

## Summary

# Competitiveness policy - Cad a dhéanfaimid feasta gan Troika?

**Don Thornhill, National Competitiveness Council**

Since 2007 net exports have been the only positive contribution to economic growth and are likely to remain so until domestic demand from both the private and public sectors recovers. The competitiveness of our exports is central to future economic welfare. It is a necessary (though not sufficient) condition for economic recovery.

The cost conditions (including pay costs) experienced by exporting firms are important in determining competitiveness. However, the concept is wider and encompasses all the factors which impact on the ability of Irish based exporters to compete successfully on international markets.

The paper argues that recent gains in cost competitiveness need to be underpinned with enduring structural changes in the economy. Policy priority should be attached to ensuring vigorous internal competition, competitively priced infrastructure, transport and communications as well as structural changes to public services, including health and education in order to secure enhanced outcomes, cost effectiveness and productivity.

Four main directions for reform are identified and outlined

1. Promoting internal competition and introducing and ensuring contestability where possible in the non- internationally traded sectors of the economy and the public services;
2. Paying particular attention to the regulation of professional groups;
3. Strengthening accountable oversight arrangements;
4. Giving special attention to health expenditure.

Some progress is being made across these areas but Irish prices are still significantly above the Euro area average. Some of the underlying data (for example in relation to high legal costs) are worrying and present significant challenges and concerns for policy makers. Health expenditure is a particular cause for concern. When adjustment is made for our relatively “young” population Ireland has the highest level of public health expenditure in the OECD. Yet, a Canadian report suggests that of a group of 17 wealthy countries Ireland is ranked only in 15<sup>th</sup> place as regards health outcomes. Also indicative of inefficiencies are the results of an OECD study which show that once off savings of €7.6bn are possible without any deterioration in health outcomes. The need to improve efficiency and outcomes in our health service is given added urgency by the prospective ageing of our population. Failure to do so will result in poorer services and unnecessarily high levels of taxation which will damage competitiveness, jobs and job creation.

A number of reform proposals are proposed and outlined. The paper notes the positive impulse given to structural reform by the Memorandum of Understanding with the EU/IMF as well as continuing Troika oversight. The paper questions our ability in the light of successive implementation failures to persist with important structural reforms in the absence of continued external oversight. Could the “restoration of economic sovereignty”, and the departure of the Troika, result in reform fatigue? The author argues the need for structures and processes which will

hold policy and decision makers to account for “what they promise to do and should be doing” and, importantly, with the ability to impose costs and sanctions on organisations which refuse to or drag their feet in meeting targets and standards. The design and implementation of these structures and processes is challenging in a democratic society - but essential.

# Competitiveness policy - Cad a dhéanfaimid feasta gan Troika?<sup>1</sup>

*Much of the policy thrust underlying this paper is in line with recommendations made by the National Competitiveness Council (NCC) over a number of years but the paper is my own responsibility. Neither the commentary nor the specific proposals in the paper should be attributed to the Council or to its members. In particular some of the specific examples mentioned arise from my own working experiences in the public and private sectors. I would particularly like to thank Dónal de Buitléir, Adrian Devitt, Conor Hand, Joe Mulholland, Eddie Molloy and Maura Thornhill for their advice, suggestions, stimulating conversations and data. All statements of opinion and errors are my own responsibility.*

## Competitiveness a necessary condition for economic recovery

Competitiveness encompasses all the factors which impact on the ability of firms in Ireland to compete successfully on international markets. It is a necessary (though not sufficient) condition for economic recovery. In the period since 2007 net exports have been the only positive contribution to economic growth and are likely to remain so until demand from both the private and public sectors recovers.

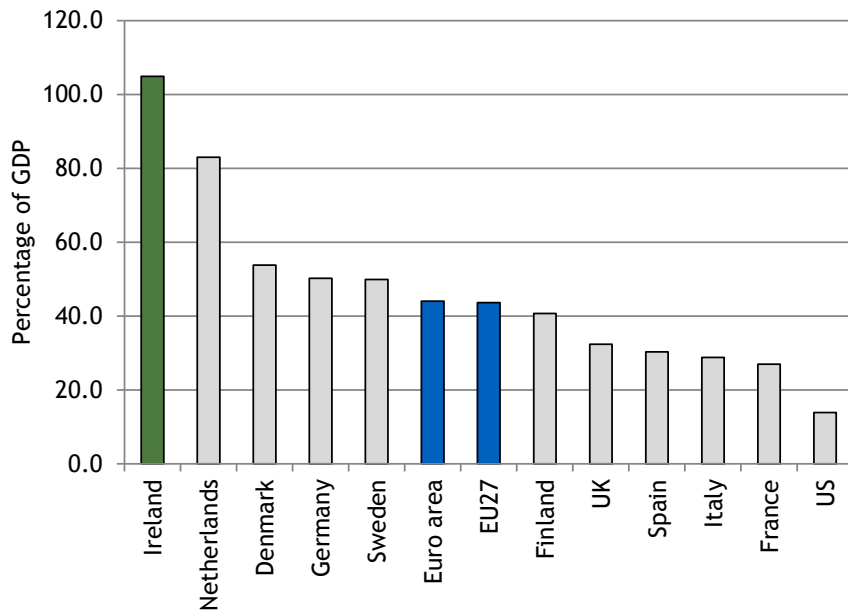
In the round, competitiveness means delivering value and satisfaction to customers. It is sometimes envisaged as purely cost related and thereby alleged to be a driver of “a race to the bottom”. Clearly price matters and as a result, production costs (of which pay costs are a part) are an important dimension of competitiveness. But better business performance through product quality, production efficiency, tax policy, and particularly innovation and productivity, also determine competitiveness. National endowments and characteristics in areas such as labour supply, quality of educational outcomes, knowledge and research capital, infrastructure, political stability, the rule of law, ease of contract enforcement and industrial relations all play a part. A successful array of competitiveness policies enables increases in living standards and improvements in the quality of life.

The very open nature of the Irish economy - we are one of a small group of western countries acutely dependent on exports (Figure 1) - further underlines the importance of competitiveness as a critical determinant of economic recovery.

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<sup>1</sup> With apologies to Cill Chais

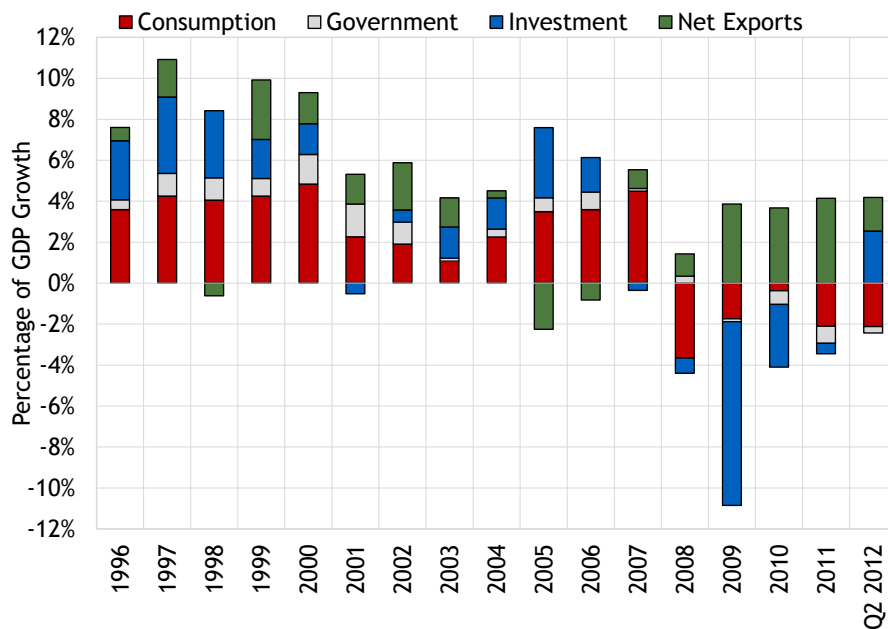
Figure 1: Exports as % of GDP, 2011



Source: Eurostat, Economy and Finance

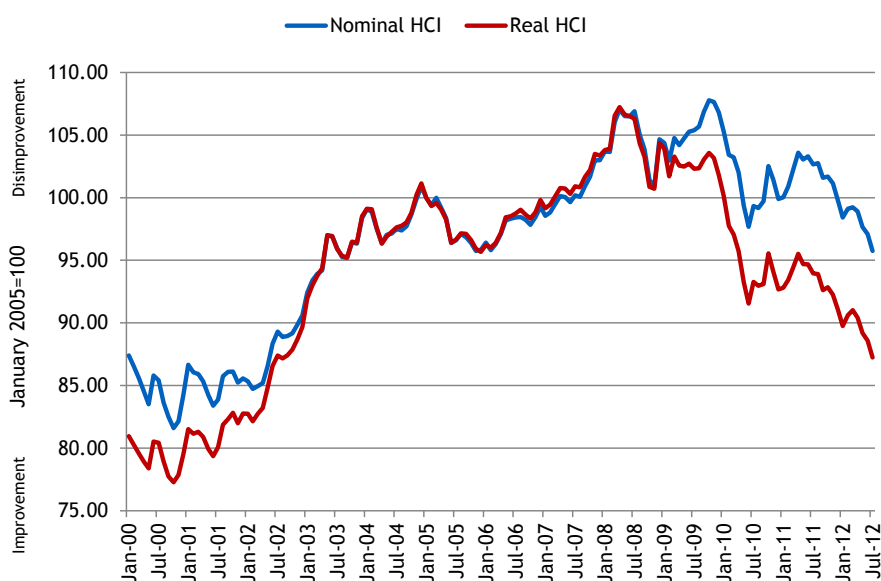
Ireland lost competitiveness during the “bubble period”. Since then cost competitiveness has improved (Figures 2 and 3).

