenditure Ceiling' – equivalent to total gross voted expenditure. In Budget 2014, the Government Expenditure Ceiling for 2014 will be €52.9 billion and at €51.5 billion and €51.9 billion for 2015 and 2016, respectively.

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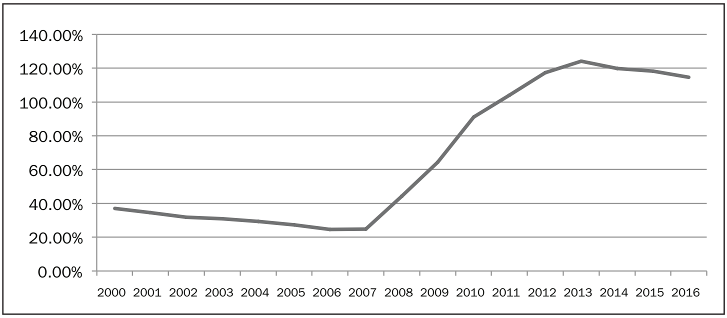
[18] If there is a failure to comply with the budgetary rule and there is a significant deviation from the MTO or the adjustment path, then the Government will be required to implement the correction mechanism and introduce a plan to restore compliance. Only in the event of exceptional circumstances, as defined under the SGP, might this rule not apply.

Following on from this, the Ministers and Secretaries (Amendment) Act 2013 provides that the Government Expenditure Ceiling shall be apportioned into individual Ministerial Expenditure Ceilings for the next three financial years. Three year Ministerial Expenditure Ceilings were published in the *Expenditure Report 2014*.

Over the period of the economic crisis, Ireland's debt increased significantly, both in nominal terms and as a proportion of national output. For 2013, the forecast ratio of gross general government debt to GDP is 124% having stood at just 25% in 2006. The increase in the Debt-to-GDP ratio has been due to a combination of factors including support for the financial sector, a contraction in GDP (which pushes up the ratio) and persistent primary deficits since 2008. The sharp increase in the stock of debt since 2007 has resulted in an increased cost of servicing the debt – from 2.7% of revenue in 2007 to 10.9% in 2012. While this is high, it is still lower than in the 1980s.

A key Government priority is to reduce the debt and the first step in doing so is to reduce the amount being borrowed and then to cease borrowing, particularly for day-to-day expenditure.[19] In terms of progress toward this goal, as noted earlier, Ireland is expected to record a small primary surplus in 2014 for the first time since 2007. This means that the revenues raised by the State are sufficient to meet expenditures (excluding debt service costs).

Figure 7 – General Government Debt as % GDP



Source: Dept. of Finance

19 It should also be noted that one reason for the high gross debt ratio is the policy decision to ensure that the Irish State is well funded as it leaves the EU/IMF Programme. In the coming years, the NTMA will run down the level of the State's cash reserves to significantly lower but still prudent levels. Gross general government debt is expected to fall to 120% of GDP in 2014 and to continue to decline to just under 115% of GDP by 2016.

Managing Our Expenditure Effectively

An on-going challenge is to ensure that the resources available are used efficiently to deliver effective public services to citizens and to address unemployment. Over the last number of years, a series of reforms have been introduced to reform our budgetary architecture. While some of these changes are a consequence of the new EU rules, others build on the Government's determination to ensure sustainable public expenditure. In addition to the EU fiscal rules outlined above, the key elements of the Public Expenditure Framework are:

- *Spending Reviews* – in 2014 there will be spending reviews of both current and capital expenditure. These will involve a line-by-line examination of expenditure and will allow the Government to recalibrate Ministerial Expenditure Ceilings in light of changing priorities and evaluations of expenditure;

- *On-going evaluation* – a number of processes are in place to develop evaluations of public expenditure (Value for Money & Policy Reviews and Focussed Policy Assessments) and the establishment of the Irish Government Economic and Evaluation Service has increased the capacity for carrying out such evaluations. Both of these resources will contribute to next year's spending reviews and continue to inform budgetary decisions on an annual basis; and

- *Performance Information* - the aim is to strengthen the focus upon what is being delivered with public resources and to build this information into the policy-making process. (The Government has decided to extend the public service performance information website *Ireland Stat* to all Departments and at present a data collection process is underway.)

