Group Economics

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Freako-NI-omics

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Economics is often called the *'dismal science'* and has been viewed by many as boring. Indeed, Sir Mervyn King famously stated that the Bank of England's ambition was to be boring, particularly in terms of monetary policy. In recent years, however, the world of economics and financial markets has been quite the opposite. A series of unprecedented events, such as the credit crunch and sovereign debt crisis, have dominated the newsflow and the man on the street has become much more aware of economics and financial market developments.

This is, however, as much to do with the appeal of the messengers as with the events themselves. Robert Peston's ability to convey complex issues simply has made him a credit crunch celebrity and a household name. In fact, the rise in popularity of economics pre-dates the credit crunch, with a new breed of authors demystifying economics to an increasing number of people. Individuals such as Tim Harford *(The Undercover Economist)* and in particular Steven D. Levitt & Stephen J. Dubner *(Freakonomics & SuperFreakonomics)* have made economics sexy and interesting.

The *Freakonomics* genre graphically illustrates how economic analysis can be applied to explain and understand a diverse range of complex issues, particularly people's behaviour. At the heart of the *Freakonomics* world view are the fundamental ideas that 'incentives are the cornerstone of modern life' and 'the conventional wisdom is often wrong'. Armed with these basic economic principles, it's interesting to cast an analytical eye over Northern Ireland's topical economic issues to assess whether all is quite as it seems.

In true *Freakonomics* style there are many lesser known statistics about the Northern Ireland economy. Did you know that Northern Ireland's fiscal deficit – or annual overdraft – was over twice that of Greece when Greece sought an IMF bailout? Did you know that there are 2.5 times as many people (186,000) in receipt of Disability Living Allowance (DLA) in Northern Ireland than there are currently employed in our export intensive manufacturing industry? Northern Ireland also has some noteworthy wage arrangements. For example, the median public sector wage amongst females is some 65% above the equivalent wage within the private sector.

And Freakonomics tells us that some of Northern Ireland's economic policies, despite having the best of intentions, may also have unintended consequences:

A flagship policy has been for tuition fees for students from Northern Ireland to be frozen at £3,500 per annum *(excluding inflation)*. This contrasts with students elsewhere in the UK who will be charged up to £9,000 per year. A key aim of this fee cap is not to dissuade students from low income households from embarking on tertiary education. But what happens next?

Typically around one third of NI school leavers have gone on to study in GB. Now, however, this is a financially unattractive option. The known unknown is how many will opt for the lower cost option of staying in NI. In turn, this increased demand for NI university places could significantly outstrip the modest increase in supply. As a result, we might find that those students who traditionally would have remained in NI, particularly those from lower income households, will be displaced. Therefore a policy that was originally designed to help students from lower income households, could leave them with no option but to study in GB with the higher fees and the higher living costs away from NI.

With the Republic of Ireland set to introduce water charges, Northern Ireland will become the only part of these islands not to fully charge for residential water usage. Notwithstanding the fact that there is a lack of an incentive / disincentive to conserve a resource, the policy is not means tested. Wealthier people therefore enjoy this £250 p.a. benefit alongside the less well-off.

One of the arguments for not introducing water charges is that households would not be able to bear the cost. However, *Freakonomics'* Dubner and Levitt might offer up an alternative analysis. For example, not having a £250 p.a. tax means households have the scope to spend the money on things that they might not otherwise buy. Interestingly, figures from Ofcom reveal that 1 in 2 households in Northern Ireland have a satellite dish which is above the UK average. Perhaps this could be due to the availability of cable services relative to the UK? Closer inspection, however, reveals that an additional 11% of local households have cable services as well An additional 11% of local households also have cable services. The combined total at 62% is above the other UK countries and the UK average of 55%.

In addition, Northern Ireland has more television sets per household than any other UK region. Again these findings might be contrary to what is expected, given that Northern Ireland has the highest levels of economic inactivity, long-term sickness and the lowest wages of any UK region. The relatively higher levels of inactivity perhaps explain why local households watch more television than the UK average according to a recent Broadcasters' Audience Research Board (BARB) survey.

Furthermore, does our industrial structure and greater adherence to a nine-to-five working day explain why prime time viewing in Northern Ireland *(6pm-7pm)* is much earlier than any other UK region? In light of this analysis, what positive impact – other than funding infrastructure investment and easing public finance pressures - might water charges have on economic inactivity and the wider economy?

Other local subsidies have included free public transport for individuals over 60 years of age. Again this enables free transport for all, regardless of need or income, and there are no restrictions on the frequency or scope of travel. Wealthy pre-pension age individuals can avoid petrol charges and car parking fees for their shopping trips and theatre visits. Indeed, those over the age of 65, regardless of income, can extend their travels to Dublin courtesy of the taxpayer. The problem is the cost of this subsidy continues to rise with an ageing population and rising fuel costs. It also has the potential to clutter public transport with passengers who are neither deemed pensioners or on low income, contributing zero revenue, not even a heavily discounted fare. There are environmental positives here as the over 60s are switching their cars for the bus, potentially freeing up the road network and reducing pollution.

Freakonomics highlights that a key problem with blanket subsidies is that they can encourage unintended incentives, generate new demand and therefore additional costs that were unforeseen at the implementation stage. A case in point is the free NHS prescription charges. Initially this policy was expected to cost £13m per annum but this has spiralled to around £20m. Never underestimate the ability of individuals to exploit a free service or indeed profit from it. Individuals have been able to get items for free such as headache tablets that they previously paid for. Indeed, there have been anecdotal reports that such free goods are being subsequently sold for a profit.

Overall, *Freakonomics* teaches us a number of valuable lessons. Despite having the best of intentions, policy makers need to be cognisant of unintended consequences in their design of policies, otherwise outcomes may be the polar opposite of what was intended in the first place. Keeping it simple is perhaps the most important lesson and, most of all, it must be remembered that in both a positive and negative way: *'people respond to incentives'.*

Richard Ramsey,
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