Figure 2: Components of Irish Economic Growth, 2001-Q2 2012



Source: CSO National Accounts

Figure 3: Ireland's Harmonised Competitiveness Indices, 2000-2012



Source: Central Bank of Ireland, Forfás Calculations

Some of this improvement has been due to softening prices and costs due to declining domestic demand. One of the policy challenges now facing us is to underpin those competitiveness gains with enduring structural changes in the economy. We now need to attach policy priority to ensuring vigorous internal competition, competitively priced infrastructure, transport and communications and structural changes to public services, including health and education in order to secure enhanced outcomes, cost effectiveness and productivity. For that reason the inclusion of internal competition issues and other structural issues in the Memorandum of Agreement between the Government and the EU/ECB/IMF troika are very welcome.

### What is meant by internal competition?

It is the extent to which suppliers of goods and services in the domestic economy are subject to contestability and competition. This applies not just in what economists call the non-traded market sector (i.e. those sectors where firms and individual producers and providers do not export and do not compete with imports). It includes professional services (including medicine and law), financial and other business services - and, importantly, public service activities such as public administration, the health services, education and the administration of justice. It is also important that importers of goods and services into Ireland also face competition on the Irish market.

### Why is internal competition so important for competitiveness?

Competition keeps margins under pressure. The American economist Mancur Olson argued that individuals and sectors given the choice would try to structure the markets in which they operated in order to maximise their margins at least effort to themselves<sup>2</sup>. This could be done very effectively by protecting existing suppliers against competition from new entrants. The strategies employed can take many forms including erecting barriers to entry, such those which used to apply

<sup>2</sup> Mancur Olson, *The Rise and Decline of Nations*, Yale University Press, 1982

to new pharmacists trying to secure Primary Care Reimbursement Service (formerly GMS) contracts and which also applied to medical general practitioners trying to join that scheme. Restrictive practices are another popular device. And of course, if all else fails, try lack of transparency and complex jargon! To take a topical example - whose interests were being served by the difficulty in finding out the prices for which housing properties are bought and sold? It is not the public interest. The decision, recently implemented, that the National Property Services Regulatory Authority (PSRA) post details of property sales within two months of completion of the sale is welcome ...but long overdue.

The net outcome of restrictions on internal competition is that owners and employees in protected firms enjoy and often share what economists call **supernormal profits** or **economic rents**<sup>3</sup>. Somebody has to pay for these rents. The negative impacts include high prices but also poor standards of service and poor product quality. Low levels of innovation, or indeed resistance to change in any form are also a consequence and this can sometimes extend to the retention of archaic practices and procedures. These are often underpinned by cartelised and anti-competitive behaviours. These negative consequences result because the customer has restricted or no choice. The dampening of innovation is a particularly heavy cost. Innovation accounts for about two thirds of the sources of economic growth<sup>4</sup>. If a society is so structured that innovation is not rewarded the result will be slower economic growth and reduced prosperity.

In contrast to suppliers operating in protected markets, producers trading internationally or facing external competition on the home market cannot impose uncompetitive prices on their customers. If they do they will go out of business. But if some of their suppliers enjoy economic rents their competitiveness will suffer (i.e. all enterprises are ultimately consumers who must purchase inputs of goods and services). Olsen argued that economic rents created by anti competitive structures and practices are among the most serious brakes on economic development.

Under the Joint EU/IMF Programme of Financial Support, Ireland has made a commitment to remove restrictions to trade and competition in sheltered sectors, such as the legal, medical and pharmaceutical professions. To illustrate the potential impact of structural reforms on the overall level of GDP, the Department of Finance ran a number of simulations<sup>5</sup>. A one per cent reduction of the price mark-up in the final goods sector was estimated to increase GDP by 0.37 per cent in the medium term, 0.66 per cent in the long run and 0.79 per cent in the very long run.

An economy and society in which there are significant sectors shielded from competition will experience higher costs and lower productivity in those sectors. These impose heavy costs on the economy and society, damaging innovation, competitiveness and export performance.

In our work over the years the NCC has tended to focus on comparing the direct costs to businesses in Ireland with those in other countries. But the need for competition and contestability applies to all areas of economic and social activity - even in areas like that we might not immediately think as being linked to exports. If, for example, employees in an Irish exporting firm face higher housing

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<sup>3</sup> An economic rent is defined as an excess distribution to any factor in a production process above the amount required to draw the factor into the process or to sustain the current use of the factor.

<sup>4</sup> According to a recent OECD study, firms in many OECD countries now invest as much in intangible assets, such as research and development (R&D), software, databases and skills, as in physical capital, such as equipment or structures. Much multifactor productivity (MFP) growth is linked to innovation and improvements in efficiency. Preliminary estimates indicate that in Austria, Finland, Sweden, the UK and the US, investment in intangible assets and MFP growth together accounted for between two-thirds and three-quarters of labour productivity growth between 1995 and 2006, thereby making innovation the main driver of growth. For more information see OECD, *The OECD Innovation Strategy: Getting a Head Start on Tomorrow*, 2010

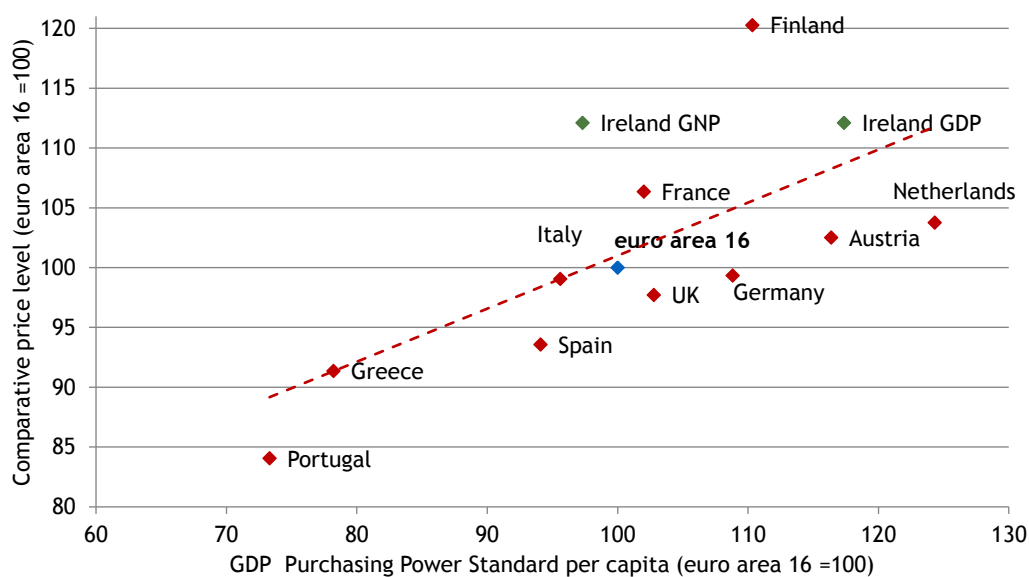
<sup>5</sup> The analysis was conducted using the QUEST III model with endogenous growth developed by the European Commission specifically for the task of examining structural reform. In order to measure the effect of such a reform on GDP, a shock that reduces the mark-up of prices over marginal costs was simulated

costs, higher legal fees and higher medical costs<sup>6</sup> than their counterparts in competitor firms in other countries this will drive up their pay demands and expectations which will work to put this Irish firm at a competitive disadvantage compared its competitors. Taxation can also damage competitiveness through, for example, increasing the tax wedge.

## So how does Ireland compare?

Comparisons are an important guide to competitiveness. The comparative picture for Ireland in respect of internally generated costs is not encouraging. Ireland is a high income and high price society but more significantly compared with other societies our prices (and thereby our costs) are high relative to our incomes as we can see from the following diagram.

