



An Chomhairle Náisiúnta Eacnamaíoch agus Shóisialta
National Economic & Social Council

Ireland's Five-Part Crisis, Five Years On: Deepening Reform and Institutional Innovation

No. 135 October 2013

National Economic and Social Council

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2. The Council may consider such matters either on its own initiative or at the request of the Government.
3. Any reports which the Council may produce shall be submitted to the Government, and shall be laid before each House of the Oireachtas and published.
4. The membership of the Council shall comprise a Chairperson appointed by the Government in consultation with the interests represented on the Council, and
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 - Four persons nominated by the Irish Congress of Trade Unions;
 - Four persons nominated by community and voluntary organisations;
 - Four persons nominated by environment organisations;
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8. The Council shall regulate its own procedure.



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Abbreviations

APJ Action Plan for Jobs	DOF Department of Finance	GEG Green Economy Group
CRD IV the fourth Capital Requirements Directive	DWS Developmental Welfare State	GNP Gross National Product
CRO Credit Review Office	EI Enterprise Ireland	ICT Information and Communications Technology
CSO Central Statistics Office	EIB European Investment Bank	IFAC Irish Fiscal Advisory Council
DAFF Department of Agriculture, Fisheries and Food	EPA Environmental Protection Agency	IFSC International Financial Services Centre
DAFM Department of Agriculture, Food and the Marine	ESM European Stability Mechanism	IMF International Monetary Fund
DAHG Department of Arts, Heritage and the Gaeltacht	ETBs Education and Training Boards	ISI Insolvency Service of Ireland
DCENR Department of Communications, Energy and Natural Resources	EU European Union	ISIF Ireland Strategic Investment Fund
DECLG Department of the Environment, Community and Local Government	EVs Electric Vehicles	LEOs Local Enterprise Offices
DJEI Department of Jobs, Enterprise and Innovation	FDI Foreign Direct Investment	LTU Long-term Unemployed
	FET Further Education and Training	MNC Multi-National Corporation
	FTE Full-Time Equivalents	MTES Medium-Term Economic Strategy
	GDP Gross Domestic Product	

NERI

Nevin Economic
Research Institute

NGOs

Non-Governmental
Organisations

NPRF

National Pensions
Reserve Fund

NTMA

National Treasury
Management Agency

OECD

Organisation for
Economic Co-
operation and
Development

OPFP

One Parent Family
Payment

R&D

Research and
Development

RSES

Regional Spatial and
Economic Strategies

SFI

Science Foundation
Ireland

SGP

Stability and Growth
Pact

SME

Small and Medium
Enterprise

UNFCCC

United Nations
Framework
Convention on
Climate Change (also
referred to in shorter
form FCCC)

USC

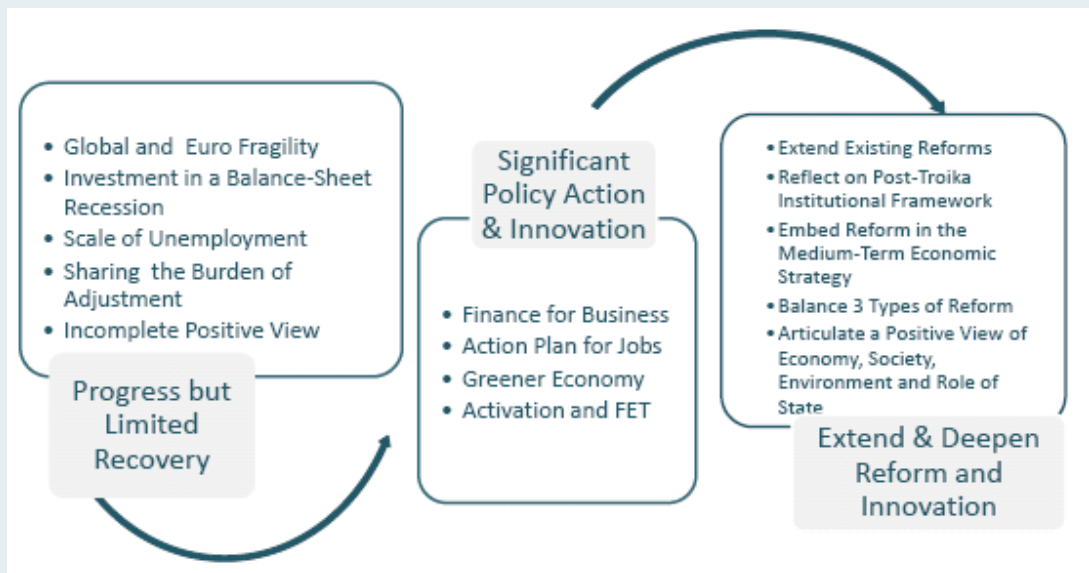
Universal Social
Charge

VECs

Vocational Education
Committees

In 2009 NESC published two reports on Ireland's Five Part Crisis. It highlighted the need to move from partial and sequential responses to a more integrated approach and identified the characteristics of an effective Irish response. This report examines Ireland's five-part crisis five years on.

Structure of the Report



Progress But Limited Recovery

There is now a significantly more integrated government response and strategy. Important progress has been achieved on several fronts:

- Budgetary adjustments of €26bn (16% of GDP) have repaired the country's reputation.

- There has been a significant recovery of cost competitiveness, an improvement in export growth (since 2010) and GDP growth (from 2011) and FDI has been sustained.
- The rate at which mortgages are falling into arrears is declining, even though the numbers are very significant.
- Positive indicators for 2013: improvements in consumer spending, investment, full-time employment, yields on Government bonds and exchequer returns.

However, international and domestic factors qualify progress and future prospects:

- **Global economy:** a sustainable global recovery is not yet firmly established.
- **Euro area:** remains vulnerable to renewed financial, banking and sovereign debt tensions and does not provide a consistent combination of macroeconomic, distributional and structural measures.
- **Investment:** the balance-sheet nature of the recession is acting as a drag on investment: Irish households and businesses invest half the euro area average.
- **Unemployment:** several years of stronger employment growth are needed if full employment is to be achieved and if net migration is to be reduced.
- **Social dimensions:** two complex sets of problems confront policy in the decade ahead and will require both targeted action and reform of mainstream services:
 - *Long-standing disadvantage:* during the boom Ireland did not achieve a sufficient increase in participation, equality of opportunity, or an adequate reduction in relative poverty and deprivation. Thus, those who were least well off prior to the economic crisis remain so.
 - *Reversal:* Many families and individuals have suffered a very significant reversal in their income, assets and fortunes as a result of the crisis.
- **Incomplete positive perspective:** In seeking a path through the crisis we do not yet have a persuasive positive perspective on the future of Irish society, economy, environment and state.

Overall, the crisis has revealed that past progress was less comprehensive and less sustainable than believed: we did not adequately address non-participation and disadvantage in the boom; our relationship to the international system has been revealed as more one of vulnerability and dependence than we thought; and, our overall system of collective decision-making and public governance has been shown to be extremely weak.

Significant Policy Action and Institutional Innovation

As part of the more integrated response to the crisis there is significant policy action and institutional innovation. In this report, the Council focused on four areas—banking and finance, enterprise policy, greening the economy and activation. It found that there have been a number of positive developments and important, but not widely noted, institutional and process innovation. These include:

- **In banking:** bank re-structuring, solvency arrangements and financing initiatives such as the Irish Strategic Investment Fund (ISIF), which could be viewed as a further step towards a formal state business or investment bank.
- **In enterprise policy:** the Action Plan for Jobs (APJ) which includes a dynamic implementation, monitoring and evaluation process.
- **In greening the economy:** the EPA State of the Environment reporting and acceptance that the challenge is how to get beyond policy and legislative ambition towards practical ways of integrating environment into mainstream economic and social policy.
- **In activation:** legislation, new structures linking welfare with supportive services and an activation service model, set out in the Government strategy *Pathways to Work*.

Extend Existing Reform in the Four Selected Areas

There is a need and important opportunity now to advance Ireland’s reform agenda in these four selected areas, and others.

Banking and Investment

- The focus of Irish policy on investment is important and the Council strongly endorses the establishment and use of the ISIF as a vehicle for national and sectoral development.
- Institutional developments underway—to develop long-term competitive forms of financing, including a state business-development bank—should be seen as steps towards a financial system that serves the real economy.
- Ongoing dialogue about the changing nature of financial regulation is needed.

Enterprise Policy

- The APJ process needs to animate and mobilise industry and agencies of the State to jointly explore issues which are more open-ended, complex, possibly contested or potentially knotty, but which if resolved could have significant potential, such as the development of an indigenous anaerobic digestion industry.
- The enterprise-policy process needs to be more open to innovation, ideas from outside business and beyond ideas that business can identify at a given moment.
- Following the OECD's recent critical assessment a more probing examination of the role of innovation policy and the innovation system is needed.

Greening the Economy

- All policy stakeholders must reflect and grapple with the problem and opportunity of integrating environmental concerns into core policy: making progress requires that trade-offs are analysed and addressed effectively.
- The ability to capture the full potential of the green economy would be enhanced by further developing an Ireland-specific cleantech 'green' enterprise strategy.
- It is important to explore ways in which green economy development can most support employment and local economic development.

Activation and Further Education and Training

- There is a need to build capacity and quality-assurance systems to provide activation supports that make a difference to unemployed people and those seeking employment.
- Case managers need extensive knowledge of the social welfare system, employment opportunities, education and training, work programmes and how to provide guidance to people with a varied range of skills and qualifications.
- A strategic review of further education and training (FET) is underway, in which the NESC Secretariat is playing a part. This should improve the provision of FET to unemployed people and address the skills mismatch in the labour force.

Post-Troika and the Medium-Term Economic Strategy

Credit for the achievement of a more integrated response to the five-part crisis should be shared between the Troika and the Irish Government. Earlier Irish high-level strategies and reform proposals often had less traction. This underlines the importance of current initiatives, such as the formulation of a new Medium-Term Economic Strategy (MTES), and the need for further work on the strategic and institutional arrangements that will operate once Ireland leaves the Programme, and intense monitoring by the Troika no longer applies.

The Council strongly supports the need for a fiscal framework that enhances stability, prevents excessive debt and supports growth; indeed, it believes that such a framework can facilitate policy experimentation by providing reassurance that expenditure on innovative initiatives is not part of a general loss of fiscal discipline or accountability.

Balance and Integrate Three Kinds of Reform

Reflection on, and reform of, the evolving processes of policy-making, monitoring, delivery and review needs to go further and be more encompassing. For example, in each of the four areas described in this report, it is worth asking: how is the reporting of *actions* or *outputs* combined with measurement of *outcomes* for citizens and firms? What process is initiated to grapple with knotty, cross-cutting, contentious and ambiguous issues?

To advance reform there is a need to balance and integrate three different types of reform:

- a) **Fiscal-driven reform:** reflecting the need for fiscal consolidation and discipline (e.g. pay adjustments, tax, shared services, rationalisation, some privatisation, budget process);
- b) **Substantive reform:** needed to underpin future prosperity, high participation and social cohesion (enterprise/MTES, activation, education, skill development, care, etc.);
- c) **System-oriented reform:** creation of the systems of strategy and policy-making, standards, autonomy and accountability necessary for the delivery of high-quality services, continuous improvement and policy adaptation.

Balancing and linking these three kinds of reform will involve some widening of the way in which the reform agenda is often discussed. The central public-sector reform agenda might be fertilised, and maybe even reconfigured, by learning from the achievements and problems in enterprise policy, banking and finance, environmental policy, activation, eldercare, education, disability, policing, end-of-

life care and homecare. A range of Irish public-sector organisations—in areas such as industrial policy, environmental protection, children’s services, food safety, and others—demonstrate the combination of innovation, quality and accountability that government is committed to achieving more widely.

The MTES and the major reform agendas listed above, offer an opportunity to balance these trajectories of reform. The central challenge is to both increase innovation and accountability at the front line and build a supportive centre capable of spreading best practice, and leading policy review and learning.

Positive Perspective on Future of Irish Society

Ireland’s path through the crisis, and the successful central design and delivery of a major public-sector reform agenda, requires to be informed by a more clearly-articulated positive perspective on the future of the Irish economy, society, environment and state.

In key areas of policy there is a risk of divergent articulations of Ireland’s challenges and the purpose of public policy: enterprise policy as an aid to individual entrepreneurs, welfare as a defence of passive transfers and existing services, environmental policy as conservation of nature against economic activity. This approach, drawing on and emphasising divergent worldviews and interests, closes off the search for practical innovations or new thinking that can generate more positive outcomes and, indeed, redefinition of interests.

NESC seeks to articulate a more unified developmental perspective on the future of Ireland’s economy, society and environment. In each of these spheres, the role of the State should be to enable upgrading and transformation in the ‘private’ sphere—whether firms, households or associations. Drawing on earlier thinking by the Council and others, this can be summarised as follows:



This is a more unified developmental perspective, *within which* inevitable conflicts can be resolved. It would allow the reform agenda to be built around understandable economic and social projects—such as business development, learning, activation, agri-food, care—seen as framework goals. It could enlist a wide range of stakeholders to the mission of creating services and interventions that are customised, bundled and continuously revised. It could explain the higher-level public transformation and reform agenda as aimed at creating, at the centre, national policy processes, organisations and information systems to support front-line quality, accountability and responsiveness. It reflects a clear view on the role of the state in enabling a competitive, dynamic, high-employment, sustainable economy and a cohesive society. Relying on standard precepts of public sector modernization—such as ‘joined-up government’, ‘leadership’ and ‘evidence-based policy’, it will be impossible to communicate the purpose and thrust of the reform agenda.

This perspective is positive in that it builds on the existing strengths of parts of the Irish public system. It is practical in that it does not set impossible hurdles (derived from Silicon Valley, on the one hand, or Scandinavia, on the other) for Irish policy to jump, or ideal ‘models’ that Ireland might aspire to. It is urgent, because the success of the fiscal correction and public-reform agenda (in achieving the ultimate goals of sustainable prosperity and social inclusion) will depend on whether the public system we build now is in tune with the economic, technological and social realities that will prevail in the years ahead.

Overall, the journey from boom to bust, and the struggle to find a way through the consequent five-part crisis, has highlighted the fact that strategies and policies can only be provisional starting points; what is critical is good systems for monitoring success and failure and institutional arrangements capable of review, learning and policy adaptation. The Council wants both to draw attention to that feature of the current context and be a part of the necessary system of evidence gathering and review.

Chapter 1

Introduction

In late 2008 and early 2009, the Council identified five closely related, but distinct, dimensions of Ireland's crisis: banking, fiscal, economic, social and reputational. Drawing on its earlier analysis of, and engagement in, Ireland's periods of relative success and failure over the decades from 1960, it emphasised the need for a coherent integrated response.

In March 2009, the Council identified some characteristics of an effective Irish response and highlighted the challenge of moving from reaction to an integrated approach. The Council argued that an effective response to the five-part crisis result should have seven characteristics:

- Address all five dimensions of the crisis: banking and credit, fiscal, economic, social and reputational;
- Be based on social solidarity, seen as sharing the burden of adjustment fairly and yielding a fair economy and society in years to come;
- Involve a consistent combination of macroeconomic, distributional and structural measures;
- Be framed around a positive perspective on the future of Irish society;
- Combine high-level coherence with maximum engagement and local problem-solving;
- Take short-term measures that move us in the correct long-term direction; and,
- Have a sequence and timing that enhances these characteristics.

In its second report in October 2009, the Council—drawing on its analysis of major aspects of economic and social policy, such as the *Developmental Welfare* (NESC, 2005b)—emphasised the importance of combining public-sector and policy reform as an added characteristic of an effective response to the crisis:

- Public policy should combine retrenchment with reform.

At various points in this report we consider how the five-part crisis has evolved against these eight characteristics. Progress has been achieved, particularly in moving towards a more integrated response and in taking short-term measures that have long-term logic. However, the picture on the other characteristics is more

qualified and, as argued in Section 2.2, is contributing to the limited recovery of the Irish economy.

Council's Ongoing Work on the Crisis

In the period from 2010 to 2012, the Council's work on the crisis had a number of strands. One was in-depth analysis and discussion of the challenge of activation policy, reflecting its centrality in the overall response to the crisis and in a developmental welfare state (NESC, 2011a). A second was analysis of the euro and the EU dimensions of Ireland's experience and policy and institutional challenges (NESC, 2012a); (NESC, 2012b). A third was the continued search for practical ideas that could assist government in taking action on key challenges, such as employment, domestic demand and SME finance (NESC, 2011b); (NESC, 2012a). A fourth was work on standards that provided detailed examination of the systems of quality, standards and accountability in six areas of human services: the school system; disability services; residential care for older people; home care for older people; end-of-life care in hospitals; and policing. A fifth was periodic discussion of the overall economic and fiscal adjustment and the degree of convergence or divergence in perspectives.

In the current project, examining the five-part crisis after five years, the Council's approach, as usual, begins with an objective review of developments, since this is an indispensable base for analysis and discussion (Chapter 2). Thereafter, the interest is mainly in four selected areas of policy development and reform: banking and the provision of finance for business; enterprise policy; greening the economy; and activation policy. In these areas the Council explored both the substantive policy initiatives taken by government and the institutional and process reforms introduced. The analysis began inside a policy area and probed how it worked, taking account of the institutional arrangements in place and the roles played by non-state actors. The purpose of the analysis undertaken was threefold: to help those working in areas to identify scope for improvement; to identify possible further reforms in each area; and to prompt discussion on the wider public-sector reform agenda.

The focus of the analysis was the substantive policy initiatives and the institutional and process innovations in each of these four areas, and the relation between these two. This is represented graphically in Table 1.1.

In a comprehensive review of Ireland's crisis response and strategy, this table would include several further rows for policy areas in which there have been very significant substantive and institutional changes during the crisis years, notably budgetary policy and local development. Further rows might be added to capture some areas in which important developments have recently been initiated, particularly fiscal policy, investment and economic planning.

Table 1.1: A Focus on Substantive Policy Initiatives and Institutional Developments

Area of Reform	Substantive Policy Initiatives & Action	Institutional & Process Innovations
Banking, Finance & Debt		
Enterprise Policy		
Greening the Economy		
Activation Policy		

Ultimately, of course, the purpose is to add value by helping the policy system to identify possible further institutional and/or policy developments and generalisations that could enhance effectiveness—as illustrated in the third column in Table 1.2.

Table 1.2: Possible Further Institutional Developments and Generalisations

Area of Reform	Substantive Policy Initiatives & Action	Institutional & Process Innovations	Possible Further Institutional Developments & Generalisations
Banking, Finance & Debt			
Enterprise Policy			
Greening the Economy			
Activation Policy			

The Argument in Outline

This report examines Ireland's five-part crisis five years on. It considers progress that has been achieved, the challenges and limits to recovery and identifies some further possible developments.

