

Why we have to enter the race to reinvent the state...

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

Richard.ramsey@ulsterbankcm.com
www.ulsterbank.com/economics
Twitter @UB_Economics

Article appears in the Irish News Business Insight published 23rd September 2014

It may surprise you to learn that the European Union, a group of 28 nations that accounts for 7 per cent of the world's population and 25 per cent of economic output, accounts for over 50 per cent of global welfare spending. These are statistics that German Chancellor, Angela Merkel, has previously emphasised in an effort to get Europe to rethink its approach to the role - and size - of the state.

A similar theme is taken up in the recently published, best-selling book, 'The Fourth Revolution: The Global Race to Reinvent the State'. The two writers are the editor in chief of the Economist, John Micklethwait, and the magazine's management editor, Adrian Wooldridge (described by The Wall Street Journal as liberals but not libertarians, right-of-centre though decidedly not neoconservative).

Essentially, they argue that democracies in the west are being outpaced by leaner competitors, largely to the East, and should learn from their 'small-state dynamism'.

They say that, in the West, the 'era of more' is coming to an end, and that: *"For the foreseeable future, the Western state will be in the business of taking things away – far more things than most people realise"*.

This is an argument that should give us pause for thought in Northern Ireland. The UK has one of the largest debt-to-GDP ratios in the western world, and within the UK, Northern Ireland has the largest fiscal-deficit-to-GDP ratio of any of the constituent parts. So, the implication is that, like all economies in the Western world, and indeed more so, Northern Ireland simply has to look at reinventing the state. What we need to do is to ensure the state becomes more of a driver of the economy.

Whilst we have heard some very encouraging noises from the current Finance Minister, Simon Hamilton in this regard, I don't think anyone could argue that Northern Ireland has expressed real zeal for public sector reform in the past. The current Finance Minister will no doubt have his work cut out to get buy-in to change Northern Ireland's attitude to the state. We must do more with less, and ensure that delivering outcomes for the public / client takes precedence over which structures or systems deliver them.

Indeed, Northern Ireland has become so wedded to its current dependence on its public-spending hand-out from Westminster that it suffers from what could - perhaps slightly harshly - be described as a form of Stockholm Syndrome.

Most people know the phrase from high-profile kidnapping and hostage cases. It is a psychological phenomenon in which hostages express empathy and sympathy for their captors and have positive feelings toward them, sometimes to the point of defending them. The term is most associated with Patty Hearst, a Californian newspaper heiress who was kidnapped in the 1970s. She appeared to develop sympathy with her captors and indeed joined them in a robbery.

Northern Ireland's version could perhaps best be described as 'Status Quo Stockholm Syndrome'. By this argument, Northern Ireland should be trying to escape its current dependence on the state for its own good, but doesn't, and indeed has come to express empathy and sympathy towards it.

Indeed, maximising the size of the block grant and external sources of funding has become a major – perhaps the number one? – strategy for the economy. But, despite 'success' on this front during an era of rapid public expenditure growth, Northern Ireland's relative economic prosperity versus the rest of the UK hasn't improved. Indeed this prosperity gap has widened.

It's not that there hasn't been economic progress. Indeed, it is commendable that the Executive has made the economy its number one priority; and the wave of new job announcements in recent times is impressive, to say the least. But, whilst we have embraced the positives and popular decisions associated with the economy being the number priority, such as the job announcements and investment, have we embraced the unpopular choices and reforms that our economy and the next generation need? Has the state in Northern Ireland been in the business of taking things away as Micklethwait, and Wooldridge suggest it should be? Free prescriptions? Free public transport for over 60s? No water charging? The evidence suggests not.

It could be said that Status Quo Stockholm Syndrome's existence is widespread and visible in Northern Ireland. In political debate, in discussion in the media, in public policy, we see evidence all around us that Northern Ireland fights to preserve the status quo regarding public expenditure and subsidies in general.

In terms of the latter, Northern Ireland has fought a rear guard action against Europe to maintain as much regional selective financial assistance as possible. Similarly, moves to introduce water charges, which prevail in other parts of the UK, have been resisted.

Where Northern Ireland has challenged the status quo, it is in areas where it is popular to do so. Not introducing welfare reform measures adopted in the UK is a recent example of this. Corporation tax has been another area where we have sought to deviate from the rest of the UK.