Figure 4: Comparative Price Level and GDP per Capita, 2011



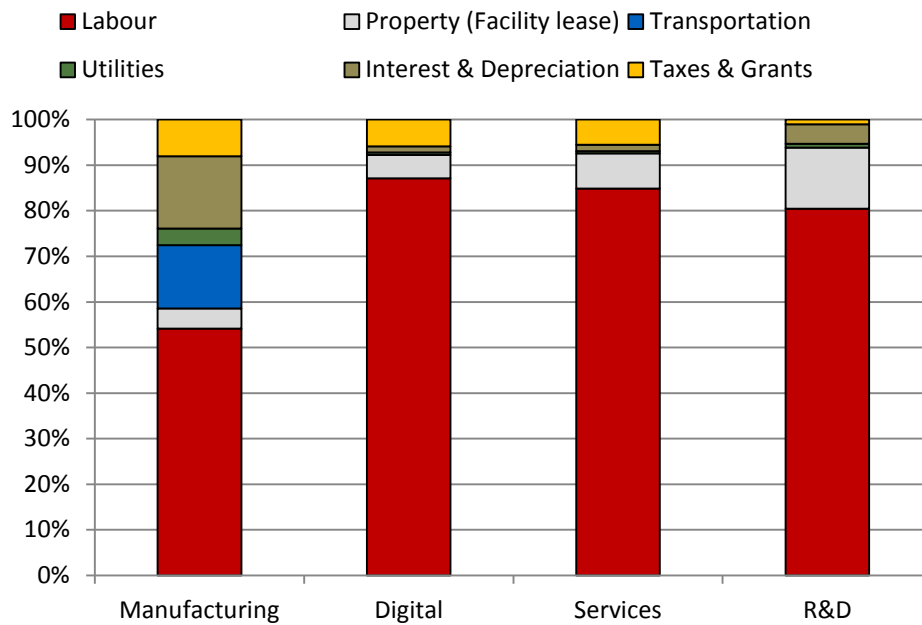
Source; EU Commission, Forfás Calculations

We need to adjust the income/price ratio so that our relative position on this diagram migrates in a south easterly direction - and the only way we can combine high real incomes with greater competitiveness is by being more productive. Greater internal competition is one of the ways of driving increased productivity.

Figure 5 presents a breakdown of the cost components for four sectors - manufacturing, digital services, broader business services, and research and development (R&D) services. They illustrate the relative importance of various location sensitive costs. There are significant differences in cost structures between the various sectors. In all cases, however, labour costs account for the majority of location sensitive costs - varying from 54 per cent in the case of manufacturing to over 87 per cent in the digital sector.

<sup>6</sup> Remuneration of medical consultants in Denmark and Finland is 2.5 times average earnings, while in Ireland the multiple is over 6 (excluding significant private fees in Ireland which are earned in addition to public salaries). Journal of the Statistical and Social Inquiry Society of Ireland, Vol. XXXIX, "An Exploration of the Nordic Model" Donal de Buitléir (Presidential Address read before the Society, 20 May 2010)

Figure 5: Location Sensitive Cost Profiles for Manufacturing, Services and R&D Operations, 2010



Source: KPMG Competitive Alternatives 2012, Forfás Calculations

The following diagrams drill down into the overall costs and prices picture. They show that labour costs have fallen but that there is progress to be made in some important areas in order to become more cost competitive. According to one survey, Dublin is the 6<sup>th</sup> most expensive major international city to construct an office block<sup>7</sup> although office rents have become more competitive<sup>8</sup>. Electricity is expensive in Ireland for SMEs - 4<sup>th</sup> most expensive in the euro area. Ireland is the 4<sup>th</sup> most expensive country among the 17 euro area countries for diesel - which, of course drives up transport and consumer costs.

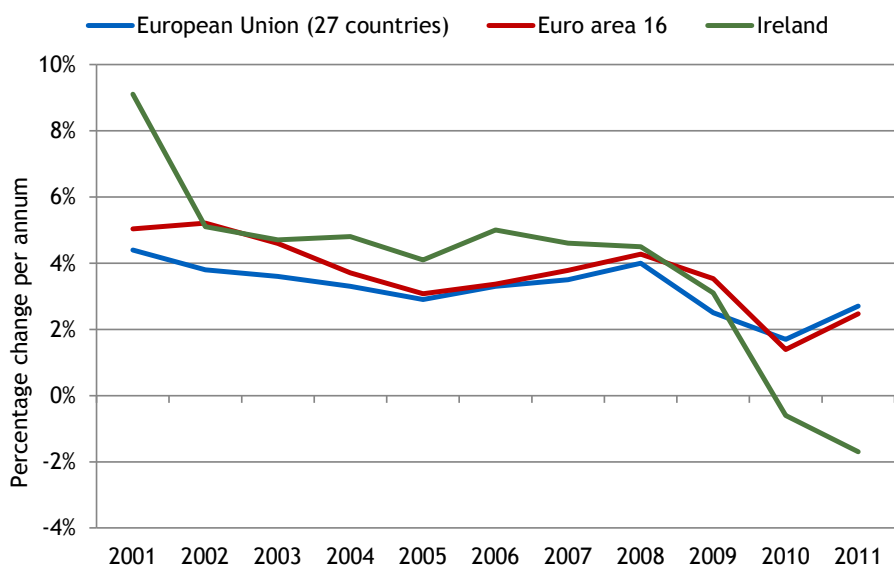
<sup>7</sup> Gardiner and Theobald, International Construction Cost Survey

<sup>8</sup> See Cushman and Wakefield, Office Space Across the World, 2012



## Labour Costs

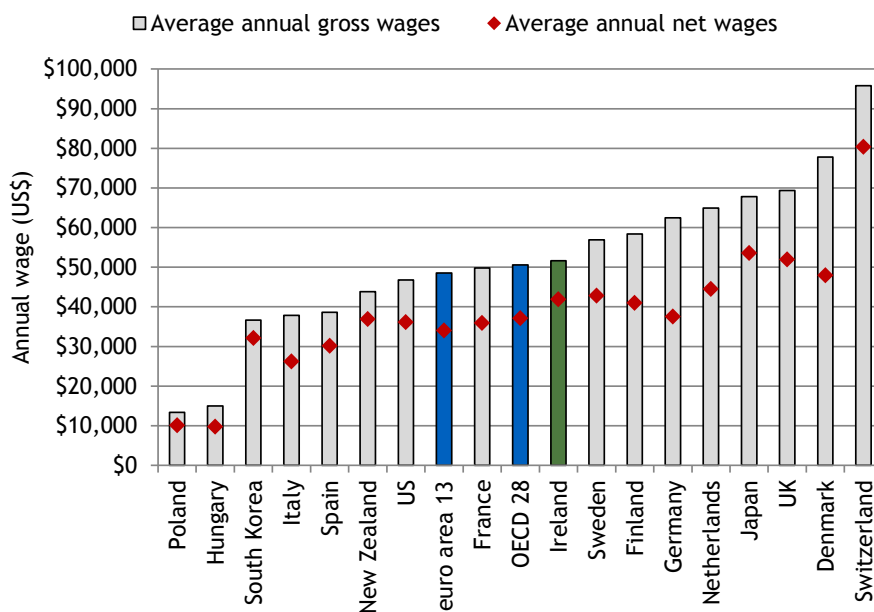
Figure 6: Growth in Labour Cost, 2001-2011



This indicator shows the trend in labour cost growth in Ireland compared with the euro area-16 and EU-27. From a high of 9.1% growth in 2001, Irish labour costs have fallen in both 2010 (-0.6%) and 2011 (-1.7%). This represents a gain in cost competitiveness as labour costs continue to rise in the EU and euro area.

Source: Eurostat, Population and Social Conditions, CSO, Labour Cost Index, Forfás Calculations

Figure 7: Average Total Labour Costs and Net Wages, 2011



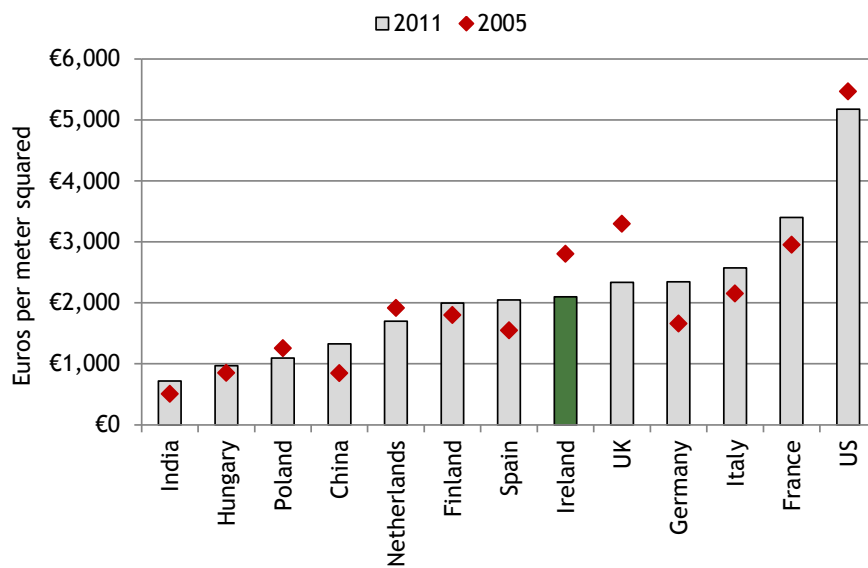
Total labour costs include wages, taxes on income and employer and employee social security contributions. Ireland has the 14<sup>th</sup> highest total labour costs level in the OECD-28<sup>9</sup>. The chart also shows average net wage levels. Ireland has the 10<sup>th</sup> highest net wage level in the OECD-28 (13% above the OECD average), partly a result of the relatively small gap between before and after-tax wages in Ireland.

Source: OECD, Taxing Wages 2011, OECD Comparative Price Levels 2012, Forfás Calculations

<sup>9</sup> The Universal Social Charge which came into effect on 1st January 2011 is captured in the Irish data.