There has been progress but limited recovery. Key developments include the correction in the public finances; resilience of exports, particularly services; and some improvement in competitiveness. However, progress is limited when looked at in terms of the recovery of growth, continuing weakness in domestic demand, particularly the low level of investment, and most notably in the scale of unemployment.

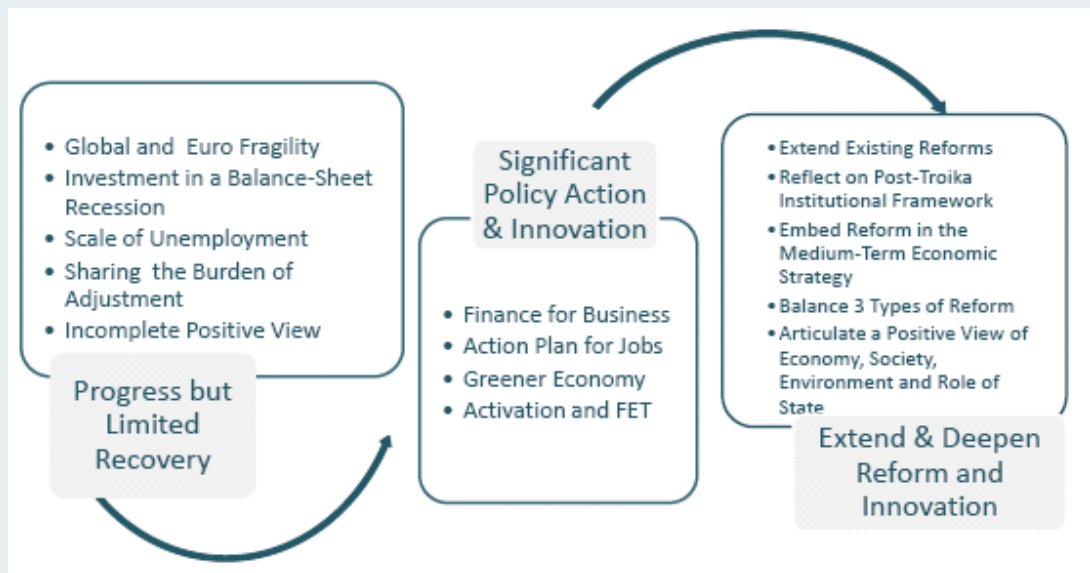
Limited progress reflects a number of international and domestic factors. These include European and global economic fragility; the balance-sheet nature of the recession and the collapse in investment; constraints on short-term action imposed by adherence to long-term logic or doctrines, particularly evident in the stance of European policy-makers; and an incomplete positive perspective on the future of Irish society. There are also continuing anxieties about whether the burden of adjustment is being fairly shared and consistent with the achievement of social cohesion in the years ahead.

There has been significant policy action, institutional innovation and reform. In the four policy areas examined by the Council in recent months—banking and finance, enterprise policy, greening the economy and activation—there have been significant positive developments. In these areas there has also been significant, but not widely noted, institutional and process innovation.

There is a need and important opportunity now to advance Ireland's reform agenda, in these four selected areas, and in others. The inquiry by NESC into the four areas, like the earlier work on standards in human services, suggests important ways that policy and institutions can be further developed. The report identifies important possible developments in each of the four areas, including: continued work on finding long-term competitive bank and non-bank forms of financing, including the role of a state-owned business-development bank; a more probing examination of the role of innovation policy and the innovation system; the potential for employment creation associated with further greening of the economy; and the need to ensure that capacity and quality-assurance systems exist to provide activation supports that make a material difference to those seeking employment.

There are also wider observations for the policy system and the relationship between the State and the economy, society and environment. The report prompts important questions for the wider policy system and, in the current context, the development of the Medium-Term Economic Strategy. These questions need to be considered as Ireland moves out of the Troika programme of financial support and the associated process of monitoring. Key to advancing the wider reform agenda is the development of a positive and unified perspective on Ireland's future and, drawing on this, a concerted effort to balance and integrate three different types of

reform. These are the reform agenda driven by the need for major fiscal consolidation and fiscal discipline; the substantive reform agenda needed to underpin future prosperity, high participation and social cohesion; and the need to create systems of policy-making autonomy and accountability necessary for the delivery of high-quality services, continuous improvement and policy adaptation



The Council's current work differs somewhat from that of earlier periods, reflecting a changed economic and policy context. Rather than seek a comprehensive substantive agreement on the direction of economic, social and environmental policy, it offers its analysis to support the monitoring and active review that is now essential in many policy areas. The journey from boom to bust, and the struggle to find a way through the consequent five-part crisis, has highlighted the fact that strategies and policies can only be provisional starting points; what is critical is good systems for monitoring success and failure and institutional arrangements capable of review, learning and policy adaption. The Council wants both to draw attention to that feature of the current context and be a part of the necessary system of evidence gathering and review.

Chapter 2

Progress but Limited Recovery

In 2009, NESC argued that the first characteristic of an effective response would be to address all five dimensions of the crisis: banking and credit, fiscal, economic, social and reputational. One of the central purposes of the Council's analysis in *Ireland's Five-Part Crisis: An Integrated National Response*, (NESC, 2009), was to highlight all five dimensions and to emphasise the need to move, as soon as possible, beyond a sequence of reactions to fast-moving banking and fiscal deterioration. This need to attend to all five dimensions applied not only to government, but was evident in the proposals of others, which tended to gloss over the economic crisis (as evidenced in Ireland's loss of competitiveness) and aspects of the social crisis. Indeed, the Council noted that, while government had no alternative to react quickly, other processes had tended to respond more slowly.

Reviewing the evolution of the response to the five-part crisis over the past five years, it must be acknowledged that there is now a significantly more integrated government response and strategy.

There has also been significant progress in framing short-term measures that have a long-term logic, at least in some major policy areas. In policy terms, the most prominent is the emphasis in the Troika programme on the reforms necessary to build a more active system of welfare linking income transfers with services that enhance people's capacities. In Chapter 3 we document policy and institutional developments in enterprise and innovation policy that, as well as seeking to restore competitiveness and business activity, aim to lay the foundations for long-term prosperity. There is some progress on integrating environmental and sustainability dimensions into core policy domains, which undoubtedly have a long-term logic. In terms of state action, the most striking policy and institutional developments reported in Chapter 3 are in banking and, particularly, initiatives to improve the provision of credit to SMEs. The evolving policies to recreate a functioning banking system have had to seek a balance between short-term repair of the banks in state ownership and the long-term creation of effective systems of finance for business and development.

There has been a sustained policy focus and action over several years on the fiscal, banking, economic, social and reputational dimensions of the crisis. Reviewing the evolving crisis five years on, it is clear that there has been significant progress on several of these fronts:

- In relation to public finances, major action has been taken. Since 2009, budgetary adjustments of around €26bn (16 per cent of GDP) have been implemented (Bergin *et al.*, 2013). The underlying deficit (i.e. excluding bank payments and receipts) has been reduced from €18.6bn in 2009 (11.5 per cent of

GDP) to €14.0bn (8.6 per cent of GDP) in 2012 (CSO, 2013a). The debt to GDP ratio is projected to peak in 2013.

- Ireland's success in adhering to the remarkably large fiscal adjustment set out in the programme with the Troika has undoubtedly done much to repair the country's reputation internationally.
- In relation to the economy, exports began to grow in 2010 and this underpinned growth of GDP from 2011. The strongest export growth in recent years has been in international services with average annual real growth of over 7 per cent between 2009 and 2012. A range of indicators show a recovery of cost competitiveness. Foreign direct investment (FDI) has been sustained and 2012 represented the highest level of net job creation in IDA-supported companies in a decade. The clearest indication of recovery is the expansion of employment with an increase of 1.0 per cent in non-agricultural employment in the year to the second quarter of 2013.
- There is evidence that the rate at which mortgages are falling into arrears is declining, even though the numbers are very significant, with 95,554 (12.3 per cent) of mortgage accounts for private dwellings over 90 days in arrears at the end of March 2013.

As the crisis has unfolded, the importance of naming the five parts and interdependence between them has been reinforced. While banking and reputation dominated the early response to the crisis, the full complexity of the interactions between the five dimensions of the crisis has now emerged more clearly. For example, it is now apparent that finding solutions to debt and mortgage arrears is a much greater societal, economic, banking and fiscal challenge than was apparent at the outset. Solutions must be found to address unsustainably high debt because of the profoundly negative impact on people and businesses; the continuing weakness of domestic demand (both consumption and investment); and concerns about bank solvency and capital requirements. In addition, the search for solutions to social, economic and banking problems must be achieved in such a way that the State is not further indebted. Finally, the fifth dimension of the crisis also needs to be acknowledged: failure to develop credible strategies for debt resolution will impact negatively on the reputation of the Irish State and the banks.

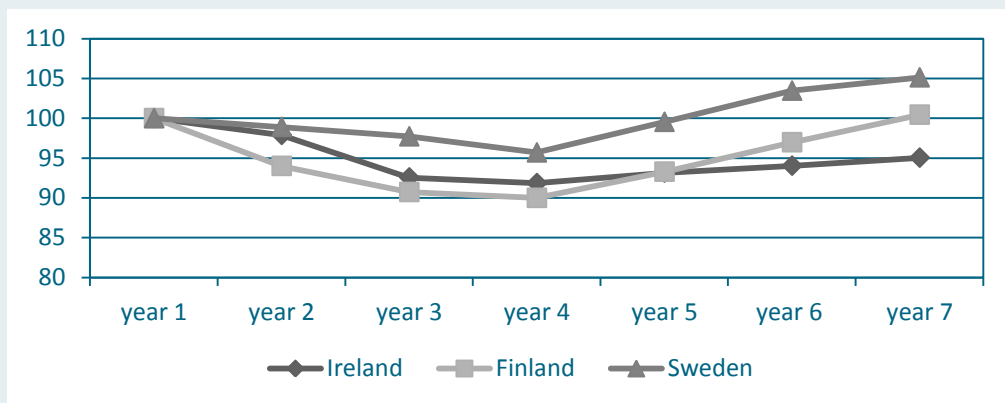
However, the undoubted progress towards a more integrated response has to be seen in context and is qualified in important respects, which we discuss in the next section.

2.1 Progress but Qualified in Important Respects

2.1.1 Ireland’s Recovery in Comparative Perspective

The limited nature of Ireland’s recovery can be illustrated by comparison to some other experiences of severe financial crises. Both Finland and Sweden experienced financial crises in the early 1990s that resulted in substantial falls in GDP. Figure 2.1 shows the path of GDP for Ireland starting with the peak year for GDP (2007) and continuing up to 2013. For Finland and Sweden the GDP series starts at 1990. It can be seen that Ireland’s initial recovery in terms of GDP is considerably weaker than the corresponding recoveries experienced by Finland and Sweden. Ireland has had a number of years of export recovery but Finland and Sweden had much stronger export growth following their crises. By this stage of economic recovery, Finland and Sweden had also experienced some expansion of domestic demand in contrast with the extended decline in Ireland. Several Asian countries (including Indonesia, Thailand, Malaysia and South Korea) also experienced severe financial crises and falls in GDP in the late 1990s. Following very difficult economic contractions, these Asian countries also experienced much stronger economic recovery than is evident in Ireland at present.

Figure 2.1: GDP in Ireland, Finland and Sweden



Source: European Commission, AMECO database.
 Note: Year 1 is 2007 for Ireland and 1990 for Sweden and Finland.

This underlines the unusual scale and complexity of Ireland’s crisis, the fragility of the international economy compared to the early 1990s and the policy and institutional challenges that confront Irish society.

2.1.2 Overall Growth and Domestic Demand

Following the sharp decline in the economy in 2008 and 2009, Irish exports began to recover in 2010. However, with the continuing steep fall in domestic demand, the economy declined in GDP and employment terms. Exports continued to recover in 2011, driven by strong growth of services, and there was a slower pace of decline in domestic demand. The export growth achieved in 2011 was sufficient to achieve an increase in GDP in that year of 2.2 per cent, the first such increase since 2007, although employment continued to fall. This export growth was broadly based and included double-digit growth in food exports.

The euro area re-entered recession in 2012 and this resulted in a slowdown in Irish exports. Total Irish exports of goods and services increased by 1.6 per cent in 2012 compared to an increase of 5.4 per cent in 2011. The slowdown in export growth in 2012 was due to a fall in the volume of total goods exports. This fall in goods exports for 2012 was dominated by the chemicals and pharmaceuticals sector. The trade figures show that the value of exports of chemicals and pharmaceuticals fell by 1.7 per cent but other goods exports increased by 4.6 per cent. However, during the course of 2012 a range of goods exports began to fall. Services exports have performed strongly in recent years and this continued in 2012.

GDP declined in the first quarter of 2013 and this was the third successive quarter of falling GDP. However, there are more recent indicators of economic recovery. There was a return to economic growth in the second quarter of 2013 with a quarterly increase in real GDP of 0.4 per cent. Exports increased by 4.3 per cent with both goods and services contributing to this growth. The output of modern and traditional manufacturing rose in the second quarter. The improvements in the external economic environment point to the scope for continued export growth in the second half of the year.

Consumer spending increased by 0.7 per cent in the second quarter of 2013. Total investment spending fell by 3.4 per cent compared to the previous quarter and was just 1 per cent higher than the level of investment in the corresponding quarter of 2012. However, short-run investment trends are distorted by movements in investment in aeroplanes. If this volatile element is excluded, it can be seen that there has been an underlying increase in investment. Total investment, excluding aeroplanes, in the second quarter of 2013 was almost 12 per cent higher than the corresponding quarter of 2012; within this, machinery and equipment (excluding aeroplanes) was up by 12.5 per cent while building and construction was up by 11.3 per cent. This increase in investment is a continuation of a recovery in investment evident in the first quarter of the year. The volume of construction output showed a quarterly increase of 1.7 per cent in the second quarter, the third successive quarter in which construction output increased. However, it is important to note this improvement comes after a period in which investment has fallen significantly. Notwithstanding the recent increase, the volume of investment in the second quarter of 2013 was more than 60 per cent below its peak level in the first quarter of 2007. Section 4.2.1 highlights the weakness of Ireland's investment rate relative to European partners.

Table 2.1: Macroeconomic Developments 2008 to 2012¹

	2008	2009	2010	2011	2012
Real GDP	-2.2	-6.4	-1.1	2.2	0.2
Real GNP	-1.8	-9.1	0.5	-1.6	1.8
Private consumption	0.1	-5.1	0.9	-1.6	-0.3
Public consumption	0.6	-3.4	-6.9	-2.8	-3.7
Investment	-9.6	-26.9	-22.6	-9.5	-1.0
Exports	-1.1	-3.8	6.4	5.4	1.6
Imports	-2.0	-3.0	-9.8	3.6	-0.4
Balance of Payments (% of GNP)	-6.6	-2.8	1.4	1.4	5.5
Employment	-0.7	-7.8	-4.0	-1.8	-0.6
Unemployment	6.4	12.0	13.8	14.6	14.8

Source: CSO, National Income and Expenditure 2012 and CSO database.

Total exchequer tax revenue for the first nine months of 2013 is in line with the budget target. Expenditure taxes are below target while corporation tax is ahead of target. The clearest indication of recovery is the expansion of employment. The second quarter of 2013 represented the fourth successive quarter of increases in employment. The recovery of employment is discussed below.

Domestic Demand

Ireland's economic downturn has been characterised by a sharp fall in domestic demand. Personal consumption, the largest part of domestic demand, has fallen by around 6 per cent in real terms between 2007 and 2012. Consumption appears to be stabilising: it fell by just 0.3 per cent in 2012 while the most recent quarterly data (second quarter of 2013) shows an increase as noted above. Total retail sales have

¹ All variables show annual percentage change in real terms unless otherwise indicated.

declined by 19.4 per cent in volume terms 2007 to 2012; if motor sales are excluded sales have fallen by 12.5 per cent over this period. Public consumption, which refers to current public spending on goods and services including the public-sector pay-bill, has fallen by over 15 per cent between 2007 and 2012.

Within domestic demand, the steepest decline by far has been in investment. Between 2007 and 2012, investment fell by more than half in real terms and by almost two-thirds in value. However, there are some indications that investment is starting to recover. The fall in investment in 2012 was 1 per cent. Investment in housing fell by more than 20 per cent in volume terms in 2012, but other building and construction increased by almost 13 per cent; the continuing success in attracting FDI would have boosted this category of investment. The increase in investment in the first half of 2013 has been noted above.

The fall in public investment was less dramatic than overall investment in the early years of the crisis. It decreased by 13.2 per cent, in nominal terms, between 2007 and 2010. However, it fell by 31.8 per cent between 2010 and 2012. The overall reduction since 2007 is just over 40 per cent. Within this, direct (exchequer) investment by government has fallen by 50 per cent (Department of Finance, 2012).

This year (2013) is likely to be the first year since the onset of the crisis in which there is an increase in investment. This increase is welcome but is from an exceptionally low base. The low level of investment has significant negative consequences in both the short and long term—given the dual nature of investment—as it undermines both current demand and the ability to upgrade physical and human resources to underpin future prosperity. This underlines the importance of the policy developments and institutional innovations being undertaken by the Department of Finance and other agencies—which we have examined in some detail in recent months and discuss later in this report.

2.1.3 Employment and Unemployment

Since the peak of employment in the first quarter of 2008 to its low point in the second quarter of 2012, total employment fell by 328,800 or 15.2 per cent.² Close to half of this fall has been in the construction sector. However, there has been a recovery of employment over the past year. Total employment in the second quarter of 2013 increased by 33,700 (1.8 per cent) relative to the second quarter of 2012. The largest annual increases in employment were in the 35-44 (+3.4 per cent) and 45-54 (+4.0 per cent) age groups. Decreases in employment were recorded in the 25-34 (-2.3 per cent) and 20-24 (-1.7 per cent) age groups.

A significant qualification to the recorded increase in employment is that roughly half of the increase was in agriculture, forestry and fishing. A methodological change has affected estimates of employment in the Quarterly National Household

² Based on the seasonally adjusted trend.

Survey (QNHS) and this applies particularly to the estimates of employment in agriculture, forestry and fishing.³ In view of this change, non-agricultural employment is a better indicator; non-agricultural employment also showed an increase over this period of 17,400 (1.0 per cent).