Together these elements constitute a framework that concentrates attention on whether or not the limited public resources available to the Government are being used in an efficient manner to deliver effective public services to the citizens.

The Department of Public Expenditure & Reform is engaged in examining and developing new and better ways of delivering public services to both improve services and reduce costs. Over the last year significant progress has been made on the implementation of the Government's *Public Service Reform Plan* and by means of the *Haddington Road Agreement*.

In delivering public services, we must identify new ways of delivering better, higher quality public services. For instance, what can Ireland learn from other countries and their experiences with new ways of designing public services, such as, from the application of behavioural insights. In *Budget 2014,* the Government announced the piloting of two Social Impact Investing projects. These projects will support outcome focussed public services.

It is also worth noting that there has been an increasing role for private and non-governmental actors in public service provision. Central to such approaches is the concept of competition through the creation of 'quasi-markets' for public services. However, this shift in the supply of public services is the subject of on-going debate. In the UK, the evidence suggests that contracting private providers has worked well in simpler and transaction based policy areas but in more complex policy areas, such as health and education, the impact is less clear (Gash *et al*, 2013: 11). In Ireland, private and voluntary actors already play an important role in public service delivery in Ireland. The challenge is to ensure that specific public services are provided through the most appropriate and accountable means in a manner that is not only cost-effective but also optimises quality and performance.

Promoting Economic Growth

Over the next few years, the Irish economy needs to grow both to generate employment and reduce the burden of General Government debt. The Department of Finance and the Department of Public Expenditure & Reform are drawing up a medium-term economic strategy (MTES) to cover the period 2014 to 2020. The purpose of the MTES is to provide the framework for the macroeconomic, fiscal and structural policies which will support sustainable economic and employment growth in the period 2014-2020.

Innovation and productivity gains are important in sustaining economic growth and to attracting investment from innovative and export oriented companies. A key challenge is to ensure that Ireland's workforce not only maintains its high levels of productivity but becomes more productive. The productivity of the Irish workforce has been an important element in attracting international investment. Productivity growth in Ireland has averaged around 2½% per annum since the early 1990s.

A key driver of innovation and productivity is competition. Competition encourages firms to reduce costs and to invest in the development of new products and production methods. While it will be important that the traded sector remains competitive, perhaps the key challenge over the next few years is to increase competition in the non-traded sectors. This is especially so in those sheltered sectors, such as utilities, health, education and legal services, that contribute to costs in the traded sector. In these sectors there needs to be incentives in place to drive cost-efficiencies and the adoption of more innovative solutions to providing services.

Since the 1980s, Ireland's infrastructural capacity has been recognised as a critical input to productivity and competitiveness. The availability of competitively priced and high quality infrastructure is a necessary ingredient to ensuring that the traded sector can compete on global markets. Ireland has invested large volumes of resources in infrastructure over the last decade or so. The challenge now is to ensure that the gains made in recent years are maintained and to identify and develop new investment projects that will further enhance the capacity of the economy to trade internationally. The Department of Public Expenditure & Reform will be reviewing Ireland's capital investment plan over the course of 2014. A related challenge is to try and develop innovative methods to encourage private investment in infrastructural projects that will benefit society.

Ireland's education system plays the most crucial role in supporting economic growth. The challenge that Ireland faces is to ensure that high quality education is being provided at all levels of the education system, including pre-school. The focus of the education system should not just be on those who will graduate next year or by 2020 but on those who will be graduating in 20 years' time. The education system must ensure that our young people have the requisite skills. To achieve this, Ireland needs to discuss how to collect relevant performance information that will best inform curriculum development and ensure that children are developing the necessary skills. In addition, we need to look at countries and assess their successful policies. Many countries have introduced more robust performance and evaluation cultures affecting teachers and schools.

While the comments here have been confined to the education sector, the reality is that this approach needs to be extended to the provision of all public services.