## Commercial Property Costs

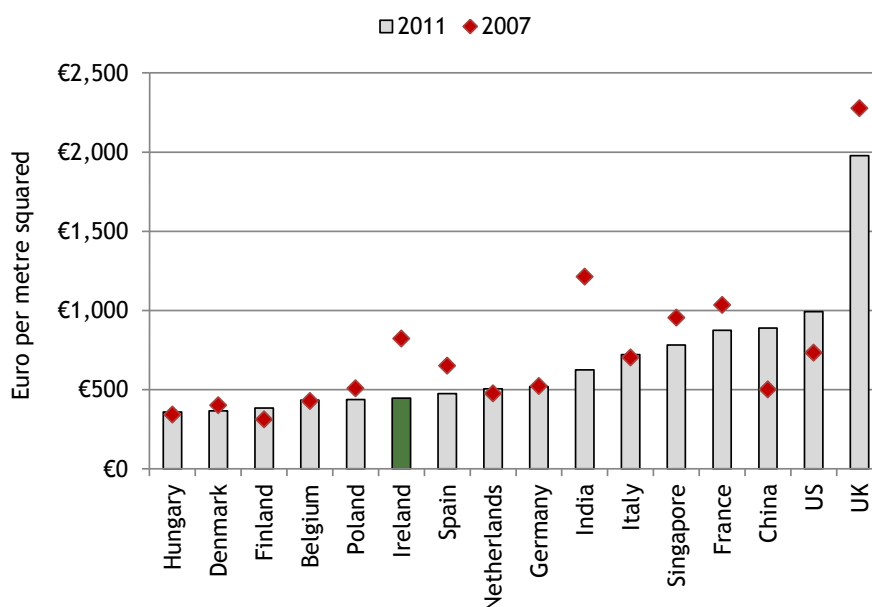
Figure 8: Cost of Constructing a Prime Office Unit<sup>10</sup>, 2011



Construction costs data takes account of building, labour and material costs. The cost of constructing a prime office unit in Ireland has fallen by 32% since costs peaked in 2007 (and down 25% from 2005). Amongst the locations surveyed, Ireland was the 6<sup>th</sup> most expensive location to construct a prime office unit in 2011.

Source: Gardiner and Theobald, International Construction Cost Survey

Figure 9: Cost of Renting a Prime Office Unit, 2011



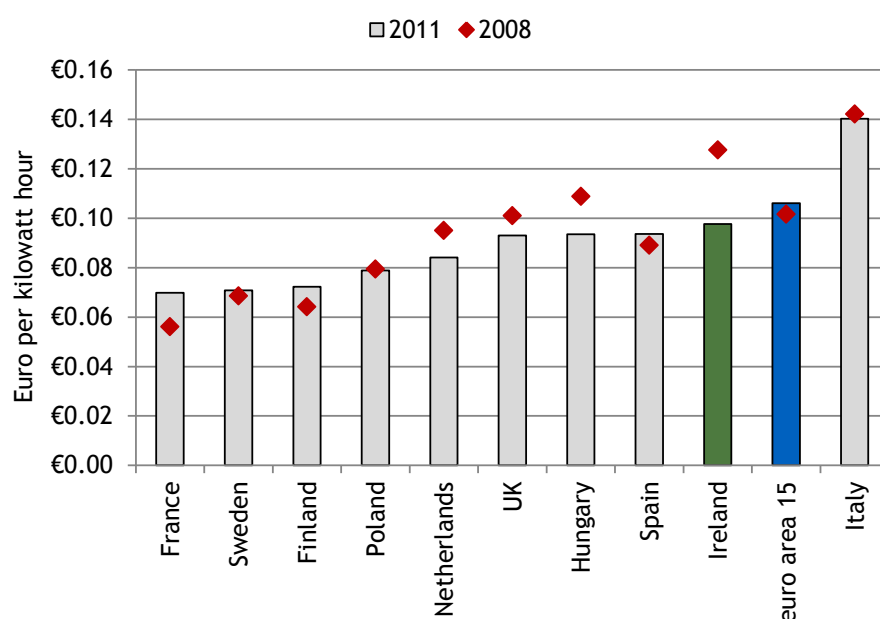
Office rents in Dublin have fallen by 45% between 2007 and 2011. The pace of decline seems to have stabilised in 2010 and 2011, with rents falling by less than 1% year on year. Dublin is now the sixth cheapest rental location amongst the 16 locations benchmarked, and is now cheaper than both Frankfurt and Madrid.

Source: Cushman and Wakefield, Office Space Across the World, 2007 - 2012

<sup>10</sup> Prices quoted are the upper boundary of the cost of the constructing a prime office unit. Prices quoted for the US reflect the upper boundary cost of constructing a price office unit in New York.

## Utility Costs

Figure 10: Industrial Electricity Prices for Large Energy Users (excluding VAT), 2011<sup>11</sup>



Despite falling by over 25% since 2008, electricity costs for large industrial users in Ireland are seventh most expensive among the euro area 15 countries. The temporary rebate introduced for large electricity users in 2010 and which has had a positive impact upon prices, is being phased out in 2012.

Source: Eurostat - Environment and Energy

Figure 11: Business Basket of Calls including International Calls (260 calls excluding VAT), US \$, 2012

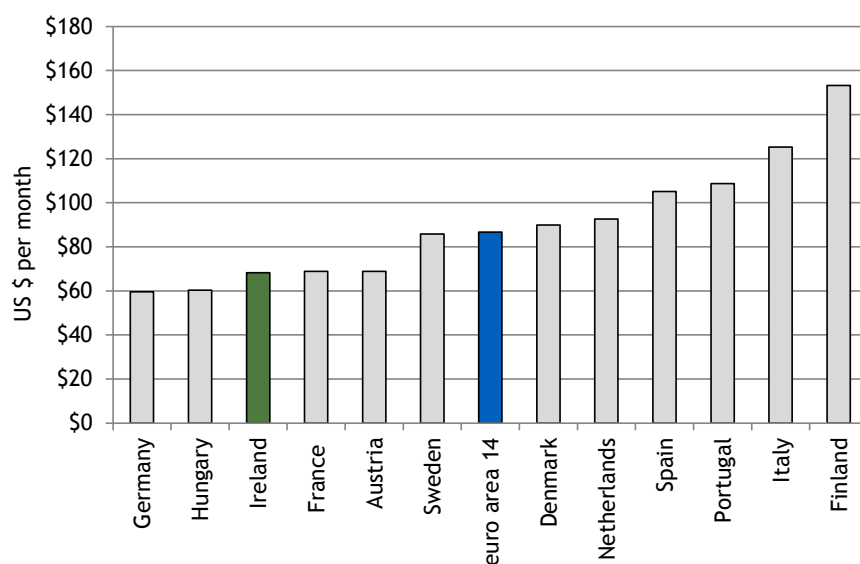


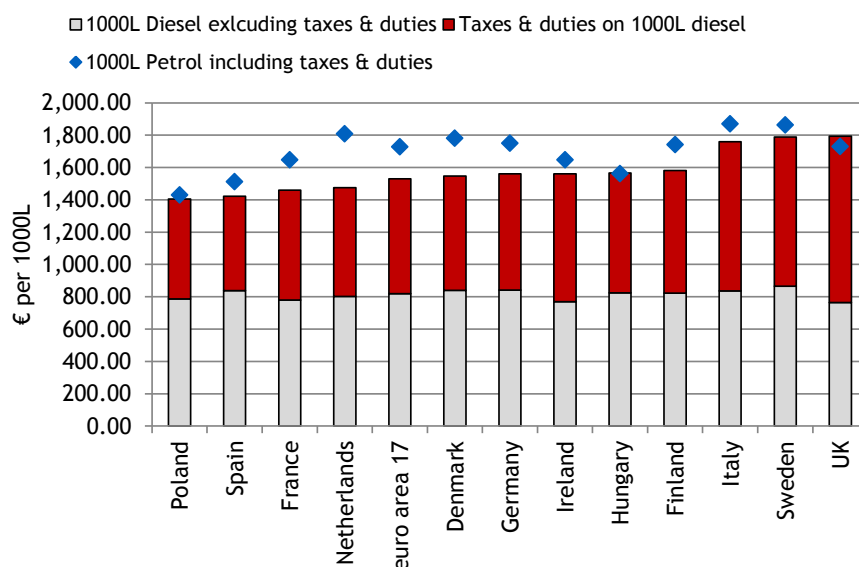
Figure 6.11 measures the cost of a business basket of calls, including international calls in February 2012. When the international element is included, Ireland slips down the rankings slightly to become the fourth cheapest location in the euro area 14 (excludes Cyprus, Estonia and Malta) for business calls.

Source: Teligen

<sup>11</sup> Electricity prices for large users are based on an annual consumption of 2,000 to 20,000 MWh. Data refer to half-yearly prices for H2 each year.

## Transport Costs

Figure 12: Average Diesel and Petrol Costs per Litre, August 2012



Some sectors are more sensitive to fluctuations in fuels costs than other sectors (e.g. the haulage industry). The cost of 1,000 litres of diesel in Ireland (€1,561) was just above the average euro area 17 price in August 2012. On this basis, Ireland is the 4<sup>th</sup> most expensive country amongst the 17 euro area countries. The average price of petrol in Ireland was €1,647 per 1,000 litres, making Ireland the 9<sup>th</sup> most expensive in the euro area.