Initially almost all of the recovery in employment was in part-time employment. However, the most recent data show an increase in full-time employment also. Over the year to the second quarter of 2013, part-time employment increased by 2.8 per cent while full-time employment increased by 1.5 per cent. In absolute terms the larger increase was in full-time employment (an increase of 21,600) in this period while part-time rose by 12,100. In terms of full-time equivalents (FTE), total employment increased by 1.8 per cent over the year to the second quarter of 2013 while non-agricultural employment in FTE terms increased by 0.9 per cent over this period⁴.

The rise in employment took place against a background of falling public-sector employment. The CSO estimates that public-sector employment fell by 1.4 per cent in the year to the second quarter of 2013 (a fall of 5,400) while it estimates that the number of employees in the private sector increased by 1.9 per cent over the same period (an increase of 21,400).

The sectoral data shows that the recovery of employment is uneven. Employment in services increased by 0.6 per cent between the second quarter of 2012 and the second quarter of 2013. Within services, five sectors saw increases in employment while another five had reductions. Employment growth was stronger in manufacturing (an increase of 2.9 per cent) and construction (an increase of 3.1 per cent) over this same period. Employment in industry (manufacturing and construction) in FTE terms increased by 2.7 per cent over the past year while employment in services in FTE terms increased by just 0.4 per cent.

Forfás data show strong growth in employment in internationally traded services in recent years with an increase in employment of 13.8 per cent between 2010 and 2012. The employment boom in international services is largely associated with multinationals. However, there has been very strong employment growth in Irish-owned companies in this sector as well (an increase of 13.0 per cent between 2010 and 2012). The employment growth in international services is occurring across computer, financial and business services.

³ After each Census of Population the CSO updates the sample of households for the QNHS to ensure the sample remains representative. Following the 2011 Census, a new sample is being introduced from the fourth quarter of 2012 to the fourth quarter of 2013. This change in sample can have some effect on estimated numbers employed, particularly at more detailed levels. The CSO notes that estimates of employment in agriculture, forestry and fishing in particular have been shown to be sensitive to these sample changes over time.

⁴ The CSO has recently published data on employment as measured by full-time equivalents (FTE) for the first time. These data are calculated by converting the numbers employed full-time and part-time into full-time equivalent units of employment.

Foreign direct investment into Ireland has been resilient in recent years. Employment in IDA Ireland companies is now over 150,000 so that employment has returned to pre-crisis levels. In 2011 and 2012, the average level of gross job creation in IDA Ireland companies was over 13,000, considerably ahead of the average gross job creation of 10,700 between 2002 and 2008. Net job creation averaged over 6,000 between 2010 and 2012, and the 2012 level of net job creation was the highest in a decade. The IDA target is to add 62,000 jobs between 2010 and 2014 and at the end of 2012 it was on track to surpass that goal (IDA, 2013).

The rate of unemployment has fallen from its peak of 15.1 per cent in the first quarter of 2012 to 13.9 per cent in the second quarter of 2013 while the rate of long-term unemployment has fallen from 9.2 per cent to 8.1 per cent over the same period. The huge challenge of unemployment is discussed further below.

2.1.4 Public Finances

Major action has been taken to correct the public finances. Since 2009, budgetary adjustments of around €26bn (16 per cent of GDP) have been implemented (Bergin *et al.*, 2013). The underlying deficit (i.e. excluding bank payments and receipts) as estimated by the CSO peaked at €18.6bn in 2009 (11.5 per cent of GDP) and fell to €14.1bn (8.6 per cent of GDP) in 2012. In both 2011 and 2012, the deficits outturns were more than one percentage point lower than the budget targets. The Department of Finance projection for 2013 is for an underlying deficit of €12.5bn (7.4 per cent of GDP).

Irish bond yields peaked in July 2011 when the yield on 10-year Irish bonds exceeded 14 per cent. Since then there has been a dramatic fall in yields; in September 2013 the yield on 10-year government bonds was just over 4 per cent.

As a result of the economic shock and the capital provided to the banks, Ireland's general government gross debt increased dramatically to reach €192.5bn at the end of 2012 (118 per cent of GDP). The State also has financial assets including considerable deposits held by the National Treasury Management Agency (NTMA). Net general government debt (i.e. gross debt less financial assets) at the end of 2012 was estimated by the CSO to be €152bn (114 per cent of GNP).⁵ While gross rather than net debt is the measure that is monitored at EU level, net general government debt as a percentage of GNP is a better measure of the real debt burden.

There are additional assets and liabilities beyond those covered by net general government debt. The CSO has recently published a balance sheet for the general government sector for the first time. Taking tangible assets (such as infrastructure,

⁵ To calculate net government debt, the CSO deducted financial assets from the gross debt figure using the same categories that are included as liabilities in the definition of general government debt. The State's holdings of equities and the value of the State commercial companies are not included in this measure.

buildings, financial resources) and liabilities together, the general government sector had an estimated net worth of -€77bn (58 per cent of GNP) at the end of 2012 before taking account of pension liabilities. When estimated public service pension liabilities are included the net worth of the general government sector was -€193bn (145 per cent of GNP).⁶

The evolution of the public finances depends critically on the future path of the economy. Further fiscal consolidation will be needed to stabilise the public finances but the extent of consolidation required depends on the growth of the economy. In the ESRI's recovery scenario, it is estimated that fiscal consolidation of €3bn in 2014 would probably be sufficient to stabilise the public finances without the need for further nominal expenditure cuts or discretionary tax increases in subsequent years. Other scenarios considered would require substantial additional cuts beyond 2014 (Bergin *et al.*, 2013). Current government plans envisage that the debt/GDP ratio will peak in 2013 (at 123 per cent of GDP) and fall in subsequent years. For the first time since the onset of the crisis, the primary or non-interest balance is expected to show a small surplus in 2014.

Notwithstanding the major actions taken to correct the public finances, they remain vulnerable in light of the very high levels of debt and deficit. The biggest threat to the public finances is that the economy does not recover. The IMF estimates that if real GDP growth were to stagnate at 1 per cent per year in the medium term then debt would be on an unsustainable path to 136 per cent of GDP by 2021. Bergin *et al.* (2013) also consider a scenario in which there is GNP growth of just over 1 per cent annually in the second half of the decade (the 'stagnation scenario'). They consider that the public finances would still be sustainable, but this is on the basis of considerably more fiscal retrenchment compared to current plans and they refer to the ability of the State to service its debts in this scenario as a 'close run thing' (*ibid.*: 127).

The need for further capital for the banks is another risk. In view of the high level of non-performing loans and more demanding capital regulations in future, the banks will require more capital. This will not necessarily have to be provided by the State. Some of it may be raised privately while the European Stability Mechanism (ESM) is another potential source. Realisation of the commitment that was made in the euro area summit statement of June 2012 to break the link between bank and sovereign debt would be highly beneficial to Ireland's financial sustainability. More generally, progress on creating a genuine European Banking Union will have a critical bearing on Ireland's ability to recover from this crisis. For example, it has been estimated that a transfer of the State's holdings to the ESM could result in a reduction in the debt ratio of between 10 and 20 per cent (McArdle, 2012). However, the possibility that progress on Banking Union may be slower than

⁶ This is based on a 2009 estimate of public-service pension liabilities. This does not take account of public-service pay cuts or changes in the numbers of public servants since then. This figure does not include commitments on social welfare pensions.

expected needs to be considered. Its achievement may be dependent on progress towards greater fiscal, economic and political union (Tutty, 2013).

New institutional arrangements have been introduced for the conduct of fiscal policy at EU and Irish levels. The Stability and Growth Pact has been revised and strengthened and Ireland is one of 25 EU member states to adopt the Treaty on Stability, Co-ordination and Governance, the fiscal component of which is known as the Fiscal Compact. The Fiscal Compact requires the adoption of EU budget rules in national legislation. In Ireland this has been achieved through the enactment of the Fiscal Responsibility Act, 2012; this Act also provided the legislative basis for the Irish Fiscal Advisory Council (IFAC). The functions of IFAC include providing an independent assessment of the macroeconomic forecasts of the Department of Finance.

A revised fiscal framework is intended to ensure that pro-cyclical fiscal positions are not adopted in future economic booms. As well as preventing excessive public debt, this enhances the scope for fiscal policy to be expansionary at times of recession. The Council strongly supports the need for a fiscal framework that enhances stability, prevents excessive debt and supports growth; indeed, it believes that an effective framework of that kind can facilitate policy experimentation by providing reassurance that expenditure on innovative initiatives is not part of a general loss of fiscal discipline or accountability.

Although a good fiscal framework would, in the medium term, prevent pro-cyclical fiscal policy, allowing fiscal stimulus at times of recession, in Ireland's current economic and public finance position, continued pursuit of fiscal correction is necessary even though this is regrettably pro-cyclical. Looking beyond Ireland's immediate position, some fear that the new fiscal framework adopted in the EU may not be as effective in supporting discipline and growth as is hoped by the member states and European institutions. One fear is that the new fiscal framework in the EU may constrain the use of the fiscal discretion when and where it exists. Indeed, at present, it can be argued that some of the core EU member states are adopting an over-restrictive fiscal stance. Another concern is that within the EU's new fiscal framework there is no distinction between current and capital expenditure. As a result, this framework could limit borrowing for public investment in situations in which the investment would provide a worthwhile return in excess of the cost of borrowing. In its 2010 report, *Re-finding Success in Europe* (NESC, 2010), NESC expressed the view that the EU *may* be advancing to a regime of real benchmarking, systemic and diagnostic monitoring, peer review, learning and system revision—in which the hard-law elements enforce engagement and searching self-examination—like that found in other, more successful, areas of EU policy. But it noted the possibility that, having had a weak regime in which member states flouted the Stability and Growth Pact (SGP) rules and resisted real benchmarking, with terrible consequences after 2008, the EU will turn to a regime that relies too heavily on precise rules, fixed targets and strong sanctions. The latter, it argues, would be a worrying development, not because it would always be too strong, but because it could even fail to deliver fiscal discipline if the precise rules did not capture the underlying weaknesses, as, indeed, was the case in the SGP (*ibid.*: 9).

In addition to the more rigorous surveillance and rules governing fiscal policy, a new Macroeconomic Imbalance Procedure has been introduced at European level. This provides for the monitoring of a broader range of indicators including current account balances, private-sector credit and competitiveness measures. For euro area countries this procedure includes rigorous enforcement with provision for financial penalties for countries that do not address macroeconomic imbalances. The focus on a broader range of variables is an advance on the earlier concentration on public finance variables and reliance on rules to address complex economic conjunctures. If it had been in place at the time, it could have triggered corrective action during Ireland's property boom. Excessive current account surpluses as well as deficits are indicators of macroeconomic imbalance. The threshold for concern for a current account surplus is 6 per cent of GDP (three-year average) while the threshold for a deficit is 4 per cent of GDP. Germany's current account surplus (based on a three-year average) is just below this threshold and is not, consequently, considered to be a macroeconomic imbalance of concern within the defined procedure. A limitation of the procedure to date is that it appears to place all of the burden of adjustment to current-account imbalances on the deficit countries.

2.1.5 Competitiveness

A range of indicators show that there has been some recovery of cost competitiveness. The nominal exchange rate (i.e., Ireland's average exchange rate weighted by trade shares) declined by 6.3 per cent between the second quarter of 2008 and the first quarter of 2013. When deflated by producer prices, the real exchange rate fell by 9.6 per cent, while in terms of consumer prices the real exchange rate fell by 15.2 per cent. This means that below-average inflation in Ireland reinforced the competitiveness gain from exchange-rate movements.

While exchange-rate movements have on average contributed to a recovery in cost competitiveness in recent years, a critical exception to this concerns the movement of sterling, a key exchange rate for indigenous exporters and those competing on the domestic market with UK producers. The value of the euro relative to sterling in August 2013 (0.86) was around 30 per cent higher than its value in January 2007 (0.66).

Labour costs have fallen in recent years relative to Ireland's trading partners. Nominal compensation per employee in common currency terms in Ireland fell by 10.5 per cent relative to the EU (15) between 2008 and 2012. However, compensation per employee in common currency terms increased by 7.8 per cent relative to the UK between 2007 and 2012 due to the fall in the value of sterling.⁷

⁷ These labour-cost calculations are based on the European Commission's AMECO database.

Ireland's consumer prices rose to be almost one quarter above the EU (15) average in 2008. This relative price premium has fallen considerably since then but Ireland's consumer prices in 2012 were still 9.1 per cent above the EU (15) average and 6.8 per cent above the UK. Irish labour costs on an hourly basis are close to the euro area average⁸ but are higher than the UK.

Despite improvements in competitiveness, challenges remain. There is a need for further structural reform to ensure contestability and higher performance in particular areas. For example, Ireland ranks fifteenth out of seventeen in terms of health outcomes through public spending, which, adjusted for demographic profiles, was one of highest in the OECD (Thornhill, 2012). In addition, the costs of legal services and energy and transport costs have not adjusted as rapidly as others. In fact, legal services in 2012 were 12 per cent higher than in 2006 (*ibid.* 13). Property and rental costs have fallen but some businesses will be locked into former higher prices, either through the purchase of property at higher prices or entering long-term leases at higher rental prices. These higher property costs become part of the cost base of some businesses (and some public bodies) and may be a factor in sustaining higher consumer prices.

Finally, an important dimension in relation to competitiveness is a tax regime that is conducive to, on the one hand, employment and the attraction and retention of skilled employees but which, on the other hand, also yields sufficient revenue to support necessary social services. The degree to which the Irish regime is achieving an effective balance between these two issues is something that requires further analysis.

2.2 Ireland's Limited Economic Recovery and Enduring Anxieties about Economic and Social Development

Ireland's moderate economic recovery has been described above. The question arises as to why Ireland has not had a stronger recovery. Why has Ireland's recovery been weaker than those experienced by Sweden and Finland following their economic crises in the 1990s and the recoveries experienced following the Asian financial crisis in the late 1990s? Ireland has had a stronger economic performance than the other crisis-hit southern European countries. The tiny Baltic States had even bigger economic falls than Ireland and have since experienced stronger recoveries. Iceland has also had a strong recovery from its severe recession.

⁸ Irish labour costs in 2012 were 3.9 per cent above the euro area average on an economy-wide basis and 2.8 per cent below for the business economy.

This section examines reasons for Ireland's limited economic recovery. In addition, it considers enduring anxieties about Ireland's direction of economic and social development, including the issue of the sharing of burden adjustment to the economic crisis.

2.2.1 Global Economic Environment and the Euro

One reason for Ireland's slower recovery compared to the Scandinavian and Asian cases referred to above is the less favourable global environment, particularly the European economy. The earlier Scandinavian and Asian recoveries benefitted from robust global economies. A second factor that contributed to the earlier Scandinavian and Asian recoveries was currency depreciation. The Asian economies had particularly large falls in the value of their currencies in the late 1990s. Weaker currencies would seem to have reinforced the effects of favourable external environments. There has been some fall in the value of the euro in recent years but relative to sterling there has been a substantial appreciation since 2007, as noted above.

By contrast, Ireland has been seeking to recover from the five-part crisis in a much weaker European and global environment. Growth in advanced economies has strengthened during 2013. However, growth has slowed in several major middle-income economies and many have been affected by financial-market instability. The OECD considers that a sustainable global economic recovery is not yet firmly established. In addition, despite significant policy and institutional steps in recent years, it is hard to see that the crisis of the euro has been resolved, either in terms of economic recovery of the euro area or threats of further financial instability.

Thus, while the euro area emerged from recession in the second quarter of 2013, significant risks remain. The scale of banking losses for the European banking system is not known and the ability of the planned banking union to address large-scale losses remains to be established. According to the OECD:

The euro area remains vulnerable to renewed financial, banking and sovereign debt tensions. Many euro area banks are insufficiently capitalised and weighed down by bad loans. Recent progress towards a common supervision and new resolution arrangements will help, but measures are required to ensure the credibility of next year's asset quality review and bank stress tests and to provide adequate financial support arrangements to meet shortfalls in bank capital (OECD, 2013a: 5).

One of the central requirements of an effective and integrated response to the crisis is a consistent combination of macroeconomic, distributional and structural measures. The need for this was the central insight emerging from analysis of Ireland's periods of relative success and failure since 1960, and particularly the problems experienced from the mid-1970s to the late 1980s (NESC, 1986); (NESC, 1989), (NESC, 1996). Despite the adherence to the programme agreed with the IMF, EU and ECB, and a more integrated government response, it is impossible to

say that Ireland is operating with a consistent combination of macroeconomic, distributional and structural measures. It is worth asking how and why this is so, and the answer is not entirely obvious. One factor, which undoubtedly goes a long way to explaining this, is that the euro area does not have a consistent combination of macroeconomic, distributional and structural measures. Reflecting the flawed design of the euro regime, it has been implementing a narrow conception of 'structural adjustment', from which it expects more results than it should, and combining this with a deflationary fiscal policy. Again, this underlines the importance for Ireland of the effective integration and management of the European economy, as well as global economic conditions.

2.2.2 The Balance Sheet Nature of Recession and the Collapse in Investment

Ireland's recession has the characteristics of what has been termed a 'balance sheet recession' by Koo, who explains the idea as follows:

The key difference between an ordinary recession and one that can produce a lost decade is that in the latter, a large portion of the private sector is actually *minimizing debt* instead of maximizing profits following the bursting of a nation-wide asset price bubble. When a debt-financed bubble bursts, asset prices collapse while liabilities remain, leaving millions of private sector balance sheets underwater. In order to regain their financial health and credit ratings, households and businesses are forced to repair their balance sheets by increasing savings or paying down debt. This act of deleveraging reduces aggregate demand and throws the economy into a very special type of recession (Koo, 2011: 19).

Koo, argued that (using data up to 2011) Ireland and Spain, as well as the US and UK, were in serious balance-sheet recessions. This was based on the huge financial surpluses of the private sector. A large private financial surplus means that private saving is substantially higher than private investment. When savings are not balanced by investment there is a withdrawal of spending power from the economy. The collapse in investment in Ireland led to private investment falling well below private savings. The contractionary impact on the economy of the fall in private spending has been partly offset by movement of the government sector into a large financial deficit.

High debt levels are one constraint on private investment and consumption. They are not the only factor depressing private spending. Even those not debt-constrained may avoid making investments for other reasons, such as a decline in confidence or, in the case of housing investment, fear of price reductions or the impact of losing a tracker-mortgage rate.