Labour Market

High unemployment is the main challenge we face. Growing the Irish economy is a necessary condition to increase employment. Recent data suggests that Ireland has reached a turning point in the labour market. Employment growth of 1.6% is projected for 2013 as a whole and this is reflected in an increase in both full-time and part-time employment across the majority of sectors in the economy. Furthermore, unemployment over the course of 2013 and September's standardised unemployment rate of 13.3% is the lowest in three and a half years. The available evidence also suggests that long-term unemployment has stabilised. While the long-term unemployed still account for the majority of those on the live register this share has fallen from 62% in Q2 2012 to 58% in Q2 2013. The problem of long-term unemployment is particularly acute for those who previously worked in the 'Craft and Related Occupations' (account for about 20% of the Live Register).

The Government has introduced a number of labour market measures as part of their *Action Plan for Jobs 2013* and the *Pathways to Work* initiatives. To deliver on *Pathways to Work*, in 2014, the Government has allocated €1.6 billion and this activation programme will provide nearly 300,000 places. *JobPath* is part of the Government's commitment to the long term unemployed and, when introduced in 2014, will mark a step change in the intensity of engagement with the long term unemployed.

The Demographic Challenge

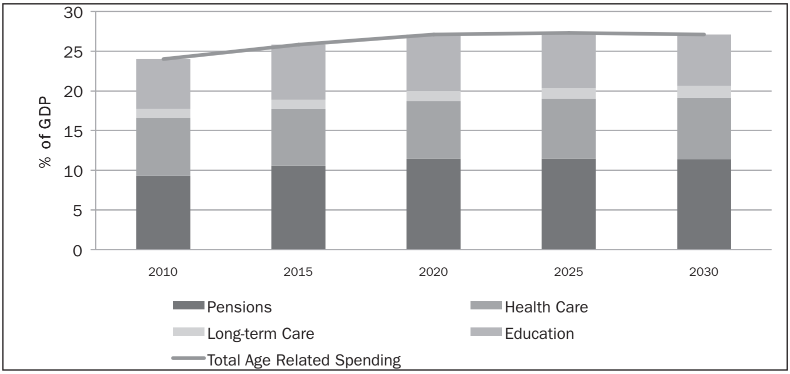
Ireland needs to discuss how to deal with issues that might not necessarily pose a specific challenge today but that will result in significant demands on public services in the medium-term. One such challenge is Ireland's changing demographic profile. The European Commission forecasts that the population of Ireland will continue to grow, increasing to 6.5 million by 2050[20]. The forecasts also suggest that the demographic profile of the Irish population will increasingly get older. The European Commission forecasts to 2060 project a decrease in the working age population of 7% from the 2010 base period, and an increase in the elderly population of 10% over the same period. This presents a significant challenge to the Exchequer in respect of its revenue base. As the proportion of the elderly increases and the working-age population shrinks, the revenue base of the State reduces just as demand for public services and pension income increases. A recent study for the Department of Social Protection highlighted major concerns about the long-term sustainability of current welfare policies.

On the other hand, there is an increasing number of young people. Today over 20% of Irish people are under the age of 14 years. The European Commission forecasts that this will remain the case at least until 2025. As this cohort age and enter the workforce they will increase the tax base and growth potential of the economy. However, in the next few years, the increasing numbers of young people will involve financial and service pressures on public services, particularly the education system and the costs associated with providing child benefit.

The changing demographic profile is expected to place significant demands on the available public resources (See Figure 8). In particular, an ageing population is likely to place significant demands on the resources allocated to provide health care services. The OECD (1987) assumes that the costs associated with people aged 65 years or older are four times those associated with younger people. Demand for expensive long-term care is influenced by the age profile of the population and the proportion of the population in each age group with a disability. This suggests that, as Ireland's demographic profile ages, the cost of long-term care will increase, especially given the labour intensive nature of caring services. At a fundamental level we must decide how this infrastructure will be provided and funded.

20 European Commission, (2012), 'The 2012 Ageing Report Economic and budgetary projections for the 27 EU Member States (2010-2060)', European Economy 2/2012.