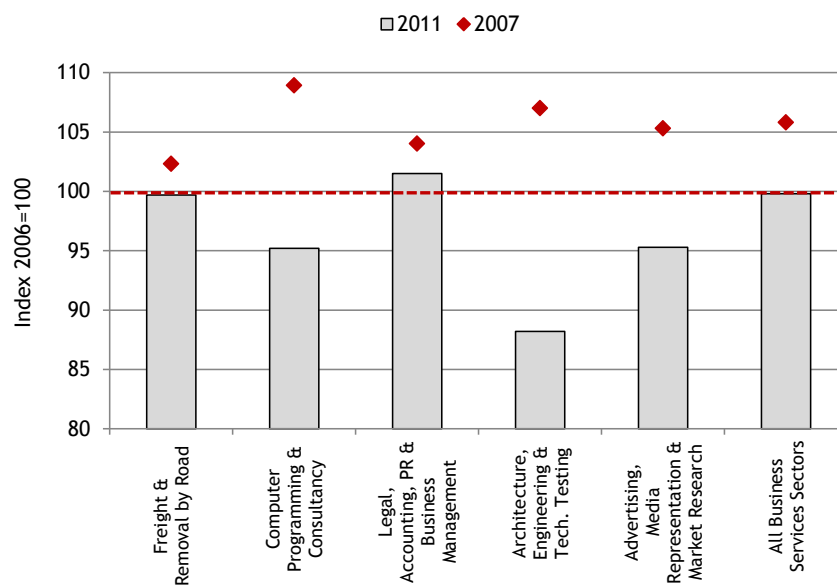
Source: European Commission, Energy Statistics & Market Observatory

## Business and professional services

This is an interesting subset. Business and professional services account for a relatively low proportion (6%) of the enterprise cost base but input into virtually every business enterprise. They are part of the bundle of services included in the simulations carried out by the Department of Finance referred to above.<sup>12</sup> The costs of most services delivered to businesses have fallen since 2006- with one exception, legal services, which are already expensive by international standards - see Figure 15. The direct comparison of legal and accountancy services (Figure 14) shows a predictable response of falling prices by accountancy service providers to the recession (i.e. falling prices). This contrasts with legal costs, where despite the severe impact of the collapse of the property market on solicitor firms in particular, costs appear to have remained constant. This raises the question as to what extent the regulatory features of the legal profession contribute to this outcome?

<sup>12</sup> The analysis was conducted using the QUEST III model with endogenous growth developed by the European Commission specifically for the task of examining structural reform.

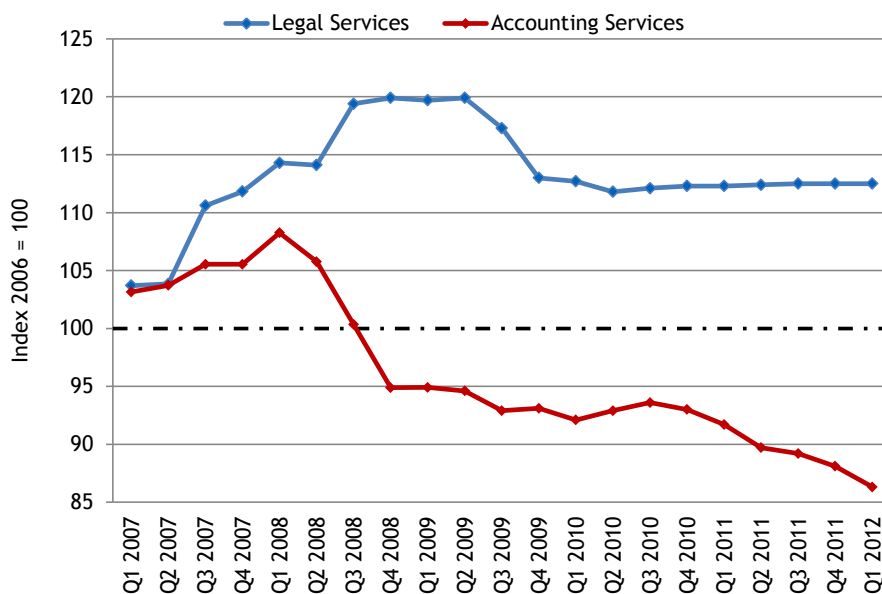
Figure 13: Services Producer Price Index, 2011



In 2011, the cost of most business services had fallen to, or below, 2006 levels. The exception to this was the Legal, Accounting, PR and Business Management category, where prices remained 1.5% above 2006 levels. The largest decrease in services costs since 2006 has been in the Architecture, Engineering and Technical testing category, where prices have fallen by nearly 12%.

Source: CSO, Services Producer Price Index

Figure 14: Accountancy and Legal Costs<sup>13</sup>, Q1 2007- Q1 2012

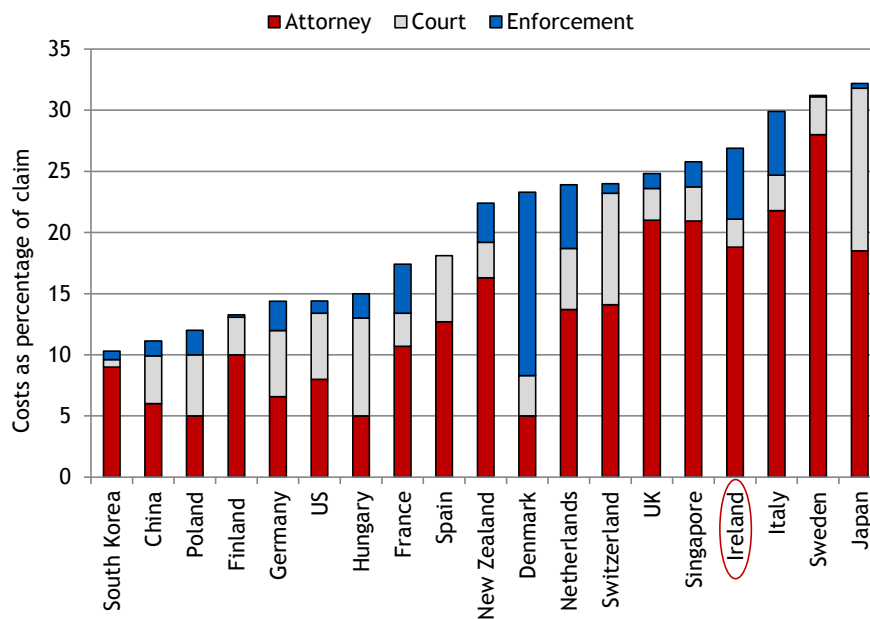


This indicator examines the evolution of accountancy and legal costs in greater detail. While the cost of accountancy services have been on a continual downward trajectory over recent years, legal service costs have remained approximately 12% above 2006 price levels.

Source: CSO, Services Producer Price Index

<sup>13</sup> Data on legal services is based on responses received from 18 companies (and 112 price observations), the majority of whom employ between 10 and 49 employees. The survey does not include data on prices for barrister services. Given the small sample size, caution should be used when interpreting the results.

Figure 15: Legal Fees, Cost of Enforcing a Business Contract, 2011



This indicator decomposes the cost of enforcing a business contract into three areas. Ireland remains one of the most expensive locations among those benchmarked for the total cost of enforcing a business contract. Attorney fees account for 70% of the cost of enforcing a business contract in Ireland.

Source: World Bank, Doing Business 2012

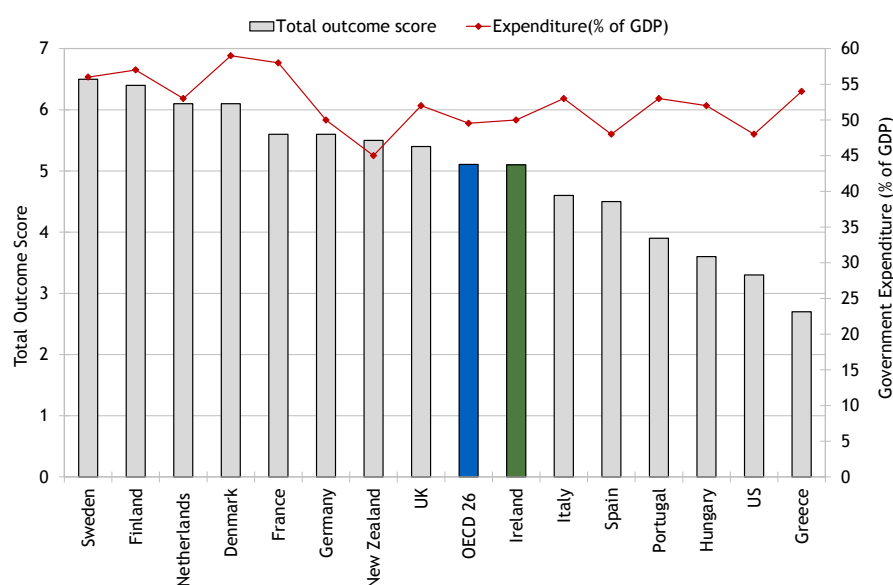
### Public services

The cost of the public service, and the pay and productivity of public servants loom large in the debate about fiscal correction. The cost effectiveness and productivity of the public sector has a major impact on competitiveness through the impact of the public sector on tax levels, and the costs and efficiency of service delivery - particularly to businesses.