Despite progress and the work taking place, the ability and/or willingness of Irish firms to invest in the Irish economy is weak. International research suggests that in a balance-sheet recession companies will, even if credit is cheap—which it is not for

Irish SMEs—seek to reduce or avoid debt. Many SMEs will need to be restructured if credit is to re-ignite the potential for SMEs to grow and create jobs. Fifty per cent of loans to SMEs are non-performing (McManus, 2013): non-performing loans include three categories—those on watch (potentially at risk), those that are vulnerable and those that are impaired. The banks themselves operate different scales (for example, AIB has a 24-point scale to distinguish different degrees of loan performance/risk). There is a critical need to address impaired or non-performing loans. The Central Bank has set targets for the restructuring of SME loans; these were issued to the relevant banks at the end of June 2013. IMF staff also suggest that further reforms of examinership should be considered for SMEs. There is also an urgent need to effectively address the high number of mortgages in arrears.

According to Reinhart and Reinhart (2010), the reduction of private debt following a credit boom is often a delayed and lengthy process that lasts about seven years but can last more than a decade. They note that the credit growth in several countries preceding the 2007 crisis fitted the pattern of previous major credit booms. ‘If deleveraging of private debt follows the tracks of previous crises, credit restraint will dampen employment and growth for some time to come’ (*ibid.*: 4). However, previous experience of other financial crises also shows the process of debt correction does not necessarily preclude economic recovery. Reinhart and Reinhart estimate the median GDP growth rate following the five most severe financial crises in advanced countries was one percentage point lower in the post-crisis decade compared to the pre-crisis decade.

2.2.3 Fiscal Adjustment

The correction of the public finances is another factor that has affected economic recovery. The fiscal measures implemented from 2009 to 2013 represented an adjustment of €26bn, or 16 per cent of GDP. This is ‘an unprecedented programme of contractionary fiscal measures that has reduced output, employment and incomes in the economy’ (Bergin *et al.*, 2013: 17). It is estimated by Bergin *et al.* that the cumulative effect of the fiscal measures since 2010 has been to reduce the growth rates of GDP and GNP by nearly one percentage point per year compared to the situation in which a neutral fiscal policy had been pursued. The option of pursuing a neutral fiscal policy in Ireland’s situation would not have been feasible: it would have meant extremely high deficits financed at high interest rates if it could be financed at all. However, this simulation illustrates that when the necessary fiscal correction is completed, there should be a boost to economic growth.

2.2.4 The Scale of the Unemployment and Participation Challenge

Ireland’s biggest challenge is to achieve a sustained increase in employment and a reduction in unemployment. While there has been a modest increase in employment over the past year, several years of stronger employment growth is needed if anything approaching full employment is to be achieved.

In the second quarter of 2013, there were just over 300,000 people unemployed. This, however, understates the need for employment as many have withdrawn from the labour force and others have emigrated. The national participation rate fell from 64.7 per cent in 2007 (quarter three) to 60.5 per cent in the second quarter of 2013. Over the years 2010 to 2012, approximately 80,000 people emigrated each year of whom almost 44,000 were Irish nationals. In the year to April 2013 it is estimated to have reached 89,000, an increase of 2.2 per cent on the 87,100 recorded in the previous year. Recent research suggest that graduates are over-represented amongst those leaving, with 62 per cent of emigrants holding third-level qualifications compared to 47 per cent of the general population (Glynn *et al.*, 2013).

At the same time, immigration has continued. Over the period 2010 to 2012 the number of people immigrating to Ireland averaged 49,300 of whom almost 24,000 were Irish nationals. The number of immigrants also increased over the 12 month period to April 2013 from 52,700 to 55,900 (or 6.0 per cent). Net emigration in the period to April 2013 was just over 33,000.

In addition to the 300,000 people who were unemployed in the second quarter of 2013, the QNHS identified a further 60,000 potential members of the labour force. These are people who are either available for but not seeking work or people who are seeking work but are not immediately available for it. There were also 149,400 under-employed part-time workers (i.e. part-time workers that would like to work more hours than they currently do). In August 2013, there were over 435,000 people on the Live Register of whom around one-fifth (85,000) were engaged in casual or part-time employment. The number on the Live Register fell by close to 21,000 over the year to August 2013.

The rate of unemployment is much higher for young people: for those under 25 the rate was almost 30 per cent in the second quarter of 2013. Unemployment rates are also a lot higher for those without a third-level qualification. In 2013 (second quarter) they were as high as 22.8 per cent for those who had completed lower-secondary level, but for those with a third-level qualification the rate was 6.3 (degree qualification) to 9.3 (non-degree qualification) per cent (CSO, 2013b). Nationals from other countries also experience a higher level of unemployment compared with Irish nationals, approximately 17 per cent compared to 13 per cent.

There is significant regional variation in the extent of the unemployment challenge. There is a six percentage-point gap between the regions with highest and lowest unemployment rates: unemployment is highest in the South-East (18.3 per cent) and lowest in the South-West (11.9 per cent). The Border region has the lowest rate of labour-force participation (55.1) while the Mid-East (63.0) has the highest. The regional gaps in unemployment and participation rates point to structural differences between regions. This matters from a policy perspective as national policies are unlikely to address region, and location, specific factors (Morgenroth, 2012).

This recession has seen an increase in long-term unemployment for both men and women, but especially for men. Long-term unemployed persons now account for

58.2 per cent of all unemployed persons. Although the rate is still much too high, a note of positivity is that the number of long-term unemployed has been declining throughout 2012 and into the second quarter of 2013 (from 204,300 in quarter one of 2012, to 175,000 in quarter two of 2013).

The percentage of people living in jobless households in Ireland has also risen since the beginning of the recession, from 15 per cent in 2007 to 22 per cent in 2010. In addition, a quarter of all children are living in jobless households. This proportion stands out when compared to other European countries, with the next highest (the UK) having 13 per cent of its households jobless. Those in jobless households comprised almost two-thirds of those in consistent poverty in 2010, which is a worrying issue for policy to address (Watson *et al.*, 2012). Long-term unemployment and workless households are key challenges for policy development.

2.2.5 Long-term Logic Dominating Immediate Action

In 2009, the Council emphasised the importance of taking short-term measures that move us in the correct long-term direction. While there was, and remains, some fear that reaction to the crisis might include short-term actions that have negative long-term consequences, there is now a sense that the reverse problem could exist in certain areas.

Looking at the European and Irish crisis response over five years, there is a sense in which long-term logic has been given precedent over immediate problems. Certainly, at EU level, there has been adherence to a doctrine of fiscal austerity, structural reform and monetary union that, although it claims to lay the foundation for future economic performance, has prolonged recession and deepened the hardship involved. It has been assumed that the virtue of adhering to “correct” long-term principles is its own reward. Immediate problems of stagnation and crisis-level unemployment across a large part of the euro area cannot be ignored forever and, very gradually, the EU-level focus is moving towards growth and employment.

At domestic level, the disjuncture between short-term response and long-term logic was not so great for a variety of reasons: in a small open economy, activist fiscal policy has smaller long-term effects, the room for short-term fiscal discretion disappeared and, as elsewhere, the prevailing doctrine on entering the crisis was that the faster the adjustment the quicker the recovery (Henriksson, 2007). But in Ireland too there is a discernible process in which immediate problems that are not yet fixed by adherence to the long-term logic of fiscal adjustment and activation are receiving increasing attention in government policy. These include employment, investment and domestic demand, and finance and business development. It is interesting that the most innovative part of Irish policy in recent years, the activist approach to SME credit and, increasingly, investment (discussed further in Chapter 3), has somewhat reversed the idea of short-term measures with a long-term logic. It shows that, in certain contexts, addressing immediate problems is the way to discover what the long-term logic is—a truth that is relevant at European as well as Irish level.

2.2.6 Sharing the Burden of Adjustment

The Council report on the five-part crisis in 2009 suggested that an effective response would be based on social solidarity, seen as sharing the burden of adjustment fairly and yielding a fair economy and society in years to come.

Not surprisingly, there is debate on the degree to which the response to the crisis has been based on social solidarity, shared the burden of adjustment fairly and will yield a fair economy and society in years to come.

Viewing the international economy over the past two decades, there is a striking factor—with three elements—that is very hard to see as fair or reflecting social solidarity. First, across most of the Western world, policy and other developments facilitated a huge increase in the scale, internationalisation, profitability and rewards of financial-sector activity relative to most other sectors and occupations. Second, the associated reckless expansion of credit, debt and risk was a major factor in creating the financial and economic collapse of 2008 and subsequent crisis. Third, and most strikingly, for a number of reasons, the financial-sector losses have largely been socialised—greatly increasing the debt of many countries and exacerbating the fiscal adjustment and long-term austerity of the public system in many states (Crouch, 2011). While this overall pattern—and its three elements—is evident in many countries, it is particularly marked in Ireland. This reflects the scale and international nature of the credit expansion, and the design of the euro and the way in which the relation between banking and sovereign debt has been handled in the European response to the crisis.

Earlier this year, the Council documented and analysed a range of issues in its report, *The Social Dimensions of the Crisis* (NESC, 2013). Reflecting the scale, breadth and nature of the crisis, it is not surprising that it identified social pressures on many fronts: employment, unemployment, income loss, increased relative income poverty and deprivation, wealth reductions and debt burdens, pressure on family life and mental health and severe reduction in the budgets of various social services and programmes⁹. The latter has undoubtedly caused hardship. Funding allocations for many social services were reduced between 2008 and 2012, with many of these reductions higher than the average reduction of 11 per cent in State expenditure during that time period. In addition, it is important to note that there has been an increase in the funding allocated to some services, which are mainly demand-led, and have seen greater demand as a consequence of the crisis (e.g. unemployment benefits, medical cards).

In grasping the social dimensions of the crisis it is important to recognise three key facts. First, most people and families have been affected, at least to some extent, by the crisis. Second, nevertheless, the impact has been much more severe for some than for others, reflecting a range of factors. Third, the social welfare system

⁹ Appendix 1 provides a summary of the social impacts of the crisis.

has played a very significant role in cushioning individuals and families from the full effects of the loss (or non-availability) of market incomes.

Synthesising the complex social effects and problems, we can identify two sets of social problems that have to be a central focus of policy and societal attention and action in the decade ahead:

- **Long-Standing Disadvantage:** The first is the set of inter-related problems reflecting long-standing social disadvantage and the especially severe impact of the crisis on those with lower levels of educational attainment and limited autonomy. In large part this set of problems reflects the important fact that, even during a protracted boom, Ireland did not achieve a sufficient increase in participation, equality of opportunity, or an adequate reduction in relative poverty and deprivation. Thus, those who were least well off prior to the economic crisis remain so. It includes people and families who are long-term unemployed or jobless, have low levels of education and skills, and have children. Although much of this problem is long-standing, it is now discussed as the problem of Ireland's unusually high, and much-increased, proportion of jobless households. For both social and economic reasons, this nexus of problems must be a key focus in the next decade.
- **Reversal:** The second set of social pressures and problems are those arising from the fact that, in stark contrast to recent decades, many families and individuals have suffered a very significant reversal in their income, assets and fortunes as a result of the crisis. This includes people who have lost jobs, had business failures, or seen large falls in income and wealth. It also includes people who carry a large excess-debt burden. Some of these households and individuals may have bought properties at the height of the boom and now find the property is in negative equity and they are unable to meet their debts. Some of these individuals and households are or were working and have some skills and qualifications. Others, however, may be in danger of falling into long-term unemployment and poverty as a result of the cumulative impact of tax increases and expenditures cuts.

These two sets of social problems, both of which are complex, need to be a central focus of public-policy development in Ireland in the coming decade. This is necessary not only for social reasons, but also to secure economic success and high levels of participation. It is agreed that they require action on many fronts: welfare reform, activation, FET, education, health, mortgages and debt, housing and other spheres. One important implication of this is that, despite the need for a sustained focus on these two sets of problems, this cannot be executed entirely through special schemes and programmes. In addition to targeted programmes to address these deep and complex problems, they require reform of the mainstream systems that deliver most of the relevant services.

2.2.7 Incomplete Positive Picture on the Future of Irish Society

Although government formulation of a more integrated approach to the five dimensions of the crisis and key long-term reform strategies have been embedded in the overall response, the depth of the crisis and the profound change underway in the EU and the wider world mean that we may not have a complete and persuasive positive perspective on the future of Irish society and economy. This is evident in the fact that a range of questions and anxieties are to be heard. Among them are:

- With major changes in the global division of labour, how will Ireland generate the desired level of prosperity and well-being in the next decade and beyond?
- What actions and programmes are necessary to upgrade the quality and quantity of human and other resources to become a leading location for technology, innovation and entrepreneurship?
- How will Ireland create the kind of systems—of fiscal policy, wage bargaining and social investment—that are necessary to prosper within the euro?
- Even if Ireland carves out a strong place in high-value added, internationally traded economic activities, how will this be combined with high levels of employment and participation?
- And even if employment and participation opportunities increase significantly what type of jobs can be expected and will they provide good quality working environments in which people will have the opportunity to make full use of their talents?
- What scale and pattern of social protection will be feasible and agreed in the decades ahead?
- What infrastructure of care will Ireland have and how will it be resourced and funded?
- What degree of equality or inequality in opportunities and outcomes will Irish society seek and find achievable?
- Can we articulate the purposes and role of the public system in a way that justifies a stable tax base and motivates the delivery of high-quality policies and services tailored to individual need?
- How will Ireland's natural resources be incorporated in overall economic and social development?
- How will Ireland respond to future trends, uncertainties and challenges in relation to demography (see Box 2.1 for an overview)?

These questions reflect a combination of recent and long-standing vulnerabilities in Ireland's situation. They clearly reflect the scale, complexity and the five interlinked dimensions of the crisis. They arise because the crisis is a very significant setback in Ireland's project of economic and social development. That was a project on which real progress had been made at various times, particularly in the period from 1990 to 2000, from which there emerged increased belief in Ireland's future. But these questions and anxieties also reflect that fact that the crisis has revealed, and in some cases confirmed, that past progress was less comprehensive and less sustainable than we had come to believe. It has underlined the fact, highlighted particularly in NESC's 2005 *Developmental Welfare State* report (NESC, 2005b), that even in a prolonged economic boom, non-participation and disadvantage were not adequately addressed. It has confirmed that, while Ireland's prosperity is closely linked to the success of the international system, that link is characterised more by vulnerability and dependence than we thought a decade ago. The vulnerability is greater because the international economy and its governance are much less secure than in the decades after the Second World War; the dependence seems greater because European integration, reflecting the design and governance of the euro, has seen the emergence of a renewed disparity between creditor and debtor countries and between core and periphery. Furthermore, and perhaps most dispiritingly, the crisis has revealed, and for some confirmed, that our overall system of collective decision-making and public governance is extremely weak. Having made great and genuine strides, our policy-making and public administration once again proved unable to use a period of growth and progress to manage risks, reduce national vulnerability and upgrade resources and capabilities in a way that laid the foundations of sustained progress. In this context, considerable leadership is needed to articulate the way in which public policy at a time of sustained retrenchment and difficulty is framed around a positive perspective for the future of Irish society.

Box 2.1: Key Demographic Trends and Uncertainties

Over the next 10 to 15 years there are a number of demographic trends and challenges.

Population: There will be an overall increase in the population, which is projected to increase by 282,000–739,000 (depending on the assumption used) between 2011 and 2026.

Young People: The number of young (0–14) people is projected to rise up to 2021 (from 976,000 to 1,065,000)¹⁰ before falling back slightly in 2026 (to 1,011,000), creating a significant increase in the demand for school places. The second-level school population is expected to substantially increase to 2026, while the primary-school population will start to decline after 2021, and the pre-school population to decline after 2016. It is also anticipated that there will be a continuing high level of participation in third-level education, with an increase in the level of education, and thus participation, in the labour force, especially for women.

Labour Market & Migration: There is a lot of uncertainty about future levels of migration and therefore some uncertainty about the size of the labour force. Most projections, however, envisage a slow increase in the labour force after about 2018, with an increase in older workers notable.

Older People: All projections forecast an increasing number of older people (from 532,000 to 855,000 between 2011 and 2026), requiring reconfiguration of the health-care and pension systems. In particular, the very old population (those aged 80 and over) is especially set to increase. The growing number of older people will present considerable social and economic challenges in the years ahead.

Unemployment: Unemployment is expected to gradually reduce, but the nature of that reduction will to some extent be dependent on appropriate labour-market policies being put in place to ensure the lower-skilled and long-term unemployed avail of opportunities, and so reduce their risk of poverty and social exclusion.

Disability: It is noted that there has been an increasing prevalence of disability (from 8 per cent in 2002 to 13 per cent of 2011), some of which is likely to be associated with an increasing elderly population.

Housing: It is predicted that there will be a gradual increase in the demand for housing, especially in the Dublin area.

Spatial Developments: It is projected that there will be a continuing shift towards Dublin and the east, with implications for the provision of services in these areas, and the retention of services in remoter areas.

¹⁰ Based on a mean average of a number of assumptions made by the CSO.

Chapter 3

Significant Policy Action, Institutional Innovation and Reform

3.1 Introduction

NESC work during 2013 focused on four areas of policy development and reform: banking and the provision of finance for business, enterprise policy, greening the economy and activation policy. In these areas, the Council seeks to explore both the substantive policy initiatives taken by government and the institutional and process reforms introduced. It heard from the departments and agencies driving these developments and linked this to the experience of the diverse groups and experts on the Council (NESC, 2013).

Table 3.1 provides an overview of the main policy developments, innovations and possible further developments in the four areas reviewed by NESC during 2013. The remainder of this chapter discusses the policy actions and institutional reform in each of the four areas. Chapter 4 discusses the possible further developments.