In short, given that our relative prosperity has declined, Northern Ireland has clearly demonstrated that simply maximising the amount of public expenditure does not equal a better economy. Maintaining the status quo is therefore not in our interests. But yet, retaining it continues to be a key focus.

In reality, as Micklethwait and Wooldridge suggest, escaping our Status Quo Stockholm Syndrome isn't so much a choice, as we will be forced out of it soon enough due to the changing environment in the UK, Europe and globally. Around the world, wherever you look, the status quo is under threat.

Closer to home, the status quo relating to Scotland's membership of the UK and the UK's relationship within the EU have also been challenged. Meanwhile in terms of public expenditure cuts, the workings of the Barnett Formula and the ring-fencing of health and education expenditure in England has meant that Northern Ireland has fared much better than the rest of Great Britain. But more public expenditure cuts are coming in the next five years than have happened to date. These are already in the fiscal plans before we consider the additional Northern Ireland cuts linked to not implementing welfare reforms.

Furthermore, Northern Ireland will face steeper cuts if the next UK government decides not to ring-fence health and education. In terms of the Barnett Formula, the assumption that it would remain

unaltered looked more than a tad optimistic; however the leaders of the three main UK parties have committed to retain it in their efforts to sway the people of Scotland to vote No in the referendum.

Following on from the Scottish Referendum and post the next General Election, there is likely to be even more focus on public expenditure going to the devolved regions. The potential rise of English nationalism will increasingly challenge public expenditure comparisons. Hypothetically, if Northern Ireland was to receive the same public expenditure per head as the North East and the West Midlands, our block grant would fall by around £2.7bn and £4.4bn respectively. Indeed, calls from Frank Field, the former Labour Minister, in the wake of the No vote in Scotland, for “a new funding deal for the UK’s regions along with an end to the Barnett Formula”, highlights the mood in English politics.

According to Micklethwait and Wooldridge, around the world, from Santiago to Stockholm, the cleverest politicians and bureaucrats are scouring the world for ideas. For one, they are having to contend with the onslaught of ‘vetocracy’, where the increasing inability of a single political entity to acquire enough power to make decisions and take effective charge is creating “dysfunctional government”. The authors say that the main political challenge of the next decade will therefore be fixing government. Due to diminishing resources, competition between regions and nations, and the opportunity (through technology) to do things better, there will be a Fourth Revolution. Those economies with ‘Good Government’ and an ability to make hard choices will prosper in an increasingly globalised world. Those that don’t, won’t.

*Richard Ramsey,
22nd September 2014*

This document is issued for information purposes only for clients of Ulster Bank Group who are eligible counterparties or professional customers, and does not constitute an offer or invitation to purchase or sell any instrument or to provide any service in any jurisdiction where the required authorisation is not held. Ulster Bank and/or its associates and/or its employees may have a position or engage in transactions in any of the instruments mentioned.

The information including any opinions expressed and the pricing given, is indicative, and constitute our judgement at time of publication and are subject to change without notice. The information contained herein should not be construed as advice, and is not intended to be construed as such. This publication provides only a brief review of the complex issues discussed and readers should not rely on information contained here without seeking specific advice on matters that concern them. Ulster Bank make no representations or warranties with respect to the information and disclaim all liability for use the recipient or their advisors make of the information. Over-the-counter (OTC) derivatives can involve a number of significant and complex risks which are dependent on the terms of the particular transaction and your circumstances. In the event the market has moved against the transaction you have undertaken, you may incur substantial costs if you wish to close out your position.

Ulster Bank Limited Registered Number: R733 Northern Ireland. Registered Office: 11-16 Donegall Square East, Belfast BT1 5UB.
Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Member of The Royal Bank of Scotland Group.

Ulster Bank Ireland Limited . A private company limited by shares , trading as Ulster Bank , Ulster Bank Group and Bank Uladh. Registered in Republic of Ireland. Registered No. 25766. Registered Office: Ulster Bank Group Centre, George’s Quay, Dublin 2. Member of the Royal Bank of Scotland Group. Ulster Bank Ireland Limited is regulated by the Central Bank of Ireland.

Calls may be recorded.



Ulster Bank Limited accepts no liability for the outcome of any actions taken arising from the use of this article