Public servants in Ireland are relatively well paid. Journalist and economic commentator, Dan O’ Brien reviewing 2008 OECD data points to the very high pay remuneration of medical specialists, nurses and teachers. The 2009 pay cuts will have reduced the relative position of Irish public servants in the international pay rankings but O’ Brien concludes that “they are likely to remain better paid than their peers internationally”<sup>14</sup>. How well does the public sector perform? Figure 16 attempts to answer this.

<sup>14</sup> Irish Times , Business, Friday September 14, 2012

Figure 16: Public Sector Performance, 2009



Ireland performs close to the OECD 26 average both in terms of public sector performance and expenditure. Expenditure levels on the public sector are largely consistent across the OECD. In contrast, there is considerable variation in the outcome scores achieved. Figures relate to 2009 and do not take into account the reductions in staff and savings achieved in Ireland since then.

Source: The Netherlands Institute for Social Research

## Health

Within the wider context of the public service, this is a sector which arguably needs special attention. In the Republic of Ireland, annual public expenditure on health accounts for 7.7 per cent of GNP (approximately €9.8 billion per annum). As a percentage of GNP, this is the 13<sup>th</sup> highest level of expenditure in the OECD<sup>15</sup>. It is important, however, when comparing cross country data on health expenditures, to have regard to different demographic profiles. Older populations in general require more expenditure on health care. Ireland has the 6<sup>th</sup> “youngest” population out of the OECD countries - with 11.1 per cent of the population aged over 65 as compared with an OECD average of 14.9 per cent. In Europe the two “oldest” populations are Germany and Italy with over 65s making up respectively 20.5 per cent and 20.4 per cent of the population.<sup>16</sup> Using a demographic adjustment carried out by Paul Redmond of Publicpolicy.ie, Ireland has the highest level of public expenditure on health within the OECD<sup>17</sup>. Ireland’s private expenditure on health accounts for 3.4 per cent of GNP, the 5<sup>th</sup> highest in the OECD after demographic adjustment.

These high levels of expenditure, both public and private, do not result in resoundingly positive health outcomes. Table 1 juxtaposes Redmond’s expenditure rankings with ranking data produced by the Conference Board of Canada for health outcomes. Of the 17 wealthy countries included in the health outcomes assessment published by the Canadian Conference Board<sup>18</sup> Ireland is ranked in 15<sup>th</sup> position. The Conference Board ranking needs to be interpreted with caution. Health outcomes

<sup>15</sup> “Expenditure and Outputs in the Irish Health System: A Cross Country Comparison”; Paul Redmond: Public Policy.ie; www.publicpolicy.ie; OECD use GDP as the denominator; for well known reasons Redmond uses GNP as the denominator for Ireland.

<sup>16</sup> Redmond; op cit

<sup>17</sup> The age demographic adjustment involves normalizing each country’s proportion of over 65s to the OECD average of 14.9 per cent - by dividing the OECD average by the proportion for each individual country; Redmond; op cit.

<sup>18</sup> Conference Board of Canada; How Canada Performs (Health)  
[http://www.conferenceboard.ca/hcp/overview/health-overview.aspx#health\\_context](http://www.conferenceboard.ca/hcp/overview/health-overview.aspx#health_context)

are not solely the result of the availability of health care. The World Health Organisation (WHO) defines health as “*the state of complete physical, mental, and social well-being and not merely the absence of disease or infirmity.*”<sup>19</sup> According to a Canadian Senate report socio-economic factors such as education, income, housing, social support networks, culture, and personal health practices account for an estimated 50 per cent of a person’s health status, while health care service accounts for 25 per cent.<sup>20</sup> Therefore, improving the health status of the population requires improving social and economic conditions, education about reducing the risks of chronic diseases (for example, by limiting tobacco and alcohol consumption and by being physically active), as well as enhancing the quality and safety of health care. Despite this important contextualisation, the data in Table 1 hardly suggest that all is well in terms of securing value for money from public and private expenditure on health care.

**Table 1: Health expenditures and outcomes - 17 wealthy countries**

Country	Rank - Health Expenditure (%GDP)	Rank- Health Expenditure (% of GDP, adjusted for demographic profile)	Rank - Health outcomes
US	1	1	17
Ireland	7	2	15
Canada	5	3	10
Netherlands	2	4	11
France	3	5	7
Denmark	8	6	16
Australia	21	7	8
Switzerland	6	8	2
Norway	18	9	4
Austria	9	10	13
Belgium	11	11	12
UK	14	12	14
Germany	4	13	9
Sweden	16	14	6
Finland	24	15	5
Italy	20	16	3
Japan	17	17	1

Sources: Expenditure and Outputs in the Irish Health System: A cross country comparison; Paul Redmond, Publicpolicy.ie (to be published shortly)

Conference Board of Canada; How Canada Performs (Health)

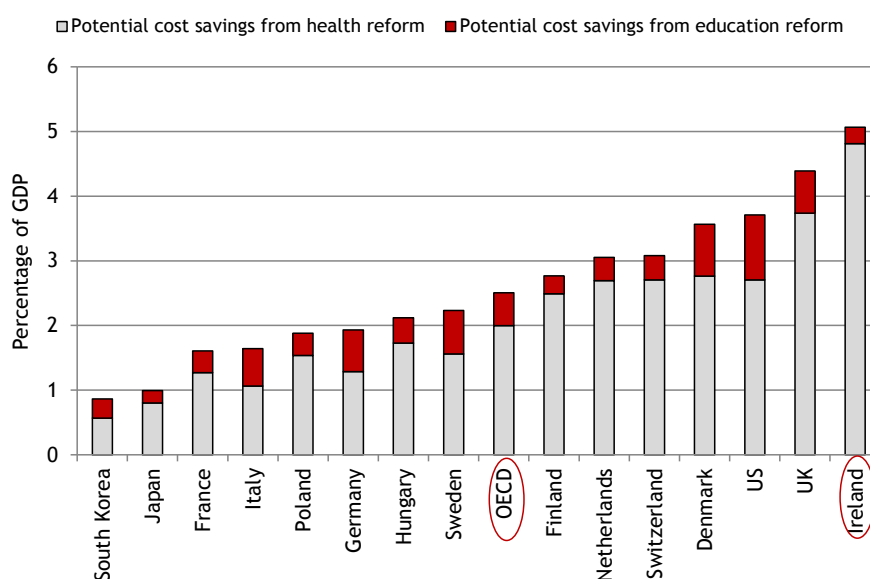
<sup>19</sup> World Health Organization, *Constitution of the World Health Organization* (accessed August 18, 2008)

<sup>20</sup> Standing Senate Committee on Social Affairs, Science and Technology, *Canada: A Healthy, Productive Canada: A Determinant of Health Approach, Final Report of the Senate Subcommittee on Population Health*, June 2009



Figure 17 provides further cause of concern and reinforces an impression that we are getting poor value from our health service. The OECD has measured the potential impact of a range of structural reforms that can impact directly on productivity and can directly improve national fiscal positions **while maintaining current outcomes** (my emphasis). The analysis suggests that while Ireland can in common with many countries achieve savings through educational reform (in our case of the order of 0.25 per cent of GDP) Ireland is “top of the group” in that health sector changes **which would sustain outcomes** could save up 4.8 per cent of GDP (or 6 per cent of GNP). This would amount to a very significant once off saving of the order of €7.6 billion.

Figure 17: Potential Cost Savings from Efficiency Gains in Primary & Secondary Education<sup>21</sup>, and in Health Care System<sup>22</sup>



The analysis suggests that while Ireland can in common with many countries achieve savings through educational reform of the order of 0.25 percent of GDP; the corresponding health sector changes could be of the order of 4.8 per cent of GDP (or over 6 per cent of GNP). This would amount to a very significant once off saving of the order of €7.6 billion.

Source: OECD, Going for Growth 2011

## What can be done?

Reform is arguably required in four areas:

1. Introducing and ensuring contestability where possible; and
2. Paying particular attention to the regulation of professional groups
3. Accountable oversight arrangements.

<sup>21</sup> Potential savings represent the difference between a no-reform scenario and a scenario where all schools in each country would become on average as efficient as those in the best performing country.

<sup>22</sup> Potential savings represent the difference between (i) a scenario where public spending and life expectancy gains would increase at the same pace over the next decade as over the decade 1997-2007 and (ii) a scenario where countries would achieve similar health improvements with lower public spending by moving towards the efficiency levels of best-performing countries. See Chapter 6; OECD estimates based on Joumard et al. (2008), "Health Status Determinants: Lifestyle, Environment, Health Care Resources and Efficiency", OECD Economics Department Working Papers, No 627

#### 4. Special attention to health expenditure

### Contestability

This is a straightforward concept. It is present when suppliers of goods and services face competition from others<sup>23</sup>. Contestability can be interfered with or blunted by restrictive practices (for example, in professions, in trades and in the public services), by Government policies (e.g. legislating for barriers to entry as was the case for taxi operators, GMS pharmacists and GPs<sup>24</sup>), by collusion between firms and suppliers - and, of course, by monopolies and oligopolies.