Table 3.1: Overview of Policy Developments, Innovations & Further Developments

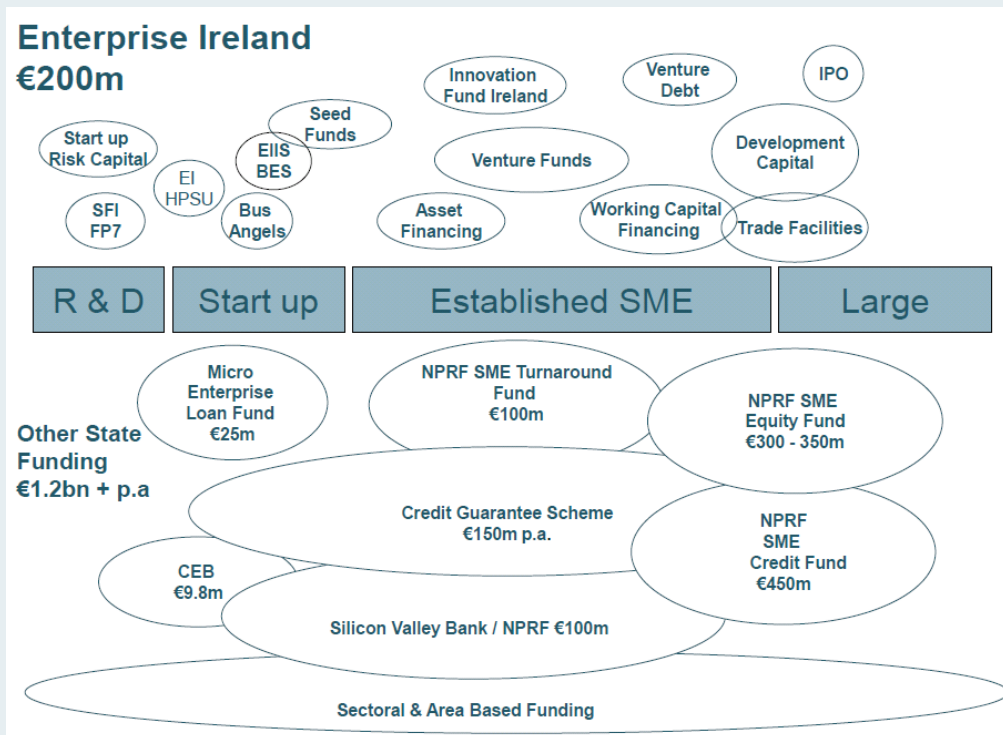
	Substantive Policy Initiatives & Action	Institutional & Process Innovations	Possible Further Institutional Developments & Generalisations
Finance for Business Growth	Restructured Bank Sector Funding Programmes Lending Targets SME Restructuring Insolvency Service Mortgage Arrears Banking Union	State Bodies Group Credit Review Office Enterprise Ireland Mentoring Capacity to Identify Problems	Recognise Developmental Role of New Arrangements, including ISIF Continue Search for Long-term Financing Options Dialogue about the Regulation of Regulation Strategic Work on Medium-Term Issues Facing the Sector
Enterprise Policy	Action Plan for Jobs Disruptive Reforms Access to Finance Research Prioritisation Food Harvest Horizon 2020 (IDA)	APJ Monitoring Committee and Technical Secretariat Food Harvest Implementation Group Senior Management EI/IDA Team	Expand EI Footprint Probe how Science Works in the Economy Probing Strategies and Sectoral Plans to Support Economic Planning and the MTES Testing and Building Scale for New Ideas Widening and Opening the APJ Process Further
Greening the Economy	EPA State of Environment Reporting EU Policy & Single Market <i>Delivering Our Green Potential</i>	Wide Range of Policy Reports and Frameworks Integration as a Challenge	Build Towards Real Integration Identify & Analyse Trade-offs Capture Full Job Potential of Greener Economy Understand the Role of Accounting and Data
Activation	Engagement and Progression Plans Sanctions for Non-co-operation Treatment of Lone Parents Additional Training Places Links to Local Employers <i>Momentum</i>	Deputy Secretary in DSP Cabinet Committee Interdepartmental Programme Board Intreo Education & Training Boards (ETBs) Solas Case-Management Systems	Managing Capacity to Implement Activation Processes Sharing learning for continuous improvement Diversity of Approaches Required

3.2 Banking and Finance

Substantive Action

The Government has intervened in very significant ways to support the banks—primarily through the provision of safeguards and capital and in restructuring the banking sector. There have been a range of government initiatives under the aegis of Enterprise Ireland, the European Investment Bank and the Irish Strategic Investment Fund (ISIF). Figure 3.1 shows the range of funding programmes in existence in May 2013. These include a number of commitments to use the National Pension Reserve Funds (NPRF), including SME investment and turnaround funds and commitments under the Innovation Fund Ireland (€125m).

Figure 3.1: Financing Enterprise



Source: Department of Finance Presentation, NESI Meeting, May 2013.

In June 2013, the government announced that new legislation would be prepared with significant implications for the National Pensions Reserve Fund (NPRF) and to establish New ERA¹¹ on a statutory basis.¹² This proposed legislation would change the NPRF into the ISIF. The remaining assets of the NPRF that have not been invested in the banks—currently valued at €6.4bn—would be made available for investment on a commercial basis in the Irish economy in order to support economic activity and employment. At present, these assets are mainly invested in listed shares and bonds in international financial markets. This represents a fundamental change in direction of the NPRF investment strategy.

The NPRF investment strategy for its discretionary portfolio (i.e., non-bank investments) is decided by the NPRF Commission. This Commission would eventually be replaced by an investment committee. Investment strategy would be decided by a new board of the National Treasury Management Agency (NTMA) in accordance with the government’s policy objectives. The NTMA at present does not have a board, but the proposed legislation will create one.

The establishment of the Irish Strategic Investment Fund, with funds of over €6bn, is an important development and could be viewed as a further step towards a formal state business or investment bank.

The State has sought to use its role in the banks to increase the flow of credit and more recently to create a process for addressing mortgage arrears. Lending targets and targets for dealing with loan and mortgage arrears have been set and will be assessed by the Central Bank (Central Bank, 2013). New legislation has been put in place in relation to insolvency and the Insolvency Service of Ireland (ISI) has been established. The Department of Finance and the Central Bank have introduced a range of measures to address the effectiveness of regulation, including three Acts¹³ and ongoing work on a Supervision and Enforcement Bill (due 2013). However, it remains the case that an internationally accepted methodology for measuring and evaluating regulatory performance is not in place. Significant developments are also underway to support a European Banking Union including: agreement on the Fourth Capital Requirements Directive and Regulation (collectively known as CRD IV); the Single Supervisory Mechanism for banks in the euro area and in participating non-euro area member states. Work is underway to create an operational framework for the direct recapitalisation of banks by the European Stability Mechanism (ESM). A single-resolution mechanism is being developed to safeguard financial stability and ensure an effective framework for resolving

¹¹ NewERA was established on a non-statutory basis in 2011 to provide oversight of the commercial state companies from a commercial perspective. Its functions include advising on the disposal or restructuring of state assets if requested and ensuring that government plans on energy, water and broadband are implemented within the commercial state sector.

¹² The NTMA (Amendment) Bill 2013 will provide for the establishment of the Ireland Strategic Investment Fund (ISIF). See <http://www.finance.gov.ie/viewdoc.asp?DocID=7712>, accessed on 5/9/13.

¹³ Credit Institutions (Stabilisation) Act 2010; Central Bank Reform Act 2010; and Credit Institutions (Resolution) Act 2011.

financial institutions while protecting taxpayers in the context of banking crises. There are also plans to reform the European Deposit Guarantee Schemes to ensure consistency of approaches to guaranteeing the savings of European citizens.

Institutional Reform and Innovation

The Irish government has led an important process of institutional innovation, including the establishment of the State Bodies Group and the Credit Review Office (CRO) and EI mentoring work for the banks. The State Bodies Group was set up in 2012 and is chaired by the Department of Finance. It comprises senior officials from the Department of Finance, the Department of Jobs, Enterprise and Innovation, Department of Education and Skills, Forfás, Enterprise Ireland, the NPRF and Fáilte Ireland. It is responsible for the development and delivery of the action points in relation to Access to Finance for SMEs under the Action Plan for Jobs. Its purpose is to examine the credit environment, oversee agency efforts to help business use funds optimally and to examine alternative and innovative sources of financing. The CRO, established in 2010, provides a review process for small and medium-sized enterprises (SMEs), sole traders and farm enterprises that are refused credit from participating banks. By the end of the first quarter of 2013, it had finalised 244 cases and upheld the borrower's case in 135 (CRO, 2013: 11). There is also very necessary and important work taking place to develop the capacity of bank staff to make lending decisions in non-property areas and to deal with arrears. For example, staff in Enterprise Ireland are working closely with bank employees, which is important as the need to develop the organisational capacity of the banks continues to feature in reports from the CRO. Taken together, these developments provide evidence of an emerging capacity to provide more fine-grained and intelligent analysis of the problems facing firms, for example:

- The Department of Finance has commissioned a number of surveys that focus on the supply and demand for credit and has held regional consultations to discuss the experiences of firms and other stakeholders in specific sectors;
- The Central Bank has a three-tier process for engaging with banks on SME loan-re-structuring: monthly meetings with senior staff; detailed onsite operational reviews and loan-file reviews.
- The CRO reviews rejected credit applications and publishes headline figures but it also carries out analysis of the reasons why applications are rejected;
- Individual banks have developed detailed scales, for example, the Bank of Ireland has a 14-point scale, which defines different degrees of loan performance.

In addition, the relationship between the regulator and the regulated has changed in important ways. The Central Bank is now involved in areas normally associated with internal management functions: it is carrying out reviews of organisational structures, resource capacity and staff skills, experiences and quality of training.

Progress on mortgages and credit availability will be monitored by a cross-Government Mortgage Arrears Steering Group and the Cabinet Committee on Mortgage Arrears and Credit Availability. A key challenge is to ensure that the targets set out are achieved.

3.3 Enterprise Policy

Substantive Action

Government launched its second Action Plan for Jobs (APJ) in 2013. It contains 333 actions and engages 16 government departments and 46 agencies. (Appendix 2 provides an overview). The main elements of the APJ are: Disruptive Reforms; Pathway to Work; Access to Finance; Competitive Advantage; Entrepreneurship; Indigenous Business; Foreign Direct Investment and Employment at Community and Local Level. Appendix 2 describes each in more detail. This represents an important widening of enterprise policy. It includes a strong focus on developments in relation to finance; covers more sectors such as construction, tourism and retail; reflects new thinking about the green economy and emphasises local and community employment. Ireland still faces the challenge of developing its indigenous business sector, a theme in discussion of enterprise policy since at least the 1970s (see Box 3.1).

The APJ acknowledges the capacity that now exists in the indigenous sector. It argues that there is a significant and growing export footprint and that in some sectors, such as construction and food, this has increased during the crisis. It focuses on the need to better connect Irish-owned firms into global supply chains, both in Ireland and abroad; the scope to develop export and/or import substitution capacity; and specific initiatives that link firms with the scientific community (Big Ideas Showcase) and international buyers (International Markets Week). In addition, in relation to foreign-owned investment the IDA's strategy (Horizon 2020) retains the focus on attracting new investment and jobs but has increased the emphasis on working with existing companies to helping drive transformation that protects and retains jobs in Ireland. Of 148 investments supported by the IDA in 2011, 46 were expansions by companies already operating in Ireland (IDA, 2013).

Box 3.1: Ireland's Development Model

Since the late 1950s, Ireland has had a dual economic development strategy involving both attraction of inward investment and building of competitive advantage in domestically owned sectors and firms. Somewhat greater success in attracting inward investment, especially in the 1970s and 1980s, has led some to assume that Ireland's development model and strategy is based almost entirely on Foreign Direct Investment (FDI). This is not accurate and, indeed, the challenge of linking indigenous and foreign business development will, in the coming decade, become a central focus of enterprise policy.

FDI has remained resilient through the crisis and been important in enabling the economy to offset some of the effects of the crisis. FDI enterprises are very important to Ireland's export earnings. Forfás figures show that foreign-owned enterprises generate approximately 90 per cent of Ireland's gross export earnings in the agency-supported sectors. This overstates their contribution, however, as there is a high import content and profit outflows associated with these exports. When account is taken of this factor, it was estimated in the NESC Secretariat paper (2011b) that Irish-owned enterprises generated approximately 28 per cent of export earnings with foreign-owned enterprises contributing 72 per cent.

While foreign-owned companies contribute the larger share of export earnings, over the decade to 2011 the growth of export earnings by indigenous enterprises (63 per cent) has exceeded the growth by foreign-owned enterprises (56 per cent). The growth of export earnings in internationally traded services was similar for Irish- and foreign-owned enterprises (127 per cent and 129 per cent respectively) but Irish-owned enterprises had stronger growth in manufacturing exports (31 per cent compared to 20 per cent).

In 2011, foreign-owned firms represented 53 per cent of employment in manufacturing and 58 per cent of employment in internationally traded services. Ireland has an exceptionally high reliance on FDI for employment and exports. A continuing challenge for Ireland is to develop a stronger indigenous export base and more Irish-based multinationals.

Institutional Reform and Innovation

The APJ has seen the creation a new process of planning and monitoring, centred in the Department of Jobs, Enterprise and Innovation and the Department of the Taoiseach. Appendix 2 provides a fuller account. It seems important to highlight these potentially important institutional innovations. Beyond that, analysis and discussion might help to improve this process in other areas, though it should not be assumed that the process could be replicated in its entirety in all areas of policy.

What has emerged, thus far, is a process with three key elements: an overarching plan; a monitoring committee and secretariat; and steering or implementation groups. The plans are developed by the Department of Enterprise, Jobs and Innovation and Forfás. The government endorses and commits to implementing the

plans. The management of the process is carried out by a Monitoring Committee, located within the Department of the Taoiseach. It is supported by a small secretariat. The activities of the Monitoring Committee and its secretariat include breaking down plans into quarterly actions; developing ‘flash’ reports to track progress; referring problems to key decision-makers; and quarterly reporting. A distinctive characteristic of the process is the technical or sectoral-level expertise of the secretariat. The APJ also includes an important institutional development designed to support indigenous development. It establishes a senior management team across IDA and EI to focus on scaling Irish enterprises into global players and forging partnerships in business, research collaboration and new ventures overseas. This team will examine how to attract inward entrepreneurs, maximise procurement opportunities and strengthen linkages between multinational corporation’s (MNCs) and SMEs.

3.4 Greening the Economy

Substantive Action

State of the Environment reports are now produced every four years¹⁴ and there is also a new online indicator. The report provides a snapshot of the environment, and tracks trends and changes. It evaluates progress in meeting environmental priorities and assesses whether national policies are being implemented and working. It also identifies priorities and challenges for the future. This is a significant development. The environment can be a valuable asset for recovery but many elements are finite and as such must be protected. A first step is more detailed and more regular assessment of the environmental trends and the impact of national policies. At an EU level, there has been considerable environmental policy development in recent years, with green issues permeating core strategic initiatives. There is a clearer and more centralised focus on resource efficiency, green growth and climate change, and an emphasis on developing a circular economy that is decoupled from environmental impacts. In this context, the Irish Presidency has progressed what is likely to be one of the key requirements for a green economy: a recognisable definition and measure of the greenness of a product or service. This will be the precursor to allowing greater EU market integration and removing barriers to trade. Currently, companies with green credentials are forced to apply to different schemes in most European countries to receive accreditation (European Commission, 2013a). In Ireland, *Delivering Our Green Potential* is a government policy statement that examines the potential of the green economy (Department of Jobs, 2012). Appendix 3 provides an overview. The policy statement argues that Ireland has significant strengths and advantages that it can leverage to exploit business opportunities in the green economy. Key among

¹⁴ Prior to 2000, Ireland produced two in 1985 and 1996.

these are natural assets and the expertise and research base. It notes that Irish natural assets—clean air and water, consistent wind, ocean resources, natural landscape and biodiversity—provide a strong platform for the development of the green economy that surpasses the potential of many other countries. This policy statement signals an important awareness of the potential for greening our economy.

Institutional Reform and Innovation

There have been some interesting policy and process innovations on greening the economy and integrating the environmental dimension into core policy. One of the most striking institutional developments is the range of policy statements and reports, from numerous departments and agencies, which examine many aspects of Ireland's environmental resources, and associated opportunities and vulnerabilities¹⁵. A selective review of EU and international policy and legislative context confirms that the environment—both its protection and its role in supporting growth—is now widely recognised. Environment is one of five headline targets of the EU 2020 Strategy relates to climate change and energy sustainability. The EU 7th Environmental Action Programme focuses action on nine priority objectives including natural capital; resource efficient, low-carbon economy and health and well-being. There is also an EU Biodiversity Strategy to 2020, an EU Habitats Directive, Water Framework Directive and Birds Directive and Environmental Impact Assessment Directive. In addition, the United Nations Framework Convention on Climate Change (UNFCCC or FCCC) seeks to stabilize greenhouse gas concentrations in the atmosphere.

The second development is a recognition that getting beyond policy and legislative ambition towards practical ways of integrating environment is now accepted as a critical challenge. The many diverse reports—including NESC's work on sustainable development in 2012 (NESC, 2012c)—share common conclusions and recommendations, which refer to this need for the integration of environmental issues into core policy decisions, both economic and social. Across Europe and in high-level EU decision-making, it continues to be difficult to integrate environmental policies into economic decision-making (European Commission, 2013b). The challenge of integrating environment is complex, for a number of reasons. Some of these apply in most countries most of the time, and some are particularly relevant at times of economic crisis, unemployment and fiscal constraints. In most democratic countries, public policy and politics tends to be strongly influenced by economic concerns; in times of acute economic crisis, unemployment and fiscal deficit, this tendency is reinforced. A limit in this regard is that the short-term interaction between economy and ecology is only being discovered gradually. It is also the case that environmental issues, and the policy

¹⁵ This includes (EPA, 2012a); (Department of Environment, 2012a) ; (Department of Jobs, 2012); (Department of Communications Energy and Natural Resources, 2012); (Department of Communications Energy and Natural Resources, 2009); (Department of Environment, 2012b); (CSO, 2013c); (Department of Communications, 2012); (Department of Environment, 2011); and (NESC Secretariat, 2012)

instruments that can address them, rarely fall within the control of a single government department or agency. Integration must also confront a wider set of policy and implementation issues—the role of centre, nature of devolution and a means of dealing with conflicts—that are not fully resolved in Irish public administration and public policy (NESC, 2005b). It is not surprising, therefore, that real integration of economic and environmental perspectives is challenging. In the case of both society and environment, it is relatively easy to enunciate the need for an integrated approach, but hard to make this real and comprehensible. There is a need to own and explore how this integration will actually happen, rather than to assume that integrating environment and economy will either happen in response to overarching strategy or emerge in time in response to bottom-up action. That policy-makers and other stakeholders accept this point is an important step forward towards making real progress.

3.5 Activation

Substantive Action

A much stronger focus on active unemployment support was spurred on by Ireland's Memorandum of Understanding with the IMF/EU/ECB (the 'Troika agreement'). A reformed system of policies to activate those receiving unemployment benefits was agreed. To implement these commitments, the government has introduced legislation, set up new structures, and published an activation service model, *Pathways to Work*, to promote activation in Ireland. Appendix 4 provides an overview of the five strands around which the work is organised. These reforms include instruments to profile jobseekers and to increase engagement with them; more effective monitoring of jobseeking activities; and sanctions for those not complying with job-search requirements. Significant changes have also been made for those on One Parent Family Payment (OPFP): on a phased basis between July 2013 and July 2015, lone parents on this payment will be moved to a transitional Jobseeker's Allowance once their youngest child has reached seven years of age. There are significant changes to the treatment of lone parents in the social welfare code, as previously they had not been required to engage in the Department of Social Protection's activation process in order to receive such a payment. Changes in how employers are engaged are also being rolled out. In particular, new schemes to encourage hiring of those on the Live Register have been introduced. These include the JobBridge internship programme, where employers can recruit a person who had been claiming unemployment benefit¹⁶ for at least three months, as an intern. In 2013, the government introduced JobsPlus, which provides a payment of up to €10,000 to employers who

¹⁶ The intern can also be in receipt of One Parent Family Payment or Disability Allowance.

recruit a person who has been on the Live Register. This simplifies previous schemes that reduced employer costs where an unemployed person was hired.

