Room for improvement

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A wise man once said: "The state is that great fictitious entity in which everyone lives at the expense of everyone else".

The fiction continues in Ireland in 1994 as a steady volume growth in public expenditure is hailed officially as 'firm control ofthe public finances'. The reality is amply illustrated in the accompanying graph, which shows that while government borrowing has certainly remained under control, there has been substantial upward drift in both expenditure and revenue, especially since 1990.

The 'correct' level of expenditure or taxation is a mix of economic judgement and political preferences: there is no magic number which we can say is optimal for the economy. However, even the Department of Finance has signalled concern over the path of the public finances in its latest *Economic Review and Outlook*. In mandarinese, this is expressed as '. . . the way in which fiscal consolidation is achieved can have an important impact on the economy's growth potential; in this regard the levels of taxation and expenditure merit careful attention' (page 11). In the language of mere mortals, this translates as 'taxation and expenditure are too high'.

The policy task need not be seen as the implementation of 'massive cutbacks'. All that is required is to keep the growth in public expenditure at or below the growth rate of the economy in general. This seems to be anticipated for the 1994 out-turn, but that forecast depends on a GNP growth rate of over 5%. If, as many suspect, official estimates of GNP overstate the health of

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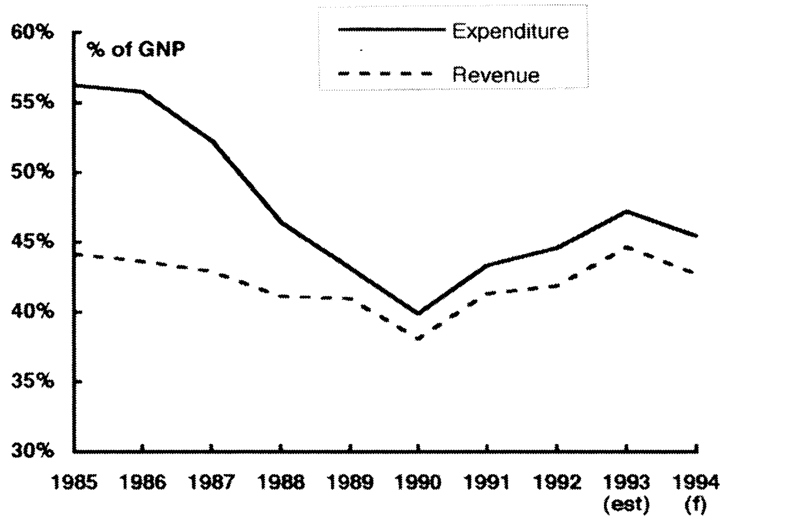

Note: Data (on budgetary basis) derived from Table 9 in 'Economic Review and Outlook 1994', Dept. of Finance.

Figure 1: Revenue and Expenditure as % of GNP 1985–94

the economy, we run the risk of having under-stated the true level of public expenditure and taxation.

If policy makers wish to achieve their stated goals, certain developments could help them to do so relatively painlessly. The last *Medium Term Review* from the ESRI pointed out that a number of factors over the next decade would tend to automatically reduce public expenditure.

For example, we can reasonably expect a substantial reduction in child dependency over the next ten years, with consequent savings on education expenditure. The ESRI takes into account a number of such demographic trends and assumes that public sector pay is stabilised. The result is an essentially automatic fall in public expenditure from 50% to 35% of GNP by 2005. The optimistic forecasts of growth made in that study were welcomed by the government: the underlying assumptions (including those of public expenditure restraint) were not as widely hailed. They were certainly not embraced as policy goals.

Beyond any year's budgetary out-turns, the long-term issues for public expenditure will relate to the policy process itself. Public sector pay determination is one old chestnut. An equally important though more technical issue is the government's accounting system, which at present continues to be entirely cash-based. New Zealand has implemented an accruals based system for the whole public sector in order to better reflect the long term consequences of policy decisions. The UK government this year announced its intention to move to a similar system.

Such a move here might help policy makers and the public to avoid drifting once again into a high-tax, high spending, underperforming economy by default, and not by policy design.

http://www.aidankane.net/writingsetc/1994_kane_finances.html