### Contestability in the provision of public services

It is often seen as very difficult indeed to introduce contestability into the provision of public services. Yet there are areas of public service activity where choices (and contestability) exist. Education is one. Many parents can choose where they send their children to school. Capitation payments to schools and the application of teacher/ pupil ratios ensure that money follows the pupils. Successful schools gain pupils and increased Exchequer support. The same dynamic applies even more strongly in third level education where money again follows the student. This means that in many areas of the country there is competition between schools and there is, of course, vigorous competition between third level institutions. Notwithstanding recent concerns about education standards I believe that this competitive dynamic is one<sup>25</sup> of the reasons why education outcomes are better than might be expected from the lower education expenditures in Ireland as compared with comparable countries.

### Contrast education with health

Institutional budgeting (for example, hospitals bargaining over budgets with the HSE/Department) is an important feature in the health sector. The introduction of systems where funding followed the user could result in much improved health service delivery. If funding followed the user - hospitals and health providers would take a different view of citizens needing health service rather than at the moment approaching delivery with a rationing mind set. Interestingly, this is the approach reflected in the recommendations made in the Report of the Expert Group on Resource Allocation and Financing in the Health Sector (9 July 2010)<sup>26</sup> and appears to be central to the health insurance model proposed by the Government. A model of “money following the service user/patient” may be more successful than the current model in delivering value for money and improved outcomes.

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<sup>23</sup> A contestable market is defined as “one into which entry is absolutely free and exit is absolutely costless”. See William Baumol, *Contestable Markets: An Uprising in the Theory of Industry Structure*, *The American Economic Review* 72:1:1, 1982

<sup>24</sup> Other examples include the manner in which the aviation industry was regulated until deregulation occurred: the use of “grandfather rights”, whereby the allocation of slots was decided by incumbents through scheduling committees, severely limited free entry. Government imposed restrictions on contestability also include situations requiring a licence to operation - an example is the licensing of public houses for the sale of alcohol, especially in restricting competition in the sale of draught beer and spirits. This last example illustrates that restrictions on contestability may be imposed for public policy reasons.

<sup>25</sup> Teacher quality and strong parental commitment and interest in education are others.

<sup>26</sup> The report contains proposals to move to a system whereby hospital treatments would be funded on a mainly prospective, episode of care basis, as compared to the current historic block grants. See [http://www.dohc.ie/publications/resource\\_allocation\\_financing\\_health\\_sector.html](http://www.dohc.ie/publications/resource_allocation_financing_health_sector.html) and presentations by Professors Frances Ruane and Charles Normond.

## Public transport

Public transport, particularly in Dublin, is a priority for introducing greater contestability. Dublin is unique in the extent to which commuters (i.e. people going to work) use their cars to get from home to the place of work<sup>27</sup>. This is very inefficient in terms of energy utilisation, it aggravates traffic congestion, increases travel times and is stressful on commuters themselves, who buy cars to tie them up for most of the day either near or at their places of work. This all adds to cost and reduces competitiveness. Despite recent improvements (both in its own operations and due to the advent of the LUAS), public transport in Dublin is largely handled by a public owned monopoly, CIE, with two arms, Dublin Bus and Irish Rail/DART neither of which seemed to attach sufficient importance to customer service - and particularly, in the case of Dublin Bus, to the key criterion of predictability<sup>28</sup>. It is significant that when the Aircoach Service was introduced to and from Dublin Airport, Dublin Bus upped its game in providing transport from the Airport to the city and suburbs.

It is done differently in London. The bus services are operated by a number of bus operating companies which work under contract to London Buses/ Transport for London (TfL) in different areas of the city. There is an integrated bus timetable and all buses adhere to the same fare structure and livery. What has been achieved in London is competition among operators for the market rather than on the routes.

An optimum design framework should be completed in sufficient time before the contract for supply of bus services on routes in Dublin goes out to tender. A supplementary approach which would tap into the apparently underutilised taxi fleet could also be tried. This has the merit of being costless, or virtually costless on the Exchequer.

Successive Ministers of Transport have shown commendable resolve in refusing to cap the number of taxi licences in the face of intense pressure from taxi owners and drivers. The logic of not capping supply is to allow a market to work and thereby to improve service and value to customers. This has been achieved. But the taxi drivers are suffering financially like many others during the recession - and have persisted with arguments for limiting entry. The optimum response to their situation is not to restrict the market by capping the number of licences but to follow the logic of reform. The relaxation of restrictions on supply could be matched by relaxation of restrictions on the demand side. Taxi drivers could be legally allowed to look for business at bus stops, offer journey sharing and reduced individual fares. This would of course pose new regulatory challenges but the potential benefits appear considerable. This might be best done by way of a policy experiment? There are routes where Dublin Bus is withdrawing or reducing services. They could be designated by the Minister or Taxi Regulator as routes where taxis were allowed to stop at bus stops and where taxi/journey sharing was encouraged. If taxi drivers and commuters knew that on these routes such options were possible, demand for taxis might increase, and it would be win-win for taxis and commuters. This could be a virtually costless experiment for the Exchequer which could be terminated if it did not work.

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<sup>27</sup> The transport component in the Green City index measures the performance of European cities in terms of the use of non-car transport, length of cycle lanes and public transport network per square meter and policies to reduce congestion. Dublin ranked last out of 30 cities in 2009, reflecting the dispersed nature of the city and a lack of alternatives to car transport in some areas. The proportion of people taking public transport to work (20%) in Dublin, the length of the public transport network, and the extent of cycle lanes are well below the euro area average. For further details, see Siemens Economist Intelligence Unit, European Green City Index

<sup>28</sup> A situation which has been substantially improved by the introduction of real time information at some bus stops and by a user-friendly smart phone app

I'm told that the legal mechanism for doing this would be straightforward. The Public Transport Regulation Act, passed in 2009, established a National Transport Authority with the responsibility to license transport services. Bus stops could be redesignated as public transport stops.

## **Contestability goes against the grain!**

Contestability and competition are concepts which do not appear to fit easily in our culture. In Ireland there still is, despite the economic transformations of the last decades, a muted "performance ethic" as discussed by Professor JJ Lee in "*Ireland 1912-1985*"<sup>29</sup>. This combined with the apparent dominance in the Irish mind of a "possessor" as opposed to a "performance" mentality poses a major challenge to introducing greater contestability into the provision of public services.

The Government commitment to open up all public service posts to external recruitment is very welcome and will hopefully tackle head on the examples of the "possessor" mentality in those larger organisations (including those in the public service) which until recently restricted recruitment other than at specified entry grades.

Another example of the "possessor" mentality arose in the area of education where as the non-Executive board chair of the on-line third level institution<sup>30</sup>, Hibernia College, I have a particular interest. Some years ago, Hibernia College introduced a very successful graduate entry programme into primary teaching accredited by HETAC and the Teaching Council. This put Hibernia in direct competition with some of the teacher training colleges who provide courses for graduate entrants into primary teaching. There are two important distinctions between the Hibernia and the traditional models. Hibernia delivers its material to where ever the student lives using e-learning and face to face tuition. The teacher training colleges require the students to attend on site at their institutions. The second distinction is that the teacher training colleges (which are all privately owned<sup>31</sup>) receive funding from the Exchequer, Hibernia does not.

It would be understating it to say that the entry of Hibernia College into this area provoked (and continues to provoke) very stiff opposition and condemnation from the traditional providers. And ironically, this is not a simple private/public sector conflict. Although the long established teacher training colleges are funded mainly by the Exchequer they are privately owned.

In my view the Hibernia example provides a good example of the disruptive and creative effects of innovation. Not only can teacher formation in Ireland be delivered in a more flexible way, opening the opportunity of securing teacher qualifications to graduates who could not attend college full time and at no cost to the taxpayer but Hibernia College has grown to be a provider of education overseas and a generator of foreign earnings and employment in Ireland.

## **Regulating the professions**

Where professions require to be regulated in the public interest (e.g. medicine, dentistry, law, accountancy and pharmacy) the profession itself should not be the regulator. There has been progress in that respect in regard to medicine, pharmacy and accountancy - and regulatory reform of the legal profession seems to be a work in progress. Some of the quainter, but expensive, features of that profession seem to be ripe for overhaul. There is an urgent need for an independent regulator of the legal profession. Independent regulation does not necessary preclude a dimension of internal regulation. Accountancy is a case in point where internal regulation of their

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<sup>29</sup> Cambridge University Press, 1989

<sup>30</sup> Declaration of Interest

<sup>31</sup> By the Roman Catholic Church and the Church of Ireland

members by the professional bodies in supervised in both Ireland and the UK by the statutory Irish Auditing & Accounting Supervisory Authority (IASSA) and the Financial Reporting Council (FRC) respectively<sup>32</sup>. It is also important that professional bodies should not be allowed to control entry and dominate education for their profession. The exercise of this control can all too easily be used to make entry difficult - particularly entry by professionals who qualified in other countries. I have heard repeated complaints from Polish professionals, such as physiotherapists and psychologists, living in Ireland that some of the administrative requirements (in the form of documentation required) placed in their way of achieving professional recognition and the right to practice seem designed to prevent their entry rather than being in place for quality assurance - and carry much higher compliance costs, for example, than those applying in the UK. If these complaints are correct they seem to be anti-competitive restrictive practices designed to protect “insiders”.