Institutional Reform and Innovation

Activation policy is the area in which there is the largest-scale institutional reform. Implementing *Pathways to Work* and the activation agenda has seen a range of new institutional processes and innovations. A somewhat similar process to that operating for APJ has been established (see Appendix 4). There has also been significant reform of institutions. The organisations that had previously provided welfare payments and training and other unemployment supports are now all part of Intreo, the new public employment service, under the Department of Social Protection. Two thousand staff were transferred from these bodies and by the end of 2012, 10 Intreo offices had been established (Department of Social Protection, 2013b), and one more was established in quarter one of 2013 (Department of Social Protection, 2013a) with plans to roll out the remaining 33 Intreo offices by the end of 2013, in line with the target.

The Department of Social Protection commissioned a service model template that was adapted for use in the Intreo offices, changing and speeding up processes for clients. A change-management and training team within the Department was also set up, which works with each new Intreo office. A variety of new functions were also set up in the Department of Social Protection, including case management, employer engagement, building links with Solas,¹⁷ and culture change/communications. They all work under the programme-management and change-management office. The Department of Social Protection now also has all relevant work programmes under its aegis. This includes the Community Employment Scheme. It is important to note that Community Employment has a dual function: it provides work experience for jobseekers and helps community and voluntary groups provide important services. It is now widely agreed that, in line with wider policy developments, there has to be renewed focus on the quality of both the progression of those participating and the services provided.

Other changes have also begun in further education and training (FET). Legislation was recently passed to reorganise the sector. First, Solas will be the new statutory authority co-ordinating and funding the FET sector, and secondly, 16 Education and Training Boards (ETBs) will be responsible for the delivery of publicly funded FET programmes. The 16 ETBs will incorporate the existing 33 VECs, and the FÁS training centres. Solas will incorporate some parts of FÁS, but has quite different functions, acting as a strategic co-ordinating and funding body and not providing training itself. In terms of Departmental responsibility, the ETBs and Solas will be under the Department of Education and Skills. For training that connects particularly to the labour market, this is a change: until 2010 this was governed by FÁS, under the Department of Enterprise, Trade and Employment.

¹⁷ This is a new statutory authority co-ordinating and funding the further education and training sector.

The Departments of Social Protection and of Education and Skills now need to connect much more than previously on FET. Therefore, the Department of Social Protection now has a representative on the MAC¹⁸ of the Department of Education and Skills, to ensure a link at a high level. In addition, the person responsible for FET in the Department of Education and Skills part-reports to the Deputy Secretary responsible for *Pathways to Work* in the Department of Social Protection. The Secretaries General of each Department also meet regularly, with the person responsible for FET in the Department of Education and Skills, and the Deputy Secretary responsible for *Pathways to Work* in the Department of Social Protection.

¹⁸ Management Advisory Committee. Each government department has a MAC, whose members are the Department's Secretary General and Assistant Secretaries (the senior managers).

Chapter 4

Deepening Reform and Institutional Innovation

4.1 Introduction

During the five years of the crisis, part of NESC's work has been to probe specific areas of policy. In its work on standards in human services Box 4.1 and the four areas discussed in Chapter 3, it has focused on understanding the internal logics and systems by which policy is designed, implemented and improved.

The nature of this NESC analysis is what might be termed 'inside-out'. It begins inside a policy or services area and investigates how it works. Such analysis takes account of the institutional arrangements in place and the roles played by non-state actors (such as NGOs in disability and firms in enterprise and development).

The evolution of a given policy sector and the trajectory of reform is judged by reference to the substantive goals of quality-tailored services and by the adaptation of policy and programmes to changing needs and conditions. This contrasts with the 'outside-in' perspective that tends to judge diverse sectors against some standard precepts of public-sector modernisation—such as 'joined-up government', 'leadership', 'evidence-based policy', etc. Rather than propose such generic solutions, our approach takes more account of the specifics and context of each policy and service area and of the work of those seeking to deliver reform and improvement. For a variety of reasons, the policy sectors really do vary in the way they are configured and the degree to which they are organised to reflect and adapt.

An important further consequence of this approach is that the necessary improvements in the central policy and administrative systems—suggested by a careful account of sectoral and front-line practice—differ from one area to another. For example, our consideration of the APJ suggests that some aspects of central co-ordination, monitoring and strategic process be thought about; our analysis of quality and standards in education suggested a very different kind of message for the central system—concerning a national architecture of data-gathering and support for schools.

Box 4.1: NESC's Method of Analysis of Institutional Reform: Quality in Human Services

During 2011, NESC undertook analysis of quality and standards in six human services: the school system; disability services; residential care for older people; home care for older people; end-of-life care in hospitals; and policing. This work was informed by international and Irish approaches to regulation and standards-setting in both human services and other regulated areas of the economy and society (see *Quality and Standards in Human Services in Ireland: Overview of Concepts and Practice* (2011c)).

These studies report a 'silent revolution' in the regulation of many of our human services, for example through the Health Information and Quality Authority (HIQA) and others. They found that there is now greater attention to the quality of services, and the standards underpinning them, due to increased oversight. While a number of reports and media articles recount that many citizens in Ireland seem to have lost trust in public services as a result of systems failures in some services, the main finding of NESC's work was that there has been progress and reform in terms of the regulation of some services by making them more accountable for quality, standards and outcomes. This message is very much in line with the thrust of the analysis in this current report, which identifies that in a number of areas (economic, social and environmental) some progress on reform has been made and we need to build on that by identifying the next challenges and institutional requirements.

A separate report synthesised the implications of these studies and reform narratives for the wider public sector reform agenda (see *Achieving Quality in Ireland's Human Services: A Synthesis Report* (2012b)). It argued that two things characterise the further institutional development necessary for continuous quality improvement: collaboration and continuous scrutiny. Thus, individual organisations need to be supported to improve through collaboration with regulators, other providers and user groups; and there needs to be continuous scrutiny of the overall quality and cost of services within a given field to ensure that they are aligned with people's and society's changing needs. It suggests the need for a 'policy centre supportive of continuous improvement', which would be concerned not just with whether individual organisations are meeting certain standards, but how they can be supported in this undertaking and how the entire sector can be continuously improved. It is envisaged that the work of the policy centre in a given context will involve a 'performance dialogue' to maintain a balance between being supportive and being provocative if services are not delivering the required standards and quality. Support for experimentation and innovation should form part of this role, as well as a focus on outcomes and the related collection, analysis, feedback, sharing and comparison of data and knowledge. These findings and ideas are pertinent to the broader reform agenda that is discussed further in Section 4.5 of this report.

A separate question is how the next institutional reform requirements in diverse sectors fit together. If, say, enterprise policy requires that thought to be given to strategic exploration of new possibilities, education requires further building of a national data architecture, and environment requires (among other things) that the strategic capability to resolve conflicts be enhanced—together these should be part of the overall public-sector reform agenda. It is important to ask whether there is a pattern to the next challenges in these diverse areas.

In summary, the purpose of this work is threefold. First, it can help those working in these areas to identify how logics or systems might be enhanced. Second, it can help identify what these policy actions and institutional changes mean for government and central administration in each area. Third, it may help us in thinking about how to advance, balance and communicate the overall policy and public-sector reform agenda. This is underlined by the need to move beyond the Troika as the institutional framework for fiscal stability, public governance and reform. In this regard, this chapter also suggests that it is necessary to achieve an appropriate balance between, and better articulation of, three broad kinds of reform—fiscal, substantive and systemic. The report closes by suggesting that this requires, in addition to careful and sympathetic study of each sectoral area, a more shared positive perspective on the future of the Irish economy, environment, society and state.

Structure of Chapter 4—Extending Reform and Innovation

Section 4.2 focuses on the four selected areas considered in Chapter 3. It identifies possible further institutional reforms and innovations in each of these four areas. Table 4.1 provides an overview of some of the actions and reforms and, in the third column, summarises possible further developments within each sector.

The remainder of the chapter discusses four more general conclusions, and is structured as outlined in Table 4.2.

Table 4.1: Extending Reform and Innovation in Four Selected Areas

Four Area of Reform	Substantive Policy Initiatives & Action	Institutional & Process Innovations	Possible Further Institutional Developments & Generalisations
Investment, Banking, & Finance	Funding Programmes Lending and Debt Resolution	New System for Developing SMEs for Growth and Innovation	Role of ISIF Long-Term Financing State Investment Bank Regulation of Regulation
Enterprise Policy	Action Plan for Jobs	Implementation and Monitoring Process	Nature of Targets, How they are Set and Reviewed Openness to Innovation and More Difficult Issues Openness to Wider Views Probe Innovation and Science Policy
Greening the Economy	EPA Reporting <i>Delivering Our Green Potential</i>	Accepting Integration as the Challenge (and Opportunity)	Trade-offs and Synergies Differentiated 'Cleantech Strategy' New Ideas—Job Intensive Marie Exploring the Role of Data
Activation Policy	<i>Pathways to Work</i>	Major Organisation Restructuring	Developing the Capacity to Implement Involvement of Stakeholder Groups Diversity of approaches Required

Table 4.2: Extending and Deepening Reform and Innovation—Four More General Conclusions

Section 4.2	Reflect on Ireland’s Post-Troika Institutional Framework for Fiscal Stability, Public governance and Reform
Section 4.3	Embed Policy and Institutional Reform in the Medium-Term Economic Strategy
Section 4.4	Balance and Articulate Three Kinds of Reform—Fiscal, Substantive and Systems
Section 4.5	Articulate a Positive Perspective on the Future of Irish Society and the Role of the State: Integrated Developmental State

4.2 Extending Reform and Innovation in Four Selected Areas

The developments in banking and finance, enterprise policy, activation and, to a degree, greening the economy, constitute a significant advance in policy co-ordination, implementation and monitoring.

The ultimate purpose of this report is to add value by helping to identify how the policy and institutional developments discussed in Chapter 3 might be extended, generalised and improved. This section summarises the possibilities for further action and reform that have emerged as a result of NESC’s work during 2013.

4.2.1 Investment, Banking and Finance—Further Action and Reform

In relation to investment, a range of measures have been taken by the government. As noted, the National Pension Reserve Fund (NPRF) is to be converted to the Ireland Strategic Investment Fund under new legislation. The NPRF assets that have not been invested in the banks—currently valued at €6.4bn—are to be made available for commercial investment in the Irish economy to support economic activity and employment. This commitment has significant potential. A key issue that needs to be addressed is how these funds can be most effectively used to support economic recovery. The pursuit of two objectives in the new strategy—to achieve a commercial return and to support economic activity in Ireland—is more demanding than the former objective of only pursuing one of these (i.e., a commercial return to contribute to future pension funding). The Council strongly

supports the increasing focus of Irish policy on investment and endorses the use of the NPRF funds for investment in the Irish economy.

While investment is recovering in 2013 as discussed above, it is from a very low base. The level of investment in Ireland in 2012 (10.0 per cent of GDP) was lower than in any other EU (28) country and just over half the euro area average (18.4 per cent). Ireland's exceptionally low level of investment is due to the very low level of investment by companies and households. Household investment in Ireland in 2011 (3.0 per cent of GDP) was half the euro area average (6.0 per cent of GDP) while business investment (4.5 per cent of GDP) was less than half of the euro area average (11.1 per cent). General government investment in Ireland (2.6 per cent of GDP) was somewhat above the euro area average (2.3 per cent) of GDP.

The low level of household investment in Ireland is understandable in the light of the unsustainably high level of housing investment in the boom. However, the situation is different for business investment. Business investment in Ireland did not increase in a comparable way during the boom and even at its peak level in 2005 (8.8 per cent of GDP) was below the euro area average (11.1 per cent of GDP). The level of business investment in Ireland is also lower than the other crisis-hit euro area member states.

An increase in investment is a necessary element of an economic recovery. Areas where there is a definite need for increased investment in Ireland at present include water, renewable-energy generation and networks, and high-speed ICT connectivity and schools. Strategic public-transport investment may also be worthwhile. The area of energy—in particular renewable energy—seems to have particular importance and in other European countries investment strategies are emerging that involve greater financial participation by individuals and small groups of investors (for example, the German energy-transformation project—*Energiewende*). Beyond these areas, wider business investment is critical. This depends on improving economic conditions and reforming systems of finance for business, as discussed in Chapter 2.

Figure 4.1: Investment in EU Member States as a Percentage of GDP, 2012

Source: Eurostat online database.

The work by the Department of Finance on the development of an appropriate and more diversified system of finance, including renewed focus on the role of the European Investment Bank (EIB), for long-term investment in SMEs, infrastructure and other long-lived capital goods (e.g. social infrastructure, R&D, education and innovation), should continue (Department of Finance, 2013). The DOF is correct to frame this as a European issue as many of the requirements—ability to securitise SME loans or develop a small bond market—may simply not be possible in Ireland.

In Ireland and globally, the banking crisis is still unfolding and likely to do so for some time to come. It looks extremely likely that central banks, regulators and policy-makers will have to work with heightened levels of uncertainty for the foreseeable future. In addition, the complexity of finance continues to grow, fuelled by a search for new products including enhanced means of securitisation for mortgages and SME loans. This has three important consequences (Gorton, 2012). First, rules are less useful as the crisis continues not to be predictable. Second, the idea that any one policy would forever solve the problem of this crisis is naive. Third, it probably means no one is in a position to see and understand all these changes. These consequences need to be reflected in the strategies and actions of those charged with managing and overseeing the State's financial system. For these reasons the institutional developments underway should not be seen as a temporary response to the crisis. Instead, they should be seen as gradually and incrementally working towards putting in place a more effective banking system that can serve the needs of the real economy. A challenge for the emerging system is that the needs of business, or the needs of households or wider society, are not always compatible with the interest of banks, and vice versa. Potential trade-offs need to be recognised and addressed in an ongoing process of policy development, innovation and continuous review.

Furthermore, greater dialogue about the regulation of regulation, meaning the structure and performance of the regulatory function, within the banking and financial sector is necessary. International research challenges, somewhat, the prevailing regulatory orthodoxy—that it was the absence of rules and supervision that caused the crisis, and that more rules and tighter supervision are the solution (*ibid.*). Others also caution that the international and banking system remains fragile (Anwati & Hellwig, 2013) and highlight the limited effectiveness of reformed Basel III regulations and rules (McCarthy, 2013); (Kay, 2012). Ongoing dialogue about the changing nature of financial regulation is needed. Specifically, is there evidence of what NESC has identified in other service areas of a 'centre supportive of continuous improvement' (NESC, 2012b) and are there lessons that can be drawn from international experience?

Finally, there is a need find space to work on medium and long-term issues such as the role of a state investment or business bank; non-bank sources of finance, including 'small' bond markets' for SMEs and crowd-funding; the impact of new international entrants; sectoral specialisation; financing service companies; and digitisation of finance.

4.2.2 Enterprise Policy—Further Action and Reform

Ireland has long had an activist approach to enterprise policy. In the instances where it has been most effective—IDA, and increasingly many parts of Enterprise Ireland—it is because the engagement is based upon a rigorous, data-intensive, recursive and organised search process. For valid historical reasons, the footprint of the enterprise agencies remains quite narrow and it may be that the agencies may simply be unable to provide the same level of flexible and responsive support to smaller sectors and to smaller firms. If the APJ is to deliver on the full potential of Irish indigenous companies, the reach and capacity of Enterprise Ireland needs to be expanded.

Related to this, there is merit in now considering whether a similar recursive and open means of engagement could be applied to science and technology and how it is supported by the State (O’Riain, 2013). The OECD has also recently suggested that Ireland’s innovation policy is in need of review (OECD, 2013b).

In addition, the knowledge and ability to interrogate business plans, which exist in IDA, EI, Bord Bia and some other agencies, needs to be a key part of national economic planning and the Medium-Term Economic Strategy (MTES). We require a feedback mechanism that is capable of assessing the needs of industry and associated sectoral plans. This should be a core feature of the approach to MTES.

Furthermore, the APJ as a process needs to ensure that it is capable of continually stimulating higher levels of performance by departments, agencies and other stakeholders. The process might be improved by ensuring that a higher proportion of actions specify outcomes rather than outputs (actions taken), and that those outcomes are more precise: meaning that there is a reasonably clear sense of what policy action will lead to and some basis for objectively assessing this. However, in suggesting more precision we are not arguing for rigidly fixed targets. The key lesson may be to consider how more data-intensive review might be incorporated into the process, and in this context the role of the institutional structures underpinning Food Harvest should be carefully considered. Food and agriculture is one of the most developed sectors in the APJ—in terms of including very specific outcomes, some of which include targets for jobs to be created. In the sector, there is an underlying process in place, which seems capable of challenging specific targets and resetting as work progresses. The process is led by the Minister for Agriculture, Food and the Marine and constructed around a high-level implementation group and a number of sectoral ‘activation’ groups and ad hoc groups. This process includes the development and achievement of very specific annual milestones.

Finally, the enterprise-policy process needs to be broader, more open to innovation and to ideas from outside business and beyond ideas that business can identify at any given moment. At present, the APJ is narrow in the sense that it focuses on concrete deliverable actions in a defined timescale. It is more an action plan for enterprise than jobs. The APJ’s focus is on creating the conditions by which enterprise may create more employment and the supply-side measures available to government to support firms. It might be enhanced by creating—within the APJ

processes or in a parallel process—space in which to consider more experimental actions. Furthermore, it is necessary to accept that there are issues for which the answers, or even the problems, are not obvious—for example, how to develop an indigenous Irish waste and agricultural anaerobic digestion industry. In these areas there are multiple aspects to the challenge—gate charges for waste, energy tariffs, planning, needs of end users in heating and transport, infrastructure, etc. In these areas, enterprise policy needs to animate and mobilise industry or agencies of the State that already are or have the potential to jointly explore and experiment with business in order to figure out how to make things work and to test and build ideas that have scale. It is also important to consider how stakeholders beyond business might be empowered to bring forward and develop proposals that could have both short-term benefits and, potentially, transformative effects on our future economic model.

