Group Economics

Ulster Bank

More economic independence may assist in NI's rebalancing effort

Contact: Richard Ramsey
Chief Economist, Northern Ireland
02890 276354 or 07881 930955

Richard.ramsey@ulsterbankcm.com

www.ulsterbank.com/economics

Article appears in Irish News Business Insight 24th May 2011

Following hot on the heels of its victory in the Eurovision song contest, Azerbaijan will next week celebrate its 93rd anniversary of independence from the Russian Empire. Countries from Cuba to Israel and from East Timor to Ecuador are also commemorating independence during May. Indeed, today the citizens of Eritrea are celebrating their independence from Ethiopia, while tomorrow the Middle-East marks the 65th anniversary of Jordan's independence from the UK.

Closer to home, the electoral success of the Scottish Nationalist Party (SNP) earlier this month has put the idea of an independent Scotland back on the radar. But, whilst independence continues to be an aspiration around the world, it can't be the endgame itself. After all, it's what you do with power and what it delivers that matters.

In the economic and financial world, independence is also highly prized, particularly in central banking. The creation of the single currency in 1999 saw members of the new euro zone – including the Republic of Ireland – give up their sovereignty on monetary policy to the independent European Central Bank (ECB). In the UK, the importance of independence was highlighted by the first Blair government which was eager to gain credibility for handling the economy within financial markets.

As a result, in May 1997 the UK government relinquished some of its powers by granting the Bank of England operational independence. This led to the creation of the interest rate setting body - the Monetary Policy Committee (MPC) - which is free from political interference and is designed to promote monetary and financial stability - in particular, low and stable inflation.

Without this kind of independence, economies generally fall victim to what has been termed the political business cycle, whereby interest rates are set for political advantage – being reduced in the run up to an election to create a feel good factor and reluctantly raised afterwards. This contributed to the boom and bust *(or so called 'stop go' policies)* which blighted the UK economy since the 1950s.

In May last year, with the UK's fiscal credibility somewhat tarnished by events in more recent years, independence of the fiscal variety reared its head in the shape of the Office for Budget Responsibility (OBR). In the same vein as the introduction of the MPC by Labour in May 1997, the OBR was set up by the coalition government in an effort to gain fiscal credibility and since its introduction markets have responded positively. Essentially the OBR is an official, independent fiscal watchdog that follows what is seen as best practice in Scandinavia, Germany and North America. Economic and Fiscal councils in some of these countries date back to the 1960s.

The OBR's main functions include analysing and forecasting the public finances, including their long-term sustainability, which relieves this responsibility from the HM Treasury. This removes the temptation of Governments to present economic and fiscal forecasts through rose-tinted spectacles and for the Chancellor of the Exchequer to fiddle the figures. In the words of George Osborne *"this will create a rod for my back down the line, and for the backs of future chancellors".*

What about Northern Ireland? Last month, the Northern Ireland government departments marked 13 years of 'independence' from direct rule and we are approaching four years since the economy was made 'the Executive's number one priority'. This phrase has been well-used, but what we are less familiar with is what it actually means in real terms. At present, it is hard to think of a country or a region that doesn't have the economy as its number one priority. The difference is the extent to which economies have been embracing unpopular but unavoidable policies that are in the economy's long-term interests.

In Northern Ireland, unpopular policies have been conspicuous by their absence. This is because there is no incentive for politicians to deliver what the economy needs as it conflicts with what the electorate will vote for. That said, post-election, there have been some encouraging noises by the First and Deputy First Minister on the tough challenges that lie ahead.

It is estimated that Northern Ireland's much-needed economic transformation will take around 25 years. The problem is that this period is punctuated with assembly and Westminster elections, leaving the economy more prone to the 'stop go' nature of the political cycle. Arguably, to date, not upsetting the electorate has actually been the number one priority. From an economic development perspective this approach is undesirable and given the fiscal outlook this is no longer tenable.

Today, the hand of economic history really is on the executive's shoulders, but this requires sound economic policies rather than sound bites. We hear it argued from some quarters that an official political opposition is needed at Stormont. From an economist's perspective, it would be hard to argue that some kind of independent economic opposition would not be beneficial. Something along the lines of what George Osborne called *'a rod for his back'* would help the local administration to deliver effectively on the economy. It would also make it easier to take difficult but necessary decisions, as independent experts would be championing this course of action for the right reasons – NI's long-term economic development.

In this respect, a greater focus on listening to and adhering to sound economic advice should not be viewed as a threat but as a critical and constructive friend. This should include a steady flow of sound, rationale, independent economic advice and rigorous economic debate. During the first term of office, when the economy was made the top priority, unfortunately political considerations drowned out economic advice. Hopefully, the second term will see a rebalancing in this sphere with sound economic advice taking more prominence. Making the right cuts requires the right advice which in turn requires having the right advisors.

In the Republic of Ireland, the highly respected economic think tank the ESRI has recently been proposing unpopular policies such as accelerating public expenditure cuts and imposing unpopular policies such as a 10% cut in public sector wages and water charges. In Northern Ireland, who is carrying out this kind of role?

Unfortunately, the provision of independent economic advice has been an industry in decline over the last decade at a time when the advice is most needed. Furthermore, there appears to be no obvious champion for such advice as a permanent feature in the Executive / NI Assembly. Instead, the preference appears to be for 'hit and run' independence where ad hoc reviews such as the Independent Review of Economic Policy are conducted as and when required. Practically every economy has a body to provide independent economic advice, and Northern Ireland needs an effective one too. It is unfortunate, that at a time when independent economic advice is most needed, the Economic Research Institute for Northern Ireland (ERINI) has been mothballed, with no plans for a replacement. Northern Ireland now faces the prospect of having no independent economic advisory body for the first time in 35 years.

The NI Executive should embrace independent advice and make it a permanent feature of its administration with a view to basing its policies on sound economic and financial logic rather than political rationale. Announcing unpopular but necessary policies does not necessarily make 'good Press' but they will have a more positive impact in the long-term. Greater economic independence needs to be an aspiration of the NI executive as this will enhance the credibility that the economy is the top priority. Will we see special economic advisers and relevant public sector reform expertise parachuted into key positions in sufficient numbers in the coming weeks? The credibility of the economy being the priority will be judged in the next four to five years and the separation of economic and political decisions are crucial if NI's long-term aim to rebalance the economy over the next 25 years is realised and 'stop go' reform avoided. Let's hope in Northern Ireland's rebalancing the economy contest, the economic jury will be awarding the executive douze rather than the dreaded nul points in four years time.

Richard Ramsey,
24 May 2011