Figure 8 – Age Related Expenditure



Source: Ageing Report 2012

A Small Open Economy in the Eurozone

Since the late 1950s a key platform of Ireland's economic policy has to been its openness to international trade and investment. This openness as well as the small size of the economy, has meant that Ireland is been especially vulnerable to the impacts of changes in the international economic environment.

In the global economy, capital and labour have become more mobile. Countries compete with one another to attract international investment. The FDI sector has been of immense importance in Ireland accounting for a very large proportion of external trade as well as employment. It is crucial that the Irish economy stays competitive. The challenges Ireland faces is to not only maintain but grow the levels of investment and to ensure that this investment leads to growth in jobs. However, this also means that Ireland remains vulnerable to external risks and we need to manage macroeconomic policy to help us cope with these.

Energy Security and Climate Change

Irelands total energy consumption in 2011 was 11,154 ktoe, 54% above the 1990 level of 7,249 ktoe. However, Ireland lacks significant oil and gas resources and is heavily reliant on energy imports. Ireland's energy import dependency grew significantly over the 1990s and 2000s due to an increase in energy use and a decline in indigenous natural gas and peat production and is notably higher than many other EU Member States. As the economy grows, so too will Ireland's energy consumption. Despite increasing levels of electricity produced from renewable sources, over the medium term the Irish economy will remain particularly exposed to changes in supply and price in international markets. The security of energy supply is a vital consideration for Ireland in coming years.

The future also poses challenges about which it is difficult to be sure about the impacts for Ireland. For instance, the warnings about climate change are becoming clearer. Irish society needs to discuss what it can do to mitigate the associated risks. However, it is difficult to have such a discussion when there is uncertainty about the likely impacts. Climate change may have several consequences for Ireland. First a warming climate is likely to alter Ireland's weather patterns, increasing the likelihood and frequency of extreme weather events such as flooding and droughts. Such weather events would put greater pressure on the national strategic infrastructure, requiring increased investment in the repair, replenishment and climate proofing of roads, railways and the electricity and water networks. In the agricultural sector, while a warmer average annual temperature is likely to benefit the growing season, more frequent extreme weather events could reduce output and increase the costs of farming.

Secondly, the cost of meeting Ireland's Greenhouse Gas Emissions' and related targets for 2020 and any such subsequent future targets will entail additional costs for both the public and private sectors. Reducing emissions from the Agriculture sector in particular is a significant challenge as this sector contributes over 30% of national GHG emissions[21] with a large share of these emissions coming from agricultural livestock where there is limited availability of cost effective mitigation options.

It is also worth noting that Ireland also faces the challenge of fulfilling its commitment, as a Party to the UNFCCC, to the developed country goal of mobilising jointly, by 2020, US $100bn in annual financial flows, from a variety of sources (public, private, innovative, alternative), in order to assist with adaptation/mitigation to climate change impacts in developing countries.

21 http://www.epa.ie/pubs/reports/air/airemissions/Ire_GHG_Emissions_1990_2012_handout.pdf

Concluding Remarks

Ireland faces many challenges and how these challenges are addressed should be the subject of broad, open public debate. These debates need to be evidence based.

There are very immediate challenges in terms of repairing Ireland's fiscal position but the effort does not simply end with returning to a balanced budget. Instead, debate about what services the State should provide to citizens must take place within the boundaries set by our membership of the euro area.

The level of resources that Ireland will have available to it to provide services will be largely dependent on how well the Irish economy is managed. When society discusses the types of public services that are provided it needs also to focus on how the available resources are used in the most efficient manner possible to provide effective public services for citizens. Furthermore, such debates should include new thinking about the way in which specific types of services are delivered and what Ireland can learn from the experience of other countries.

Reducing unemployment will require a return to growth and the right activation and labour market policies.

To some extent Ireland has some control over how these challenges are addressed as ultimately they are reliant on a willingness to change to make Ireland a better place to live.

While all involved in discussing how to build 'a future worth living for' are ambitious for Ireland and the Irish people, the debate itself must not lose sight of the various challenges that Ireland faces. It is also important to note that despite the conference theme, there is no end point at which we can say we have arrived at 'a future worth living for' but instead acknowledge that our aim as a people is one of continuing and sustainable progress so that tomorrow can be better than today.

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