4.2.3 Greening the Economy—Further Action and Reform

Given the global pressures on environmental resources and growing scarcity, Ireland’s natural endowments are a distinctive strategic asset. The scale of the opportunity is very significant: the EU economy could reduce its total material requirements by 17 per cent and, if achieved, would boost GDP by up to 3.3 per cent and create between 1.4 and 2.8 million jobs (European Commission, 2011). The EPA *State of the Environment Report* (2012b) shows that the quality of the environment is generally high. However, biodiversity loss is considerable, environmental assets are finite and as such are extremely vulnerable to overuse and misuse. The EPA identifies the key challenges for Ireland: ensuring that our natural environment is valued and protected; building a resource-efficient, low-carbon economy, which includes the challenge of meeting Ireland’s 2020 targets for greenhouse gas emissions; and finally, the need to place environmental considerations at the centre of policy and decision-making at national, regional and local levels.

The final challenge of integrating environment, economy and society is critical. It is complex and will not be achieved merely by calling for integration of environmental concerns into core policy or by proposing generic approaches such as ‘joined-up government’. All involved must reflect and grapple with the problem. Without doing so, the opportunities associated with environment will not be fully realised. There is a need to own and explore how integration will actually happen, rather than to assume that integrating environment and economy will either happen in response to overarching strategy or emerge in time in response to bottom-up action. In practice, integration of economic, social and environmental policy implies trade-offs. There are certainly synergies, but making progress on integration requires that the trade-offs are identified, analysed and addressed effectively. Indeed, some years ago NESC highlighted the fact that despite many improvements in environmental policy, Ireland did not have an institutional mechanism capable of resolving conflicts in a timely and effective way (NESC, 2005a). The inter-relation between the environmental, economic and social dimensions needs to be worked out and explored based on the specific ways in which environmental, social and economic issues interact *in the Irish context*.

More explicit consideration of the different kinds of environmental policy—and within these, the roles of different bodies¹⁹—would concretise the areas and ways in which the three dimensions interact and overlap. In addition, research work can help define how economy, environment and social priorities integrate in practice (Davies, 2013 (forthcoming)).

The second area concerns jobs. The ability to capture the full potential of the green economy could be further enhanced by developing a more differentiated strategy for Ireland’s cleantech ‘green’ enterprise. Natural endowments (such as wind and land-based agriculture) and challenges (low quality of the existing housing stock and scale of unemployment in the construction sector) can provide a basis for a more targeted national strategy or ‘green priorities’. Combining how we manage these endowments or challenges with the ICT skills and technologies that now exist in the economy offers a fertile basis upon which to formulate a focused national cleantech strategy. The development of such a strategy would allow a more searching examination of the domestic and international employment potential associated with products and services in these sectors.

In addition, more jobs may be created by broadening what is included in the green economy. Current ‘green’ strategy is predominantly about ways that businesses or individuals can produce and/or consume products and services at lower cost to the environment. This is an integral part of the greening of the economy; however, there are other ways in which the economy might be greener. Appendix 5 summarises the one body of work that suggests additional ways. The challenge in policy terms may be to find ways to explore ideas like these. Many—such as labour-intensive marine or wood-based insulation products—would seem to go with the grain of current policy. In these instances the ideas need to be engaged with but without setting predefined limits on how much they may challenge existing approaches. Thus, consideration of how to develop more labour-intensive fishing, for example, could have profound consequences for our marine policy. Other ideas suggested—for example, in relation to taxation, circular economy and employment contracts—will be more challenging for the policy system. However, this should not mean that these are excluded from further consideration and development. In these areas, local-level projects and experimentation—rather than immediate action on behalf of government—is likely to be key to their future integration into mainstream policy.

Finally, an important further development is an exploration into the data and accounting systems as they relate to environmental assets and costs. Irish experience in recent years highlights the difficulties that arise for economies when critical assets are not valued correctly. In relation to the environment, there are a number of issues that make valuation challenging. These relate to the degree of

¹⁹ It is interesting to note that in its *Environmental Performance Review of Ireland*, the OECD recommended that ‘in the context of the ongoing review of local governance, [Ireland should] examine the *environmental responsibilities of different administrative levels* [emphasis in original] to identify opportunities for better co-ordination, economies of scale and improved policy development and implementation’ (OECD, 2010).

scarcity or substitutability of environmental assets; the interactive impact of the ‘entirety’ of decisions on a region’s development path; and uncertainty about the value or cost that future generations may attach to assets or their absence (Atkinson, 2009). Data and indicators are available in Ireland²⁰ and internationally and knowledge would seem to be improving in relation to valuation.²¹ However, it is not clear what impact the existing data is having on the decisions of firms and households, and, indeed, of policy-makers. To support integration, the Council believes this issue should be explored further. However, it may also be that the source of inspiration for greater integration (of economy, society and environment) are firms and households themselves. In this sense, there would also be value in further research to explore the systems of decision-making and valuation that are employed in what might be termed loosely as greener organisations.

4.2.4 Activation and Further Education and Training—Further Action and Reform

Reforms of welfare, activation and FET are among the most important and challenging issues facing Irish public policy, administration and, indeed, societal actors. It is recognised that, given what has already been done, very significant further action and reform and institutional innovation are necessary. Here we briefly discuss the need for further reform to address issues of capacity, skills, engagement of employers and other stakeholders, data-gathering and review.

An immediate challenge in implementing Ireland’s activation agenda is the capacity to provide the range of services that constitute activation. Three hundred staff were working as employment-support case managers at the end of 2012, and this number is due to double in 2013. However, this is not enough to deal with all those on the Live Register. Contracting additional case-management capacity from the private and voluntary sector has been suggested as a means to address this in *Pathways to Work*. If capacity to implement case-management activities needs to be sourced from outside the public sector, effective central management systems will need to be developed to oversee this challenging area of work. Collection of good data to identify outcomes, what works and what does not, is key in managing outsourced (and in-house) capacity—and also in continuously improving activation. For continuous improvement, what is effective needs to be identified, and this can be done through feedback from service-users and employers, and sharing information from them and all available data sources. Those working with the unemployed have a range of useful local knowledge and experience that needs to feed into wider national policy-making and implementation, to ensure that it is continually improved.

²⁰ This includes the EPA’s work for the *State of Environment* report, the CSO national sustainable development indicators and the ESRI work on measuring Ireland’s green net national product (GNNP).

²¹ For example, in 2011 the UK National Ecosystem Assessment provided a detailed analysis of the UK’s natural environment in terms of the benefits it provides to society and continuing economic prosperity.

If a decision is made to train more Intreo staff as case managers, their skills and aptitude will be important. In terms of skills, they will need to have extensive knowledge of the social welfare system, employment opportunities, further education and training, work programmes and how to provide career guidance to people with a very varied range of skills and qualifications. Such skills will help ensure that jobseekers receive the best career-guidance assistance to prepare them for employment and training opportunities.

A key further development for activation will be to involve employers in the reconfigured further education and training (FET) sector, to help address skills mismatches. A strategic review of FET provision is currently being undertaken, in which the NESC Secretariat is playing a part. This will help address the skills mismatch in the labour force. Key issues that could be usefully considered include types of course, innovative forms of delivery, and numbers of places. The connection between FET and social welfare policy and delivery will also be key, given the skills mismatch between many of those unemployed and the labour-market skills gaps. It will be important to ensure that this connection works well at both national and local level.

There are also other aspects of the activation reform process that require further consideration. These include the development of ‘jobs polarisation’, or the ‘hourglass economy’, with growth in specialised high-skill, high-wage jobs; moderate growth in low-skilled, low-paid jobs (often part-time and/or precarious); and a decline in intermediate skilled jobs. Lower-paid, part-time and/or precarious employment provides a greater link to the work force than unemployment, but it is important to consider the extent to which these jobs may provide adequate income for individuals and their families and the interaction of these ways of working with the welfare system. Some concern has also been raised about the extent to which the Jobseeker’s Allowance template can be used to build a single payment for people of working age, as it may not provide the supports needed by for example, those on disability payments, or lone parents who have difficulties accessing affordable childcare (Disability Federation of Ireland, 2012).²² There will also continue to be other groups of vulnerable people who need to be supported into the labour force—particularly if activation is extended further beyond those on the Live Register. Vulnerable people in particular will need ongoing support from the public employment service, right through from appropriate education/training or work-experience programmes to the labour market, to ensure that there are positive job outcomes for those participating in such programmes. Employers may also need support to develop pathways into work for groups who are far from the labour force, and to handle their transition into the workplace. This could help share the risks of this transition between employers, employees and the State (Fowkes, 2011).

²² For example, One Family’s Ten Solutions, looks for specific supports to help lone parents move from welfare to work, at <http://www.onefamily.ie/professionals/policy-research/ten-solutions-for-smarter-futures/what-are-the-10-solutions/>, accessed 23 August 2013.

In addition, international experience shows the importance of engaging with all stakeholders involved in activation, in order to continuously improve its services (Finn, 2011); (Lam, 2007). Engagement with employers is critical. The second *Pathways to Work* contains several new commitments to link employers to those on the Live Register, particularly through the work of the LEOs. It will be important to ensure that adequately trained and experienced personnel in LEOs carry out this work, so that it yields the best possible results. Employers will also need to be comprehensively involved in the development of labour-market-related further education and training.

Finally, collecting, collating, analysing and sharing data on progress and problems is emerging in international research as key for the continuous improvement of activation (Jacobi & Kluge, 2006); (Lam, 2007). In Germany, a comprehensive data-collection system was put in place to track the Hartz reforms of the public-employment service, which have allowed evaluation of which aspects of the reforms have worked, where, and for which groups (Jacobi & Kluge, 2006). The Australian Star Ratings data system also draws on relatively rich data, which allows successful job-placement providers to be identified. This system is designed and managed by the Department of Education, Employment and Workplace Relations, and the organisations providing unemployment services populate it (Lam, 2007). It would be useful to look at how a similar data-collection tool, linking needs, outputs and outcomes, could be used for activation in Ireland.

While internal systems of data generation, benchmarking and review are a central requirement, they need to be embedded in a system of dynamic accountability to both the policy authorities and service users. This can also be supported by periodic independent evaluation—provided it is conducted in a way that seeks to identify not the correct ‘treatment’ but which approaches are effective for which citizens in which contexts (Pawson, 2013).

4.3 Reflect on Ireland’s Post-Troika Institutional Framework for Fiscal Stability, Public Governance and Reform

An important factor in the achievement of, and adherence to, a more integrated strategy was undoubtedly the agenda set out in the December 2010 Programme of Financial Support for Ireland and the system of conditionality and monitoring established with the Troika under that programme.

However, the operation of that system of delivery and monitoring is largely an achievement of the Irish government and, it should be noted, the public-sector trade unions through their entry into and delivery of the Croke Park I Agreement. The nature and scale of this achievement should not be underestimated, in a public service that was working with reduced human and financial resources. Indeed, the multiple, heavy demands on the public system should be kept in mind in any

commentary and judgement. In addition, a very significant part of the fiscal adjustment strategy and reform agenda set out in the 2010 Programme reflected policy analysis and ideas developed earlier within the Irish system. Taking both design and delivery together, it means that credit for achievement of a more integrated strategic overall response should be shared between the Troika and the Irish Government. But, by the same token, it highlights the degree to which earlier Irish high-level strategies and reform proposals, including policy reform and public-sector reform, had less traction outside of the institutional arrangements and conditionality of the Programme (something discussed and analysed in some detail in NESC's 2005 *Strategy* report (NESC, 2005a: Chapter 5)).

Taken together, these points underline the importance of current initiatives, such as the formulation of a new MTES and the need to work on the strategic and institutional arrangements that will operate once Ireland leaves the Programme, and intense monitoring by the Troika no longer applies. Indeed, a central argument of this report is that reflection on and probing of the evolving processes of policy-making, monitoring, delivery and review probably needs to go further and be more encompassing.

The Council's emphasis on short-term measures with a long-term logic in its 2009 reports on the five-part crisis reflected a concern about the tendency for Irish public policy and collective decision-making to prioritise the short term, sometimes undermining long-term economic and social progress. Indeed, it is widely agreed that this was a factor in creating the crisis, which is an historic reversal of Ireland's progress. While the imperatives of the crisis and the Programme have imposed disciplines to help government resist short-term and sectional pressures, it is of great importance that Ireland's own systems of public policy and collective decision-making are reformed in ways that make such a recurrence impossible outside of the context of Trioka monitoring.

Section 4.1 outlined possible actions and further reforms in each of the four areas analysed by NESC in the last year. We believe it would be useful to reflect on the developments in these—and other areas, including fiscal policy and new institutional arrangements and processes associated with it—to identify the specific institutional arrangements that might be required, in each area, to support further progress. The relevance of this is enhanced by the fact that the government is embarking on a formulation of a new national Medium-term Economic Strategy, a part of which is likely to include design of institutional arrangement for policy-setting, implementation, monitoring and revision. In this context, we comment further in Section 4.3 on how NESC's current method of inquiry might be used in formulating and delivering the MTES.

Although it has not been done comprehensively in this report, it would be of useful to further compare and contrast the institutional and process innovations in these four areas. In such an analysis, it would be useful to ask questions, such as the following:

- How does the central government monitoring process relate to the more fine-grained monitoring by the agencies that actually deliver programmes to citizens and firms?
- How are targets specified and used in each process?
- Where is the focus on outcomes, and not just outputs, most developed?
- What is the relation between reporting of *actions* or *outputs* and measurement of *outcomes* in each policy sphere?
- How does each of the institutions and processes deal with actions and problems that do not yield to direct checks on implementation?
- What process is initiated to grapple with the particularly knotty, cross-cutting or ambiguous issues?
- How does each of these processes deal with policy initiatives that, despite initial acceptance, prove contentious among relevant stakeholders?
- Which kind of policy problem (decision, implementation, monitoring, learning, innovation or revision) will each process be most effective in addressing?
- In each case, does the tighter central process engender policy innovation or tend to drive it out?
- What kind of engagement with non-state stakeholders is used in each process, and to what effect?
- Which of the institutional arrangements and co-ordination processes is most open to inclusion of novel and untested possibilities, such as the circular economy or new ICT opportunities?

These questions reflect an instinct, derived in part from study of international public-sector reform over the past two decades, that the recent Irish innovations, though a definite step forward, may remain incomplete in a number of respects. At the same time, we are aware that in a number of areas (such as industrial policy and, more recently, finance for SMEs), Ireland has a definite leadership, based largely on organisations and agencies that conduct disciplined, data-intensive search and problem-solving. Together, these suggest that it would be useful to work through the questions listed above, including the way in which targets, actions and outcomes are designed and used. The Council will keep this important task in view in designing and executing its further work.

4.4 Embed Policy and Institutional Reform in the Medium-Term Economic Strategy

In a world of flux, there are few long-term principles that can reliably guide short-term action. Yet this is precisely what most people will expect a MTES to provide. A challenge for the MTES, therefore, is to find a way to guide short-term action. The application of vision and knowledge will help to a degree, but practical policy development and implementation, based on the experience and capabilities of a range of actors, would also seem critical.

This was evident in the way in which the crisis of the 1980s pushed Denmark to invent activation policies, which in turn prompted reforms of the welfare system. It was this search for practical responses to severe crisis that set Denmark on the road that eventually led to the ‘principles’ of flexicurity and the transition from a ‘Keynesian welfare state’ to what they now call ‘an enabling welfare state’ (Kristensen & Lilja, 2011: 10).

But this capacity is also evident in Ireland. Chapter 3 described the remarkable series of initiatives taken by the Department of Finance and other bodies to address the pressing problems faced by SMEs. It showed that the Irish policy and institutional innovations concerning SME finance and development, and also investment, are redefining the relationship between finance and the real economy. A central argument of this report is that these innovations should not be seen as temporary measures, pending the repair and return of the pillar banks, but as important steps towards a new set of relationships that must be seen as permanent. Similarly, the analysis in the other areas of this report leads to conclusions about the value of considering how the arrangements in place might be reconfigured, for example in enterprise policy, to allow greater consideration of innovative ideas.

A method of inquiry similar to that used in this report, if it was embedded in the arrangements and processes associated with the MTES, would enhance its ability to become an institutional driving force for economic growth and development. This would create a dynamic process in which the MTES and sectoral plans are closely linked. As outlined in the Introduction to this chapter, this would be based on an ‘inside-out’ analysis that begins by probing substantive actions and policy goals and the degree to which policy (or services) is adapting to changing needs and conditions. As seen in Section 4.2, this can provide a basis on which to identify the next challenges facing stakeholders, and it can also identify the ways in which central administrations might need to reconfigure their relationships with front-line stakeholders and agencies, for example by reconsidering the types of targets set.

The ability to identify the institutional requirements that would support and/provoke stakeholders—in specific areas such as food, renewable energy, ICT, labour-intensive marine, tourism and specific regions or cities—to identify challenges and to continuously improve would ensure that the MTES could become a lasting force for economic, social and environmental development.

Combine high-level coherence and engagement with local problem-solving

The ability to link strategy and sectoral plans and front line action brings to the fore a further characteristic of an effective response to the crisis, identified by NESC in 2009, namely the need for high-level coherence and engagement with local problem-solving. In 2009, the Council argued that some of the critical elements of an effective response—macroeconomic policy, incomes policy, banking policy and social policy—urgently required a coherent and clear government policy and, ideally, agreed approaches across a range of high-level actors (government, the social partners, major regulatory agencies and the financial institutions). But other critically important policy areas—such as skill development, aspects of social policy and wider public-sector reform—would require central government to set the parameters and for a wide range of actors to jointly search for practical responses to the problems we now face. It was noted that lack of agreement on a high-level strategic response (most critically, on fiscal policy and incomes policy) might lead not only to an inconsistent national policy, but prevent or postpone lower-level engagement in the kind of problem-solving that was and is urgently required. The Council saw it as critical that hundreds of agencies, units, firms and associations were enlisted in devising effective and imaginative approaches to the challenges facing the Irish economy, society and environment.

The crisis has certainly seen important changes in the balance between high-level policy and front-line engagement and the degree of centralization. The onset of the crisis brought the high-level policy issues listed above, notably fiscal policy and systemic banking risks, centre stage and this, inevitably, created a centralisation of policy-making. In addition, the response to the crisis saw the demise of social partnership. This meant that the complex channels through which the State engaged with a wide range of stakeholders was effectively put in abeyance. Furthermore, the entry into the Programme with the IMF, EU and ECB further concentrated policy-making in the core executive.