Members of regulated professions should be obliged to meet strict price transparency requirements. One approach to this would be to require that professionals such as solicitors, barristers, dentists and medical doctors in practice be required to post prices for their services (including hourly rates) on the relevant regulator’s website. All professionals should be required to provide clients with meaningful cost estimates to prospective customers.

There should also be a statutory requirement for independent periodic reviews, at intervals of say 5 years, of all regulated professions. Such a review would ensure regulatory authorities are fulfilling their duties in a satisfactory manner, that sufficient competition exists and would also identify any restrictive practices that may need to be addressed.

#### **Accountable oversight arrangements**

Within the public sector and service, arrangements for accountability need to be overhauled. Beginning at the top, Secretaries-General and CEOs should be more clearly accountable for outcomes within policy and resource frameworks provided by the Government - or in the case of statutory organisations the relevant boards which in turn are immediately accountable to the relevant Ministers. But to make this accountability meaningful they should also have the necessary authority - which means cascading delegation of accountability relationships within organisations and meaningful control over staffing and finance.

The objective in future public service pay negotiations should be to move toward establishing referred to rates for the jobs, having regard to the qualifications, skills and experience required and labour market conditions - and to eliminate the complex morass of allowances. These allowances (with limited exceptions) should either phased-out or incorporated into salaries (for example in the case of school principals). There should also be an end to so- called productivity bargaining and its counterpart of restrictive practices. Settling pay rates should ideally also have regard to international benchmarking of pay and productivity - tempered by fiscal and competitiveness realities. There should be no objection to high pay for public servants - provided that performance targets are met, the pay rates are affordable and comparable with relevant international peers.

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<sup>32</sup> Declaration of interest: I am a member of the Chartered Accountants Regulatory Board which has a majority membership of non- accountants. My sense is that the presence of a “lay” majority has altered the way in which regulatory issues are addressed - and in a way which enhances the public interest.

## The need for transcending oversight

As far as competitiveness related issues are concerned the key oversight departments are the Department of the Taoiseach and the Department of Jobs, Enterprise and Innovation (DJEI). In theory an overarching oversight body is already in place. The National Competitiveness Council (NCC), with independent membership, reports to the Taoiseach and the Minister for Jobs, Enterprise and Innovation on key competitiveness issues facing the Irish economy and offers recommendations on policy actions required to enhance Ireland's competitive position. The reality is that there is no time bound, structured mechanism in place for consideration, and if appropriate implementation, of the reports of the Council. The NCC currently receives research and secretariat support from Forfás. Under the planned integration of Forfás with DJEI this support will in future be provided from within the Department. The new arrangements would be made more forceful by establishing a Competitiveness Commission reporting to the Taoiseach and to the Minister, and located within DJEI, whose remit would be pursue implementation of NCC recommendations with Departments and to report annually to the Government, the Oireachtas and to the public on progress and outcomes. The Commission would be strengthened by putting it on a statutory basis with a small (3 member) external board.

## Health - special attention needed?

The data presented earlier in this paper, while short of being conclusive, are worrying.

- 1) Allowing for demographic adjustments we spend heavily on health.
- 2) Our outcomes do not appear to be "best in class".

We cannot continue the way we are going. Major step changes are needed - which the Government and, hopefully all political parties, appear to recognise. If we don't improve the efficiency of health expenditures and the quality of health outcomes, the consequences will be poor health services and unnecessarily high levels of taxation which will damage competitiveness, jobs and job creation.

Popular debate and discussion about health unfortunately focuses on a narrow range of easily understood statements and commonly held beliefs:

- We have the highest paid medical consultants in Europe with annual incomes 80 percent higher than Germany;
- We have the fourth highest paid nurses;
- We too many nurses with 15.2 nurses per 1,000 population, which is twice the OECD average<sup>33</sup>;
- We have too many medical "administrators";
- Medical drugs appear to be disproportionately expensive - estimates suggest that the Exchequer could save €50m annually if the HSE could secure UK NHS prices from manufacturers<sup>34</sup>.

In some cases these examples might satisfy an immediate populist need for scapegoats and simplistic remedies. We need to move beyond that. Scapegoating elicits conflict, defensiveness and

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<sup>33</sup> In Ireland the data for nurse numbers refers to the number of professionally active nurses (including practicing nurses and those working in the health sector as managers, educators, researchers etc.) whereas in some other countries the data refers either to practicing nurses only (i.e. those who are providing care directly to patients) or to nurses who are licensed to practice.

<sup>34</sup> "British prices would cut drugs bill by €50m"; The Irish Times, Friday, September 21, 2012

foot dragging and can be a distraction. Public understanding of the issues and complexities in delivering an efficient health service is vital. Without this understanding we run the risk that the necessary public support for sustaining reform of the system will be replaced by ineffectual or damaging quick fix prescriptions and that reform efforts will be abandoned before they are given sufficient time to bed down.

The scale of the challenges facing us may require a process analogous to the New Ireland Forum which was established to discuss potential developments that might alleviate the Troubles in Northern Ireland. The Forum involved representatives of political parties under an independent chair and had its own secretariat. Arguably its report contributed significantly to the efforts and negotiations which eventually led to a peaceful outcome on the island and institutionalised power-sharing in Northern Ireland. The 1993 National Education Convention, which prepared the ground for a later White Paper on Education, is another model. This also had an independent chair and secretariat. The task of a “Health Forum” reporting to the Oireachtas should not be to produce policy prescriptions - arguably the last thing we need are abrupt changes in policy direction or in implementation strategies. But much more widely based understanding is required as an antidote to populism ...and panic. The remit of a “Health Forum” could be to report, following enquiry, into:

- 1) The conditions for securing a health service that cost effectively secures positive health outcomes
- 2) The broader societal conditions and circumstances which encourage and support health outcomes that are among the best in the world, and,
- 3) The challenges facing reform.

The Forum would have an independent chair and secretariat (comprising national and international experts) and would hold its sessions in public. Submissions would be invited. Views would be sought from experts, interest groups and commentators, some of whom could be questioned at the Forum. A report would be presented to the Oireachtas for debate within a period of no more than 9 months from the first meeting of the Forum.

### **Living without the Troika - Cad a dhéanfaimid feasta gan.....?**

The paper has outlined a substantial list of reforms to the way we conduct our affairs, with the objective of creating enduring improvements in our competitiveness. Some of these, such as the introduction of contestability into the provision of public services, are now part of policy but implementation is at an early stage. But there is no shortage of ideas and of proposals for policy and institutional change, nor has there been. The set of recommendations in this paper is just one example of several. But when it comes to reform our implementation record is far from encouraging. A list of policy implementation failures includes:

- 1) Regulatory failures in our financial system;
- 2) Reform of local government and local taxation;
- 3) Transport reform;
- 4) Failure to consolidate planning and environmental laws;
- 5) Integration of Revenue and Social Protection computer systems;
- 6) HSE reform and rationalisation at the time of its establishment;
- 7) Hospital rationalisations and efficiencies.....and several others.

Management consultant and organisational expert, Eddie Molloy, has spoken and written about what he has described as an *Implementation Deficit Disorder*<sup>35</sup> in our public space. He and others have been very critical about our capacity to introduce and implement reforms which have been repeatedly recommended in various reports and reviews. Yet when the Troika came to town, Government committed to, and began implementing reforms which many long ago recognised as necessary - such as the introduction of an annual property tax, enhanced competition law and public service reform. If Ireland regains access to the international financial markets, at acceptable cost and if we say goodbye to the Troika what will happen?

We will be subject to the Fiscal Stability Pact which will ensure fiscal and financial discipline and, in that regard the setting up of the Fiscal Council is very important. But will we implement the structural and other reforms needed to meet the existential challenge of becoming more competitive on international export markets for goods and services or will we falter on the reform journey without the oversight of the Troika? Sadly our history suggests that the risks of reform fatigue and failure are very real. If we fail, the costs will be reflected in high levels of embedded unemployment and emigration, higher levels of taxation which impair economic growth as well as diminishing levels of provision and quality in our public services. This would be an ironic and tragic consequence of our efforts to “restore economic sovereignty”. We have a continued need for robust oversight mechanisms with implementation capacity. We need structures and processes where experienced and expert outsiders (from both outside the country and the relevant domains of activity) hold decision makers and policy makers (and through them society) to account for what they promise to do and should be doing and...importantly, with the ability to impose costs and sanctions on organisations which refuse or drag their feet in meeting targets and standards. In a specific sectoral area we have a successful example already in the form of the Health Information and Quality Authority (HIQA) which has the statutory power to sanction non- performance. The design and implementation of these structures and processes in a democratic society is challenging but essential.

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<sup>35</sup> “Ireland’s ‘Sixth Crisis’; Implementation Deficit Disorder”; Eddie Molloy; MacGill Summer School 2010