It was argued in an earlier report, *Ireland At Another Turning Point*, that a concentration of authority was also one of the three key characteristics of Ireland's response to the earlier crises of the 1950s and 1980s (the other two being a renewed focus on development and institutional reform and creation) (NESDO, 2009: 73-81). But, it was argued, to the degree that these earlier crisis-induced turning points involved concentration of authority, this was done in order to liberate talent and capabilities rather than to increase control. Much of this report has been about Ireland's renewed focus on development, after a period on non-developmental expansion, and the definite agenda of institutional reform. If this way of thinking about crises and turning points is useful, it prompts the question: how can the recent concentration of authority best be used to achieve the necessary reform and liberate talent and capabilities—in both the public system and wider society—rather than increase control?

While the most evident trend has been increased centralisation, seen as necessary to achieve fiscal adjustment, it seems that after the initial responses government departments and agencies increasingly engage with a range of non-state actors and organisations in advancing individual programmes and addressing specific

problems. One example, which was looked at during the Secretariat’s work on climate change, is Food Harvest 2020. It involves close and ongoing engagement by key departments and agencies with a range of agricultural and food-industry organisations. In a different context, the Department of Social Protection engages with a range of non-state providers and NGOs in designing and delivering *Pathways to Work*.

In the kind of reflection on institutional and process reform that this report suggests needs to happen, it would be worthwhile to consider the various patterns of engagement that are emerging, or re-emerging, and their relative effectiveness.

Finally, an important element in the changing patterns of engagement—both between the centre of government and other parts of the public system, and between the State and non-state actors—is the new system of local government and local development set out by the Department of the Environment, Community and Local Government (Appendix 6). To date, the Council has not analysed or discussed this important new institutional architecture.

4.5 Balance and Articulate Three Broad Kinds of Reform

A common perception at the front line and among citizens is that many expenditure (and some tax) decisions—although they contribute to narrowing the deficit in the short term—may have a range of negative consequences, sometimes even creating increased expenditure needs in the long term. This is undoubtedly a factor in shaping the real and perceived human and social consequences of fiscal adjustment. Yet, in some respects this may be inevitable in achieving a fiscal correction on the remarkable scale Ireland has delivered, for two distinct reasons. The most basic is that successive expenditure reductions on this scale are inevitably blunt and unavoidably have some negative and perverse consequences. The other is that the demands of *designing and delivering* a fiscal correction on this scale—by key government departments and large spending entities such as the HSE—may largely preclude detailed consideration of the relation between the long-term and short-term expenditure. There may simply be no space to ask the questions that would ideally be posed: what cuts now will increase spending needs in future? And what spending now would reduce future cost?

It is true that Ireland has achieved major improvements in its public finances, as a result of significant pay adjustments, tax changes, rationalisation, some privatisation, shared services and changes to the budget process. In addition, there is a wide agenda of substantive policy reform, in areas as diverse as enterprise, activation, education, water, health and training—although some of these are more visible and widely discussed than others. There is also the agenda of public-sector reform set out by the Department of Public Expenditure and Reform.

Our analysis, in this report and earlier ones on activation and human services, has looked at a number of substantive policy and service sectors, taking account of resource issues, substantive agendas and institutional arrangements. It has sought to identify further system and institutional changes that are necessary if the substantive goals (such as innovation, literacy, participation and quality care) are to be achieved.

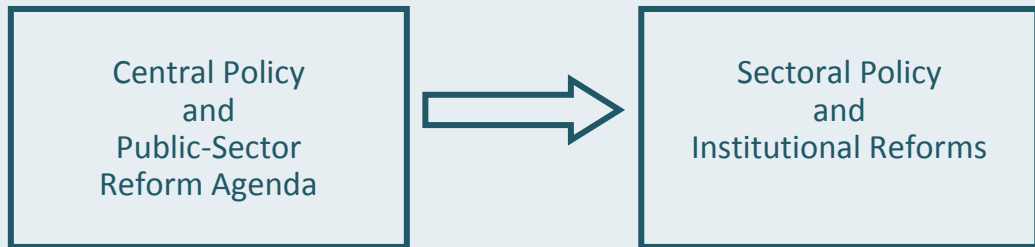
This kind of analysis suggests that many of the elements that need to be combined in the strategy and sequence of reform already exist. A range of Irish public-sector organisations—in areas such as industrial policy, environmental protection, children’s services, food safety, animal health, and others— already demonstrate the combination of innovation, quality and accountability that government is committed to achieving more widely. Thus, what is taken for granted in these areas—an initial and provisional overarching plan, but recognition that implementation is critical; fine-grained measurement in frontline organisations; root-cause analysis; reporting, monitoring and peer review of results; open consultation and problem-solving stakeholder networks; and revision of goals, means and metrics—are becoming key requirements in a range of other services, such as health, education, welfare and activation, training, care and policing. Indeed, there is some evidence that this may now be recognised and beginning to inform the work of public bodies in the agri-food sector, social protection and activation and education, which reinforces the value of careful study and reflection on their reform work.

As noted at the start of this chapter, some of these system and institutional changes relate to front-line problem-solving, some to high-level strategy and some to the connections between the two. To take this line of inquiry further we think it is now necessary to give attention to the appropriate balance between, and better articulation of, three broad kinds of reform:

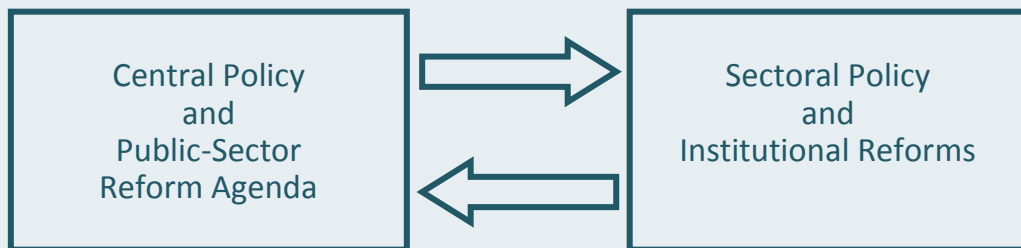
- a) **Fiscal-driven reform:** the reform agenda driven by the need for major fiscal consolidation and fiscal discipline (pay adjustments, tax, shared services, rationalisation, some privatisation, budget process, etc.);
- b) **Substantive reform:** the agenda of substantive policy reform needed to underpin future prosperity, high participation and social cohesion (enterprise/MTES, activation, education, skill development, local/regional development, care, etc.);
- c) **System-oriented reform:** creation of the systems of strategy and policy-making, standards, autonomy and accountability necessary for the delivery of high-quality services, continuous improvement and policy adaptation.

Furthermore, our analysis and approach suggests that giving attention to the relationship between these three kinds of reform should involve some widening of the way in which the reform agenda is often discussed. For a number of reasons, there is a tendency to think of the central and core government policy and reform

agenda informing, and largely determining, the sectoral and front-line policy changes and institutional evolution, as depicted below.



Given the importance of this channel of causation, much depends on the vision and content of the central public-sector reform programme, something we discuss briefly in the closing section. Our analysis of policy and institutional change in a range of areas suggests that the central reform agenda can be, and sometimes is, greatly informed by the changes in particular policy sectors and organisations. This general idea is depicted below.



Thus, in ways that we do not elaborate on here, the central public-sector reform agenda might be fertilised, and maybe even reconfigured, by learning from the achievements and problems in enterprise policy, banking and finance, environmental policy, activation, eldercare, education, disability, policing, end-of-life care and homecare.

The MTES and the major current reform agendas, such as those in activation, training, education and care, offer the ideal opportunity to explore the balance between these trajectories of reform. Among the issues likely to require attention are how to both increase innovation and accountability at the front line and how to

build a supportive centre capable of spreading best practice, and leading policy review and learning.

However, we believe that Ireland's path through the crisis, and the successful central design and delivery of a major public-sector reform agenda requires to be informed by a more clearly articulated positive perspective on the future of the Irish economy, society and state.

4.6 Articulate a Positive Perspective on the Future of Irish Society and the Role of the State

4.6.1 From Divergent Articulations to a More Unified Developmental Perspective

In Section 2.2.7, we suggested that, despite the policy achievements of recent years, we may not have a persuasive positive perspective on the future of Irish society, economy, environment and state. Indeed, there is a tendency among some to take recourse to divergent articulations of Ireland's challenges and the purpose, and nature, of public policy. Some examples include the following:

- Enterprise policy is sometimes seen as about meeting the needs of individual firms as identified by enterprise itself or, conversely, as purely about addressing identified market failures, defined in narrow terms;
- Welfare policy issues are sometimes discussed in terms of the maintenance of passive transfers and existing service systems that, in fact, fail many, especially the disadvantaged or, conversely, as an unambiguous drain on the economy and economic performance;
- Environmental policy can be cast in terms of conservation of the natural environment against the damage of economic activity or, conversely, as always an additional cost imposed on enterprise and consumers.

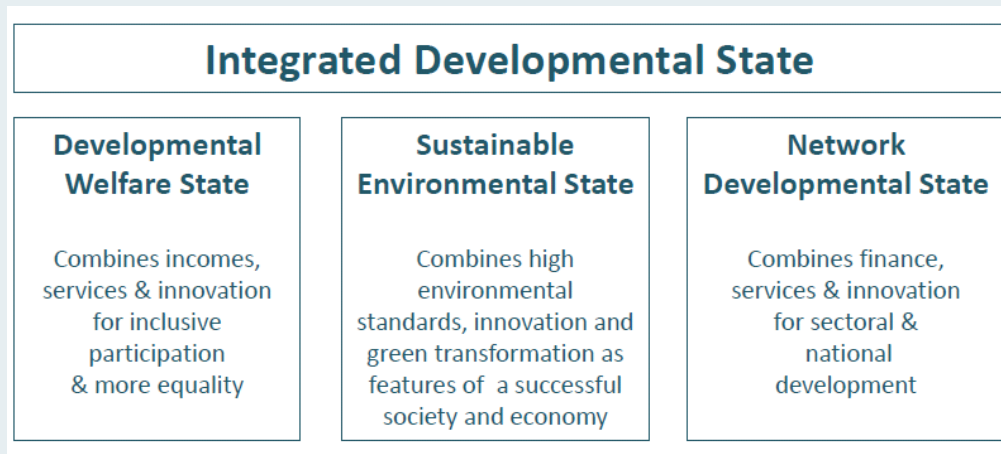
We believe that these ideas, reflecting divergent perspectives, can make it harder to steer a collective course through the ongoing crisis. They tend to frame issues as inevitable conflicts between divergent worldviews and interests; they cast most policy issues as zero-sum and thereby prematurely close off the search for practical innovations or new thinking that can generate more positive outcomes and, indeed, redefinition of interests. As argued in the original reports on the five-part crisis, the lack of a widely shared positive perspective can make it difficult to communicate the logic and direction of policy that unavoidably combines retrenchment with reform. More specifically, as we argue in more detail below, it makes it hard to identify the kinds of public-sector reform that will be most productive in creating the kind of economy and society that we want.

The Council believes that it is possible to identify and articulate a more unified developmental perspective on the future of Ireland's economy, society and environment. It is possible, indeed necessary, to adopt a different understanding of three broad elements of public policy—enterprise policy, welfare and environmental policy—reflecting a less polarised view of how the economy, society, environment and state are embedded in, and relate to, one another. The key idea is the need to configure the State so that it enables upgrading and transformation in the 'private' sphere—whether firms, households or associations. Drawing on earlier thinking by the Council and others, this can be summarised as follows:

- The State as an agent of development, best described as a 'networked development state' (Ó Riain, 2000), combining finance, services and innovation, to promote sectoral and national development—reflecting a perspective on Ireland's long-run development challenge and structural position in the world economy;
- The developmental welfare state, combining incomes, services and innovation for participation and greater equality—reflecting a view that strong economic performance depends on effective social policy, and social policy must play a role in supporting economic prosperity;
- Public policy and public-governance structures as a key shaper of both the natural and man-made environment—reflecting a view that high environmental standards and quality are a feature of a successful society and, rather than being an inevitable burden, can support an innovative Irish economy (Comhar, 2009); (NESC, 2005a); (NESC, 2012c).

These three views provide a more unified perspective on economy, society and environment (Figure 4.3). They do not exclude tensions and conflicts, for a number of reasons. For example, the developmental welfare-state thinking accepts that social policy *could* damage economic performance and employment; environmental policy *could* impose excess costs; features of employment relations in business *could* make desired social outcomes hard to achieve. In addition, these general conceptions always operate in concrete economic, social, technological and natural contexts, which are changing. In using them to create a reasonably unified perspective on Ireland's path through the crisis and future development, we need to flesh them out by seeking to understand the business, technological, geopolitical and social realities, challenges and possibilities that will prevail in the decade ahead, and beyond. But taken together these can provide a more unified developmental perspective, *within which* inevitable conflicts can be resolved. Indeed, a key Developmental Welfare State (DWS) idea—that 'the economic is in the social and the social is in the economic'—demands that we think about policy in both economic and social terms, including the complex interactions.

Figure 4.2: A More Unified Perspective



4.6.2 Advantages of More Integrated Perspective

The first advantage is that development of a such a positive perspective on the future of Irish society, economy, environment and state, would allow a strong articulation, at the highest level, of the ‘goals’ of public-service transformation. It would allow the reform agenda to be built around understandable economic and social projects—such as business development, learning, agri-food, care,—seen as framework goals. It could enlist a wide range of stakeholders to the mission of creating services and interventions that are customised, bundled and continuously revised. It could explain the higher-level public transformation and reform agenda as aimed at creating, at the centre, national policy processes, organisations and information systems to support front-line quality, accountability and responsiveness: that is, public bodies and policies enabling and stimulating transformation in the private sector. Conversely, without this, we believe it will be impossible to communicate the purpose and thrust of the reform agenda.

The second advantage is that it is an *integrated* picture of economy, environment, society and state, rather than one that sees the fiscal imperative forcing us to make big choices *between* economy, environment, society and state, even though we do have to make big choices.

Third, it cuts somewhat across conventional ideological and conceptual debates about state versus private enterprise, rules versus markets, ‘liberal market economies’ versus ‘co-ordinated market economies’, etc.

Fourth, it is *practical*, in that it does not set impossible hurdles (derived from Silicon Valley, on the one hand, or Scandinavia, on the other) for Irish policy to jump, or

ideal ‘models’ that Ireland might aspire to emulate. It is framed in a way that accepts the fact that policies for prosperity and social protection are context-specific. Indeed, one of the key features in this initial picture of an emerging (and successful) economy, society and state is the capacity of firms, NGOs and public bodies, working in non-ideal contexts, to see problems, explore their causes and search for solutions.

Fifth, it is *positive*, in that this initial perspective on the economy-environment-society-state draws attention to areas of Ireland’s public system and business landscape (and, indeed, society) that already display some of the capabilities and practices that are the key to a radically more effective public system. This report, in Chapter 3, confirms that there is every reason to believe that developments in particular sectors and public bodies can inform and help to develop the central public-sector reform agenda. The ‘inside-out’ type of analysis underpinning this report can assist the reform agenda by providing a perspective on the existing strengths and weaknesses of the public system. It may also help in shifting the focus from managerial processes and public-sector ‘modernisation’ precepts to *projects* built around valued goals, such as innovation, competitiveness, educational excellence, children’s well-being, caring and social cohesion.

4.6.3 An Integrated Developmental Perspective in Tune with Emerging Realities

Substantively, the success of the fiscal correction and public-reform agenda (in achieving the ultimate goals of sustainable prosperity and social inclusion) will depend on whether the public system we build now is in tune with the economic, technological and social realities that will prevail in the years ahead.

It is not possible in this report to provide a sufficiently detailed account of emerging realities. Nevertheless, we believe that it is possible to identify some features of the emerging business, technological, social and institutional context that might provide some general guidance to the ongoing refinement and articulation of the public-sector reform agenda.

Despite current economic volatility, there is every reason to believe that the fundamental shift towards open innovation, underway for the past two decades, is continuing. This, and other trends, have profound implications, which include: continuous innovation, in both services and manufacturing; decentralised value chains and inter-firm networks, in which there is pervasive re-definition of roles; fluidity between traded and non-traded activities; inter-disciplinary problem-solving and generally, much less distinction between conception and execution.

These developments suggest that the changes in firms and the economy, internationally and in Ireland, are creating new kinds of careers and working patterns, demanding new kinds of skills and changing the nature and incidence of social risks. In Ireland and elsewhere, traditional systems of education, skill formation, social insurance and welfare provision seem less suited to preparing people for the new economy and insuring them against the risks they face.

Across the democratic world, this is prompting changes in the state and public administration. Some are well advanced, particularly in public bodies that engage intensively with enterprises. Perhaps the most important trend is the shift towards a service-based welfare state. To address the risks people face in a dynamic, networked economy requires services that are customised, bundled and continuously revised. In the international research and policy community we see a variety of labels that seek to capture this shift: ‘The Social Investment State’; the ‘Enabling Welfare State’. Indeed, NESC’s work on the DWS has attracted significant attention in these international debates.

This shift towards service-based welfare, and need for public agencies to engage with enterprises, are prompting profound changes in the way public bodies *are organised*. We see a shift from rule-based public hierarchies to more authorisation of front-line discretion (which does not necessarily involve a reduction in central steering and oversight) and from self-regulated and autonomous professions to teams of professionals who have to work together to address regulatory, technical, educational or social problems. In both cases, the key organisational innovation is the creation of systems of in-depth review and reporting, which allows innovation by service providers to be combined with accountability.

A third dimension of this integrated view of economy-society-state is that there is a growing convergence in the organisational capabilities and routines of the more successful enterprises, public bodies and NGOs. International research, as well as NESC work on Irish organisations such as the EPA, suggests that some of the key organisational disciplines developed in firms in the past quarter-century—such as error detection, root-cause analysis, continuous improvement, simultaneous engineering and less distinction between supervisory and implementation roles—offer the possibility of combining innovation and accountability in ways that were thought impossible in the public sector. The more successful and innovative enterprises, public bodies and NGOs have developed a capacity to engage in active search in which the focus is on identifying problems, exploring their causes and searching for solutions. Such exploration is necessary precisely because in a surprising set of spheres there is not an *ex ante* solution known by a principal who has the capacity to instruct an agent. Where this is so, irrespective of the issue that a public sector organisation is grappling with—improving water quality, attracting higher value added Foreign Direct Investment (FDI), improving the quality of eldercare, delivering higher-quality training to both the unemployed and the employed, achieving better retention rates in schools for young males, reducing welfare dependency amongst ‘lone parents’, etc.—they must focus on building their capacity to engage in review of their practice and search for new solutions and the best partners



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